Can PCA's Meet the Challenge of '70's?

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It is a cliché of our times, but nevertheless true, that competition and technology force us to accept change. Nowhere has this been more apparent than in American Agriculture. Fewer and larger farms, high priced credit, increasing wage rates, galloping technology, increasing uncertainty in prices, rising taxes, and changing farm policies — all of these expressions are indicative of the changes occurring throughout the agricultural business world.

The Federal Farm Credit Board, which has the responsibility of setting the national policy guidelines under which individual member Cooperative Farm Credit System (FCS) Banks and Associations must operate, has known for some time, as we all have, that the "crunch" is on and that because of it, the credit needs of our complex and increasingly industrialized agriculture are in a state of flux. Thus, the Federal Farm Credit Board, in May, 1969, appointed 27 farm leaders from farm organizations, commodity groups, education, the banking community, the farm press, and farm youth, as well as the FCS, to the Commission on Agricultural Credit. The Commission was given the assignment to study anticipated credit needs of U. S. Agriculture during the decade of the 1970's and to advise the Federal Board as to how the FCS can help meet these needs most effectively. The report and recommendations of the Commission were published in March of 1970 under the title, *The Farm Credit System In The 70's.* This report contains numerous recommendations for very significant changes by the FCS in its members' authorized lending activities, operating policies, and credit related service offerings.

We are in basic agreement with the bulk of the recommendations put forth by the Commission. Indeed, we heartily recommend its report as worthwhile reading for all those having vested or other interests in the welfare of the FCS. However, we feel very strongly that someone should call attention to the fact that, *notwithstanding any national directives* that may be handed down by the Federal Farm Credit Board, *the success* (or failure) *of the FCS really depends on the personal initiative and business acumen of its individual borrower members and Bank and Association managers.* Certain evidence raises serious questions as to the ability of one component of the System, namely the Production Credit Associations (PCA's), to meet the challenge of the 70's. To be sure, it should be pointed out that many districts are very progressive and have not "thrown in the towel," as in the case in certain Western districts. To begin, let's first establish the proper historical perspective.

The FCS Development and Structure

The beginnings of the Farm Credit System can be traced back to the Federal Farm Loan Act of 1916 which authorized establishment of the Federal Land Banks (FLB's) and Land Bank Associations. However, it was not until passage of the 1933 Farm Credit Act that the nationwide system of local Credit Cooperatives — PCA's — was authorized. The Farm Credit Act of 1933, in addition to providing seed money for the establishment of the PCA's, also established the Banks for Cooperatives and placed both the PCA's and Bank for Coops under the supervision of the Farm Credit Administration.

Today, the FCS is *wholly owned by the farmers and cooperatives* who borrow from it. The FLB's led the way by repaying all of their government capital in 1947, and the PCA's completed that task by paying off the last of their original $90 million in government capital in 1969. Further, as a result of legislation passed in 1956, the PCA's began acquiring stock in the Federal Intermediate Credit Banks which were entirely Government-owned at the time. Complete ownership of those Banks by the

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Associations was accomplished December 31, 1968.

The entire FCS, while now totally owned by its borrower members, *still remains under the tight control of the Government and the Farm Credit Administration.* Member borrowers, to be sure, have a voice in the control of their system. They elect boards that direct the local associations and participate in selecting district Farm Credit Boards and the nominees for the Federal Farm Credit Board, who in turn make policies and hire management for district Banks and the Farm Credit Administration, respectively. But, it is the President of the United States, with the advice and consent of the Senate, that ultimately decides on the membership of the Federal Farm Credit Board. All Presidential appointments so far have been made from the nominees submitted by the System. However, it is apparent that the System by virtue of its rigidly defined institutional structure and strong lines of control is far from being autonomous—a fact which we wish to emphasize here and will analyze further later on.

Market Developments

Proponents of the FCS point with pride not only to the payout on the Government seed money, but also to the remarkable growth in the System's volume of business. For example, at the end of the first full calendar year of operation (1934), farmers and ranchers had borrowed $109 million from production credit associations, including $16 million in loans purchased from regional agricultural credit corporations. In fiscal 1969, they borrowed $6.5 billion. PCA's had 123,000 members and made 131,000 loans at the end of that first year. Now they have 535,000 members, and 372,000 loans were made in the past fiscal year. From a humble beginning representing about a one-tenth share of the institutional short-term credit market, the PCA's have grown to the point where in recent years they have provided more than one-quarter of the institutional short-term credit.

