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THE FEDERAL FARM LOAN ACT—DISCUSSION

KINGMAN N. ROBINS:—Mr. Thompson's paper is the most acceptable exposition of the intent of the Federal Farm Loan Act that I have seen. It is to be regretted that so few public utterances on the subject of rural credits have been so free of misapprehension and misrepresentation of existing conditions in rural finance, or so appreciative of the real requirements of the situation.

There are many statements in Mr. Thompson's paper which I should like to emphasize—few that I should question. There are some considerations, however, that occur to me which I do not find suggested in his presentation of the subject.

Since time forbids more than a mere suggestion of these points, I have taken the liberty of analyzing the act with a view to stating categorically the underlying principles on which it is based. I have undertaken to classify these principles as "constructive" and "destructive" for lack of better terms. Such a classification must rest entirely on individual opinion, for the act is not yet operative, and consideration of it, therefore, must be theoretical. I take it, however, that there will be more or less general agreement or disagreement with the classification, depending on the social philosophy and economic beliefs of each man who judges it. Obviously there is not time here to argue economic or sociological theories—I can merely state the case and leave the argument to you.

I state the destructive factors first:

1. *The element of special privilege is fundamental to the act, in its provisions:* (a) For the exemption of the securities issued by the federal land banks from all taxation. By this provision the farmer's obligation is granted a differential of as much as 2 per cent per annum in such states as Ohio over the obligation of any other class in the community. The burden of taxation of which the farmer is thus relieved is obviously shifted to other classes of the population. (b) For the payment out of the public treasury of the small army of officials and employees provided for under the act. (c) For the use of an indefinite period of public funds without interest to capitalize the banks. (d) For the substitution of the credit of the United States government for farm credit in so far as the unthinking public is led to believe that bonds termed in the act "instrumentalities of the government of the United States" are actually the obligation of the government, and in so far as the United States government may feel called upon to make

good the obligation thus implied, in case of loss on the actual security.

2. *Economic law is violated by the provisions for:* (a) Restricting the loaning operations of the joint-stock banks in arbitrary geographical limits. This ignores a fundamental principle of investment selling, namely, that an agency manned by men of good reputation in their own community can command much greater confidence than an equally reliable agency in another community. The law, however, forbids the utilization of this principle in the organization of well managed joint-stock banks in the great money markets of the country to loan wherever there is demand for their funds. California can borrow only through local channels instead of directly from Chicago. (b) Fixing the maximum interest rate by statute. The law of supply and demand will control the rate in any event, and a fixed maximum may conceivably render the act inoperative in the communities most in need of increased facilities. The experience of the states with usury laws is evidence of this contention. (c) Joint guarantees, putting good, bad, and indifferent securities in the same category, penalizing the good for the advantage of the inferior.

5. The act recognizes, although, in our own judgment, it does not taxation from the former to other classes of the population; (b) the dilution of government credit; (c) the erection of a new bureaucratic system without civil service or other hindrance to political exploitation; (d) the inflationary tendency of the act with regard to land values, —a potent element in raising living costs.

4. *The act fails to serve its purpose in the following particulars among others:* (a) Restrictions on loaning are such that only about 52 per cent of the farmers of the United States can qualify as borrowers. (b) This 52 per cent constitutes that element of the farmers already best taken care of by existing agencies—no provision is made for farmers who have not already security for double the amount of the loan asked for. The landless man, the tenant, the farmer and the farmer's son with small savings, who want to establish themselves on the land, are not served by the new machinery. (c) There is no provision for the straight-term type of loan now most in vogue with farmers. The amortized loan is compulsory. Experience in the United States has not evidenced a demand among farmers for the amortized loan. They prefer a loan carrying privilege of prepayment in whole or in part, but without mandatory repayments, so that they can pay according to the season. Why should a farmer who is a business man, and who makes his borrowed money earn him more than

the interest he pays, want to be compelled to return his loan in dribbles, leaving his chief source of credit, his farm, encumbered meanwhile? Surely the farmer who makes such use of borrowed capital is to be encouraged and represents a type of farming ability far higher and more to be desired than the farmer who, to save his farm, must get out of debt because he cannot earn current interest on his investment, whether his investment be his own money or borrowed money. To argue that the system is necessary because farmers cannot make their land investment earn adequate interest is simply to demonstrate that the valuation of the land is too high. It will not help matters to install a system which provides for the continuance of such inflation. (d) There is no adequate provision in the act for extending interest and principal payments in seasons of failure, and for financing slow payments. It is a common experience of farm-mortgage bankers operating in the newer regions to advance to holders of mortgages in behalf of borrowers 50 to 75 per cent of interest as it falls due, and to carry these payments and principal items as well, sometimes for as much as two years, where they know that the default is due to misfortune and not to negligence or failure.

5. *The act attempts to create a governmental monopoly of farm-credit banking, on a foundation of special privilege.* (a) The provisions under which private enterprise can operate under the act are so discouraging and discriminatory in favor of the federal farm land banks that experienced farm-mortgage bankers generally agree that they cannot safely venture, especially as the law specifically forbids the joint conduct by the same management of a private mortgage banking business and a joint-stock land bank. (b) Owing to the element of special privilege supporting the federal farm-loan banks and joint-stock banks, their efficiency as economical and comprehensive rural-credit agencies can never be compared on a fair basis with private agencies. As Mr. George E. Putnam says in the December number of the *American Economic Review*, "This action [discrimination between federal land banks and joint-stock banks] was in virtual recognition of the superior efficiency of private enterprise when given an equal opportunity. It is inconceivable why the opportunity should have been withheld."

Turning to the pleasanter aspect of the subject we find the following constructive principles:

1. Farm land security is publicly recognized on a basis of its intrinsic worth.

2. Public supervision of farm-mortgage banks is provided, putting this form of banking on a plane with commercial banking.

3. Pressure is brought to bear on the states to enact proper title and collection laws.

4. Provision is made for a standardized form of security that may command public confidence and that may be approved by the market for its convenience and known stability.

5. The act recognizes, although, in our own judgment, it does not properly provide for, the right and advantage of coöperative credit arrangements among farmers.

6. Appraisal of land is to be based on the earning power of the land appraised. Adherence to this principle would do more than any other provision of the act to check inflation of land values, and would operate the more advantageously because of the other provisions of the act encouraging inflation.

JAMES B. MORMAN.—Mr. Thompson's paper gives a review of the main provisions of the Federal Farm Loan Act which was signed by the President and became effective on July 17, 1916. In discussing this paper I shall confine my remarks almost entirely to a few economic problems which are raised therein.

1. *Two kinds of land banks.* When it comes to a discussion of the intent of Congress in providing two systems of land banks, there is room for a wide difference of opinion. This act as it now stands was a compromise between two widely divergent bills passed by the Senate and by the House of Representatives. When these two bills went to conference, the conferees after a struggle finally agreed upon the act in its present form.

Congress as a whole had little to do with this measure except to vote upon it. The credit for the act is due to the influence of only a few men who were able to exert sufficient control over the Joint Committee on Rural Credits to have incorporated into the act certain well-known policies relating to farm-mortgage credit. While one insisted on having a coöperative system of borrowers, the other insisted on a capitalistic system of lenders. The former is expressed in the federal land banks which can do business in farm-mortgage loans with national farm-loan associations only; the latter is expressed in the joint-stock land banks which can make loans to individuals.

This law provides for a system of mortgage credit only. It is implied in the paper under discussion that the two kinds of land banks

deal with two classes of farmers on a different credit basis. Thus farmers who deal with joint-stock land banks are said to be able "to furnish adequate security for their loans," while those farmers who procure loans of the federal land banks through their national farm-loan associations are said to be "greatly in need of improvement in this respect." In other words, the two bases of mortgage credit here implied are adequate security and inadequate security for loans.

I know of no such difference in credit basis expressed or implied in the Federal Farm Loan Act. Loans made by the two kinds of mortgage banks are precisely the same so far as the security basis is concerned, namely, the appraised value of farm lands. Loans are to be made up to 50 per cent of the appraised value of the land offered as security for a loan, and the final and determining appraisal is that made by the same government appraiser who serves both kinds of bank operating in the same district. There is neither greater risk nor greater advantage with either kind of land bank. The security required is adequate to meet the demands of the investment market for safe credit instruments based on first mortgages on farm lands. No farmer can borrow of either kind of land bank who can not thus furnish adequate security for his loan.

2. *The proper granting of farm-mortgage credit.* The author of the paper under discussion maintains that "practically all the problems involved in the provisions of the present law arise either in safeguarding the proper granting of farm-mortgage credit or in providing the form of security needed to reach the investment market."

Among the problems thus raised are the economical administration of the national farm-loan associations, the duties pertaining to the offices of secretary-treasurer and loan committee, and the liability assumed in becoming a member of a national farm-loan association.