The PCA's and other member institutions of the FCS have indeed had a fine record of accomplishment. When one combines this past history with projections relating to the future credit needs in agriculture (estimates vary from $30-$54 billion additional credit needed by 1980), it is easy to understand why virtually everyone involved with the FCS has a very optimistic outlook as to the status and viability of the System. As evidenced by the Commission report and the testimony appearing in a supplementary appendix, the System is almost totally preoccupied with where and how to meet the demands for credit that are going to be placed upon it.

Past history can often be misleading. We believe there is good evidence to suggest that many of the PCA's may be hard-pressed during the 70's to maintain their current volume of business, let alone increase their relative share of the short-term credit markets. First of all, we call attention to the fact that the PCA's have prospered the most in those areas of the country where farms are not too large, where the traditional "family farm" has prevailed, and where their only competition comes from small rural banks that have been, in general, unable to satisfy local agricultural credit needs. In those areas where farms and ranches have attributes similar to those which are anticipated nationally in the future and where branch banking gives even the smallest local banks access to large reserves, the PCA's have obtained a much smaller share of the total credit extended. For example, in Arizona where the size of the farm in terms of investment may be comparable to what it will be in other areas in a few years, the PCA's had only 7.4 percent of the total non-real estate loans outstanding in January 1969.

The comparative advantage that the PCA's have enjoyed cannot be expected to continue in the areas where the small country banks have been plagued with inadequate reserves and restrictive legal lending limits. Commercial banks in rural America are rapidly gearing up to service the new "industrialized agriculture." Moreover, this service will be on a strong competitive basis. Individual legal lending limits are continuing to show a strong upward trend, and a recent ruling by the Federal Reserve Board now makes it possible for large city banks in states where branch banking is not permitted to have loan offices removed from the bank premises; e.g., in rural areas.

Also contributing to the stronger competitive position of commercial banks is their willingness and ability to provide the many credit related services so much in demand by this nation's new breed of farmers. For example, a 1967 report by the Agricultural Committee of the American Bankers Association showed that "The number of agricultural banks offering an agriculturally oriented computer service has increased substantially during the past 12 months. Nine percent of the banks in *1967*, compared to 3 percent a year earlier, offer such a service. Another 8 percent, compared to 5 percent a year ago, plan to start such a service soon. Nearly 7 out of 10 banks now offering a service provide an automated farm accounting program." Income tax accounting, estate planning, insurance programs, management consultation, and credit card financing are additional services that are, or soon will be, associated with full service agricultural banks.

Can the PCAs Compete?

The top farmers today and the ones that are going to be successful 5 and 10 years from now have no compunction whatsoever as to where they procure the funds necessary to run the farm business. A good manager will, other things being equal, do his credit business where he can get the best service. It would appear that the PCA's will be unable to compete on such a basis unless they change noticeably their methods of operation. In the March 1970 issue of the *Farm Journal*, page 28, Claude W. Gifford reported that a survey of some 2,000 active farmers indicated that, while over half of the voters approve of the idea of the FCS offering services such as electronic record-keeping, income tax accounting, and estate planning, nevertheless 20 percent of the voters feigned neutrality, and many agreed that offering such services would overload an already-busy organization. That same study revealed that 47 percent of the voters fully oppose credit card financing by the FCS.

The results of our own survey during 1970 makes us even more skeptical as to the ability of the PCA's to maintain a competitive position in the short-term credit market. Association managers were asked to indicate for a list of 10 credit related services which services were being provided and the anticipated use where the service was not being provided. A total of 136 out of the 450 operating PCA's responded to the questionnaire, and the responses were fairly evenly distributed by geographic area.