In discussing these problems it should be remembered that the Federal Farm Loan Act is an attempt to adapt European experience to American farm conditions. The mortgage and bond-selling features are derived from the German *Landschaften*, a system of coöperative farm-mortgage credit associations. But the restrictions on mortgage loans laid upon borrowers who are members of national farm-loan associations are not *Landschaften* at all. The same is true with reference to the organization and management of the local loan associations. They follow closely the *Raiffeisen* coöperative societies which make short-time loans to their members. But these loans are secured by notes with two or more endorsers and not by farm mortgages,

Now this combination of short-time with long-time principles may be especially adapted to American rural conditions in certain parts of the country and among certain classes of farmers. It may result in the development of a more pronounced coöperative spirit among farmers in this country—a result much to be desired for the economic welfare of rural communities.

At the same time it must be recognized that this is an experiment in rural credits which may or may not prove adaptable to American conditions. The comparatively large size of the average farm makes the organization and operation of a national farm-loan association in many parts of the country a problem not easy of solution. As pointed out by Mr. Thompson, the problems raised relate to financing associations, the territory they cover, the duties of the secretary-treasurer, and the supervision over the expenditure of loans. These problems can doubtless be met, however, if they are fully realized at the beginning.

Following the principles of Raiffeisen societies, the successful financing of farm-loan associations can best be accomplished by as much gratuitous service of members as possible. Neither the government nor the federal land banks will furnish the money to pay the running expenses of an association. Whatever expense has to be incurred must come out of the pockets of the members; so that, for the economical administration of a farm-loan association, it will be advisable for members to render whatever service they can without compensation. Mr. Thompson cites in illustration the service of the loan committee which “supplies without charge an appraisal of the lands offered as security,” though the land allows the reasonable expenses of the loan committee to be paid out of the funds of the association.

The question of membership and the extent of territory within which an association will do business is another problem raised as a result of granting farm-mortgage credit. The large size of the average American farm, equaling 138 acres for the whole country, a knowledge of the character and solvency of members, and the supervision over the use of loans by borrowers should necessarily limit the extent of territory of an association in order to keep down expenses. Such limitation is in accordance with Raiffeisen principles. With a limited territory, a small membership, and largely gratuitous service, the share of the expenses of an association need not be much for each member to bear.

On the problem of the duties of the secretary-treasurer, Mr. Thompson says:

The secretary-treasurer of the association performs important services by transmitting approved applications and the necessary papers to the federal land bank, by handling all the funds, and by carrying on the necessary correspondence. He is also required by law to ascertain whether borrowers use the proceeds of their loans in the manner specified in their application blanks, and to report thereon to the federal land bank.

With all these duties and others required of the secretary-treasurer, the question of providing for his salary permitted by law will probably be one of the hardest to answer. The main expense of national farm-loan associations will doubtless be this officer's salary. The duties imposed upon him will require more time than he could in many cases afford to render without pay, unless the association is very small and confined to a very limited territory. Many of the duties attached to this office as provided by the Farm Loan Act are performed by the members of the Raiffeisen society without compensation, as an element in coöperative organization and for the mutual protection and financial benefit of members. The character and solvency of each person are well known before he is admitted to membership, supervision over the use of loans is done by the neighbors of a borrower, and the territory within which a Raiffeisen society operates is confined to very narrow limits. Moreover, many of these societies have a religious or philanthropic corp of officers who give their time and services freely; a member may offer to serve as secretary-treasurer without pay; and the use of a room in a member's house or place of business may be accepted at a merely nominal rental where the business of the society may be transacted. In short, the coöperative spirit of mutual aid and service is so pronounced that the duties of the secretary-treasurer and the expenses of a society are reduced to the minimum.

The author of the paper under discussion has called attention to these problems. They have not been raised for the purpose of knocking them down, but for the purpose of pointing a way out of the difficulties which the act itself raises. Many of these incidental features are not even hinted at in the provisions of the law. They are there and must be met sooner or later, because of the principles involved in the organization of national farm-loan associations and because they will involve expenses of administration.

As a matter of fact, the law requires of the secretary-treasurer even larger duties than those enumerated by Mr. Thompson. In addition to supervision over the expenditure of loans, this officer is required

“to ascertain and report to said bank the amount of any delinquent taxes on land mortgaged to said bank and the name of the delinquent.”

Now note what these two requirements taken together demand in the way of service on the part of the secretary-treasurer. He must know the contents of each member's application for a loan, since it is required that each borrower state to what uses his loan is to be put. His application is sent to the federal land bank of the district and the bank keeps it. In order to become familiar with the objects named in the borrower's application, the secretary-treasurer should keep on hand duplicates of all applications for loans. In order to carry out the provisions of the law as to the supervision over the use of loans, he must visit every farm. He must also examine the tax books to find out if the borrower's taxes have been paid. The law requires the secretary-treasurer, therefore, to exercise constant surveillance over the farms and over the activities of borrowers. If a large area is covered by an association, these duties mean the spending of considerable time. If the secretary-treasurer has to be paid in proportion to the amount of time spent under these circumstances, his remuneration will constitute a problem of no small magnitude to the officers and members of a national farm-loan association.

Another problem which arises in connection with making mortgage loans by the federal land banks is that of the obligations assumed in becoming a member of a local association. The borrower has to subscribe for stock in the association to the amount of 5 per cent of his loan. This is an asset or investment. But in addition the borrower assumes a liability for the debts of the association to the amount of 5 per cent of his loan.

On this point I am inclined to take issue with the author of the paper, who maintains that the 5 per cent subscription for stock by the borrower “is not in the nature of an extra charge or bonus,” since he says that “the stock serves as an investment paying such dividends as may be declared.”

The law permits the borrower two ways of providing for this stock subscription. He may either pay cash for the stock at the time he procures a loan, or he may borrow from the federal land bank “the sum necessary to pay for shares of stock subscribed for by him in the national farm-loan association, such sum to be made a part of the face of the loan and paid off in amortization payments.”

Now, if the borrower pays cash for his stock he loses the use of that much money up to the time his stock begins to pay him dividends,

however long or short that may be. If he has \$100 invested in stock, the use of that sum is reasonably worth \$6 a year at any ordinary business rate of interest. If no dividends are declared the first year, the rate on his loan is practically equivalent to a commission charge of \$6. If dividends are paid after the first year but do not equal the average rate of interest on business capital, his commission charge on his loan will be less than it was the first year, but it will be an amount represented by the difference between the amount of his dividends and the usual rate of interest for the use of business capital.

But if the borrower adopts the other alternative and borrows the stock subscription of the federal land bank, having it added to the face of his loan, he pays interest on this amount of money without having the use of it until his stock holdings begin to draw dividends. In either case, therefore, the requirement that a borrower shall purchase stock is from a strict economic point of view equivalent to a commission charge on loans.

This raises other questions, namely, that of the likelihood of a borrower getting dividends on his stock holdings in a local farm-loan association, and the amount he is likely to get.

The dividends on stock held by farmers in their associations must be derived from the profits of the federal land banks. But the land banks will be under heavy expenses at first as a result of their organization. There is little prospect of their paying dividends on stock for the first year and perhaps longer. This fact is well recognized by those familiar with banking experience. Unless associations are formed in large numbers in every district, and unless the farm-loan bonds sell with sufficient readiness to provide the money for making mortgage loans, there will be no profits to provide dividends.

It is anticipated, however, that the federal land banks will become profitable when carrying on a normal farm-mortgage business. If dividends are declared they will belong to the associations and not to the individual members of the association. These dividends must first be used to pay the expenses of the association. The more there is spent for expenses, the less there will be to divide among the farmers as stockholders.

But the law provides for building up a reserve fund out of the net earnings of national farm-loan associations. Finally, after expenses are paid and the amount has been set aside for the reserve fund, it is optional with the directors of an association whether dividends shall be paid to shareholders or not. The prospects of

borrowers getting dividends soon or of getting any sum from this source are more or less uncertain.

The writer of the paper also raises the question as to what constitutes a "farmer," so that he may borrow of a federal land bank. It has been practically decided that the farm owner who leases his farm to a tenant on a cash or share rental basis is an absentee landlord. As such he could not become a member of a local association and borrow of a federal land bank. He could, however, borrow of a joint-stock land bank and thereby reap the benefits of the Farm Loan Act in the form of reduced interest rates, long-time loans, and an easy method of repayment.

The farmer's need for additional capital is met by a provision of the act. Mr. Thompson's statement on this point is not so emphatic as it might be made. He says: "There is no reason why a borrower under the act may not ask for a reappraisal after the loan has run a few years, and renew or increase his loan."

The law says: "A reappraisal may be permitted *at any time* in the discretion of the federal land bank, and such additional loan may be granted as such reappraisal will warrant under the provisions of this paragraph." It is expected, therefore, that requests for reappraisals will be made and that increase of loans will be granted as borrowers increase the value of their security by the productive use of the capital previously borrowed.