Table 1. Association Manager Attitudes with Respect to Credit Related Services

	Service	Percent Currently Providing the Service	Service Not Provided But Percent of Customers Who Would Use the Service if it Were Provided
		Percent	
(1)	**Electronic Farm Records**	12.9	9.2
(2)	**Income Tax Service**	9.5	26.8
(3)	**General Management Consultation**	71.00	15.7
(4)	**Ordinary Life Insurance**	3.0	21.1
(5)	**Health Insurance**	.7	31.3
(6)	**Credit Life Insurance**	99.0	9.5
(7)	**Fire Insurance**	3.0	27.6
(8)	**Crop Hail Insurance**	20.0	15.1
(9)	**Comprehensive — All Risk Insurance in Connection With Point of Sale Financing**	23.0	23.7
(10)	**Credit Card Service**	.7	26.8

The data in Column 1 indicate that with the exception of general management consultation (and here we expect a large number have confused filling out loan applications with intensive advice on short- and long-range planning) and credit life insurance, the PCA's are only beginning, just beginning, to offer a full package of credit related services. As the data in Column 2 indicate, it's not because these services are not of interest to borrowers. In fact, many Association managers in response to an open-ended question as to their expectations of future directions in the financing of U.S. agriculture clearly indicated that they felt farmers were going to demand and need more and more professional consultation and full financial service as an integral part of their borrowing activities. The major reasons why more services are not now being provided were revealed when the Association managers were asked — also on an open-ended basis — to indicate for each "no" response why a particular service wasn't offered. In 41 percent of the cases, "not permitted" was given as the only response. In 31 percent of the cases, "service already offered by others" was given as the only response.

The PCA Association managers recognize, as was stressed earlier in this article, that they are under the tight control of the Government and the Farm Credit Administration. The managers also know that because of this, they will apparently be rebuffed if they attempt to promote additional services where those services are already being offered at a competitive price. This does not mean a break even price. The Commission on Agricultural Credit also supported this philosophy when it recommended (1) "The primary consideration in offering any service should be the benefit it provides members and the lender in using and extending credit, and not the remuneration which may accrue to the Banks or Associations," and (2) "The availability of competent services through other normal business channels should be recognized and where they are provided at reasonable cost, the System should not develop competing services but assist members in the profitable use of such services."

A no-competition operating policy is logical for a government agency in a free enterprise economy. However, we have already established that the FCS is now *totally owned by its borrower members*, and recognize it or not, the restrictive operating policies imposed on the Associations and Banks are impinging directly on the pocketbook of those borrower members. We here quote a PCA brochure, "Production Credit Associations, in turn, return their earnings to farmer-members in the form of dividends on their stock and in patronage refunds in proportion to the interest they have paid during the year. Thus, these savings have the effect of reducing the cost of farmer-members in financing their farm business." Obviously, earnings made on credit related service offerings would also have the effect of reducing the borrowing cost for PCA members. Lest there be any doubt, let us point out that where services are provided, they are not offered solely on the basis of benevolence. It seems economically illogical for the Farm Credit Administration to deprive the user-owned System of the opportunity to reduce borrowing cost.

We see reason for additional concern based on other results from our survey of Association managers. When asked to indicate which of the following, (a) Income statement for the previous year, (b) Net worth statement, (c) A budget itemizing expectations over the loan period, and (d) A history of loan repayment, they would rank as 1st, 2nd, etc., as a basis for evaluating a farmer's loan application, 32.1 percent wrote in and gave first priority to the "man factor" and his honesty and moral character. We, too, sympathize with implications surrounding the Horatio Alger myth, but it takes a lot more than hard work and strong moral fiber to be a success in today's farm and ranch world. (Count the number of hard-working, highly moral, *displaced* farmers in your area!) We feel this point can best be summed up by quoting directly from the responses the Association managers sent in on our questionnaire:

> *We must change as agriculture changes to keep abreast of these changes. Some of our 1930's policies will have to have a major face lifting.*
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> *and*
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> *Freedom and flexibility within the Farm Credit System must be obtained, in order for Agri Credit to be properly handled. For this to happen we must be relieved of controls and supervision by the FICB's and the Farm Credit Administration.*
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> *and*
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> *The District Directors and Local Directors and some officers are reluctant to take the bull by the horns and do what is best for farmers in general — Institutional pride and the desire of those in control to stay in control.*

Institutions and old myths are hard to change, and there is a natural tendency to seek security in the womb of tradition and the Holy Grail of yesterday's answers. Because of this, we have raised these questions as to the ability of the PCA's to meet the challenge of the 70's. As was stated at the outset, competition and technology force us to accept change if we are to succeed. The only alternative for those that are unable or unwilling to accept this mandate is failure. For the good of the System — their own good — we urge every PCA borrower-member and Association manager to take whatever decisive action is necessary for success.