In Mr. Thompson's opinion the success of the federal farm-loan system will depend on "the fitness and energy of the men who are placed at the head of each of the land banks." That this will be one of the most vital elements for their successful operation can not be doubted. But there is a still more fundamental factor of success than this, namely, the organization and successful management of national farm-loan associations. The federal land banks can only make loans through these associations and through agents. The latter must be some "duly incorporated bank, trust company, mortgage company, or savings institution, chartered by the state in which it has its principal office." But no agent can be appointed until the law has been in effect one year, and there are other reasons which make this provision inoperative.

For the success of the federal land banks, therefore, it is vitally important that numbers of farm-loan associations be organized in every land-bank district. At present Mr. Thompson limits the general activity in organizing these associations to the South and West. This

being the case, vast sections of our country are lacking in that initiative which is absolutely necessary to the success of the federal land banks in those districts. As the farmers become better acquainted with the prospective benefits which might come to them through this system by means of propoganda carried on by the Federal Farm Loan Board, the organization of farm-loan associations may be accelerated in those districts not now well represented.

3. *The benefits to be expected.* Now, what are the benefits to be expected from this act? In briefly alluding to this topic I quite agree with the writer of the paper that *borrowers* may expect farm-mortgage loans at materially reduced rates of interest, on long time ranging from five to forty years, on easy terms of repayment; a dependable source of obtaining credit, development of the coöperative spirit, encouragement to thrift, removal of the fear of foreclosure, and the raising of the status of tenants to that of land-owning farmers.

In its prospective benefit to tenant farmers, however, the risks of heavy indebtedness, of taxation, insurance, lack of working capital, and of other burdens which accompany land ownership should not be overlooked. So far as the operation of the farm-loan act is concerned, Mr. Thompson declares that "it may not be out of place to give warning against extravagant hopes for the elimination of farm tenancy. The existence of the tenant farmer in an agricultural economy rests on far deeper foundations than the one question as to what credit facilities are available."

The benefits to *investors* may be stated to be ready access to a standard form of security in convenient denominations and the encouragement of thrift among the rural population whereby their small savings may be ultimately invested in tax-free farm-loan bonds.

4. *Concluding remarks.* Now, let us look the land bank situation squarely in the face from a strictly economic point of view, as a result of Mr. Thompson's paper and this discussion.

For the granting of mortgage credit to farmers, the joint-stock land banks would seem to have decided advantages over the federal land banks. The latter are limited to twelve in number in the beginning; but any federal land bank may establish branches within its land bank district subject to the approval of the Federal Farm Loan Board. The establishment of branch federal land banks, however, would necessarily depend upon the growth in the number of national farm-loan associations within each district.

Joint-stock land banks, on the other hand, may be organized in every state; there is no limitation as to the number that may be organized if the farm-mortgage business warrants an increase in their number and if they offer the promise of profits to private capital by means of which they must be organized; and they can do business within the state in which each bank has its principal office and in one contiguous state. Joint-stock land banks, therefore, may cover the whole country in any number to meet the farm-loan needs of the different localities. This is a decided advantage over the federal land bank system.

From the standpoint of the borrower, the joint-stock land banks offer advantages superior to those of the federal land banks. Mr. Thompson points out that "the door to a joint-stock land bank is left wide open" to the individual farmer. He is not compelled to find nine or more other farmers to unite with him in order to get a loan; he is not compelled to subscribe for share capital in the bank making him a loan; he bears no responsibility in the expense of running the joint-stock land bank; and he assumes no 5 per cent liability in case of the bank becoming insolvent.

Thus the individual farmer can proceed to a joint-stock land bank, procure his loan on precisely the same terms as of a federal land bank, and have no questions asked as to how he is going to expend his loan. With a little more safeguard thrown around the use of loans made by joint-stock land banks, they could be made splendid institutions for encouraging a serviceable system of mortgage credit among farmers.

In like manner, if the federal land banks were so organized that they offered equal or superior opportunity to individual borrowers as compared with joint-stock land banks, the success of this government-supervised farm-mortgage system would be assured without the shadow of a doubt.

In the operation of the Federal Farm Loan Act, therefore, is presented a series of economic and social problems which are by no means difficult of solution. With these problems satisfactorily solved, the act is full of promise for correcting a wide range of farm-mortgage abuses and for bringing great benefits to farmers throughout the United States.