UNIVERSITY OF IDAHO

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Production Credit Use in Idaho Agriculture

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and
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Production credit is a vital part of Idaho agriculture. Farmers are borrowing more money for production than ever before because of (1) increased farm size, (2) newly developed irrigated land and (3) the use of new, more costly farm machinery. Commercial banks, production credit associations and the FHA are the most important sources of this credit. Nearly half of the farmers interviewed in this study borrowed from a particular credit agency because they had used this source for many years. Only eight percent said they borrowed from a particular agency because interest rates were lowest.

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A Summary of This Credit Study

Production credit has become a vital part of modern farming. Farmers are borrowing more money now than ever before. According to this study the main reasons given by farmers for the expansion in production credit use were these:

1. *An increase in the acreage of irrigated crop land through development of new land.*
2. *An increase in average farm size. Large farms use more production credit than smaller ones.*
3. *Changing technology. One man can farm more acres through the use of new and more costly machinery.*

The most important sources of production credit in Idaho were commercial banks, production credit associations and the Farmers Home Administration. Of these three, banks provided about 58 percent of the total production credit followed by the production credit associations with 30 percent and the Farmers Home Administration with over 12 percent. These figures do not include production credit provided by individuals, dealers of all types of farm supplies and other credit sources. The latter were important credit sources but data were not available giving amounts of credit provided by them. Production credit provided by the three principal lenders in Idaho has nearly doubled since 1953.

Farmers generally felt that production credit was a good thing if not abused. Some thought credit was too easy to get. Older farmers and farmers with less than 100 acres of land were more opposed to credit use than were younger farmers or farmers with larger acreages. Attitudes and use of credit were closely correlated. Those using credit were generally favorable toward its use.

Over 80 percent of the farmers interviewed said the credit agencies had very little influence on farm management decisions. Most of the farmers who thought the agency influenced management decisions borrowed from the Farmers Home Administration which closely supervises its loans. This factor, however, varies from year to year depending upon general economic conditions in the area.

CONCLUSIONS

An adequate supply of credit is available in the areas of Idaho which were studied. However, just because it is available doesn't mean that everyone should use all he can get. Borrowers should seriously consider their entire farm operation and credit needs periodically. The following suggestions may be helpful to a farmer who has decided he needs credit to finance production costs.

Shop around before borrowing. There are many lenders and many different plans of repayment available. Also there is some variance in interest rates. Negotiation with lenders may be possible. The larger volume borrowers with the best credit ratings are in the strongest position to negotiate for the lowest possible terms, particularly if lower rates are available from a different lender.

Before going to a lender have a plan. Work out a budget of expected income and expenses for the coming production season. A statement of net worth including an inventory is also valuable. Lenders will usually go along with someone who has a reasonable plan and some definite ideas. The borrower should not try to hide anything from the lender that may affect the outcome, or his ability to repay the loan. The more the lender knows about the borrower, the better he can serve the borrower's needs.

If merchant credit is used, make sure the interest rate and carrying charges are known. It may often be less expensive to borrow from a lending agency and pay cash for machinery, fertilizer and other needs. Also one may be able to get a discount for a cash purchase.

Credit is like other resources used in production. It must be used with care if satisfactory results are to be obtained.

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M. B. Conley and R. V. Withers

INTRODUCTION

Credit, like machinery, has come to be a common tool used on the farm. Many farmers have found that through wise use of credit, they have been able to expand and progress much more rapidly than without it. On the other hand, credit is like fire. It can be very helpful when used properly but can be devastating when it is not properly controlled.

There are several types of credit used by farmers. Important types are real-estate or long-term credit, shorter loans of the intermediate type, and production or operating credit which is usually obained for periods of one year or less. This is the report of a study which was made dealing with production-type credit.

The rapid expansion in the use of production credit drew attention to the importance of this type of credit. Basic knowledge seemed to be lacking in this area. A study was begun in an attempt to find out what has been happening in the use of production credit. In order to keep the problem of manageable size it was decided to study farms in potato producing areas and emphasize the use of operating credit in potato production. The objectives laid out for the study were as follows:

1. *To determine how much and for what purposes operating credit was used on potato farms.*
2. *To find the important sources of production credit on these farms.*
3. *To assess the general attitudes of farmers toward the use of production credit.*
4. *To learn whether the availability of production credit had any appreciable influence on management decisions.*

METHODS USED IN THE STUDY

A sample of farms was drawn from four counties. These four counties, Cassia, Minidoka, Bingham and Bonneville, produced about 55 percent of the state's potato crop in 1963. The potato producing areas of the counties were divided up into blocks of about ten farms and a sample of these blocks was drawn. An attempt was made to interview all farmers in each block in the sample. Thus, while potatoes was the principal crop, some farmers in the sample had no potatoes. Part-time as well as full-time farmers were interviewed.

A questionnaire was completed with each farmer interviewed. It contained a summary of the farm business as well as information about the amounts, sources and uses of production credit on the farm.

Representatives of the major lending agencies in each county were also contacted for information on lending policies and general practices in making production loans to farms. Merchants providing supplies to farmers were interviewed as to their policies of length of time given before bills must be paid and carrying charges on bills which become delinquent.

Information was collected from 87 farms and several lending agencies. The material was analyzed and summarized to obtain the general picture of production credit use in the sample areas.

AMOUNT OF CREDIT USED

The use of production credit has become increasingly important to farmers. The magnitude of this growth can be seen in Figure 1. The three major types of lending agencies are shown. Each has had substantial increases in production credit extended. The growth between 1953 and 1964 was about 85 percent. It is difficult to determine, however, just how much growth has occurred since these are January 1 figures only. They do not consider loans paid back before January 1 each year. Also, credit provided by lenders other than the three types listed was not considered.

The increase in the use of production credit, or operating credit as it is sometimes called, was due to several factors. One significant factor was an increase in irrigated acreage within the state. In recent years about 50,000 acres of cropland per year have been developed and brought under irrigation. This has mostly come about through the development of deep wells and improved pumping systems. Some has resulted from high lift pumping along the Snake River. Much of the new land is used for row crop production, primarily potatoes. Considerably more capital is required per acre for producing row crops than for grain or hay. Production costs per acre may be three or four times greater for potatoes or sugar beets than for grain. Thus the demand for credit is increased when row crops are included in the rotation.

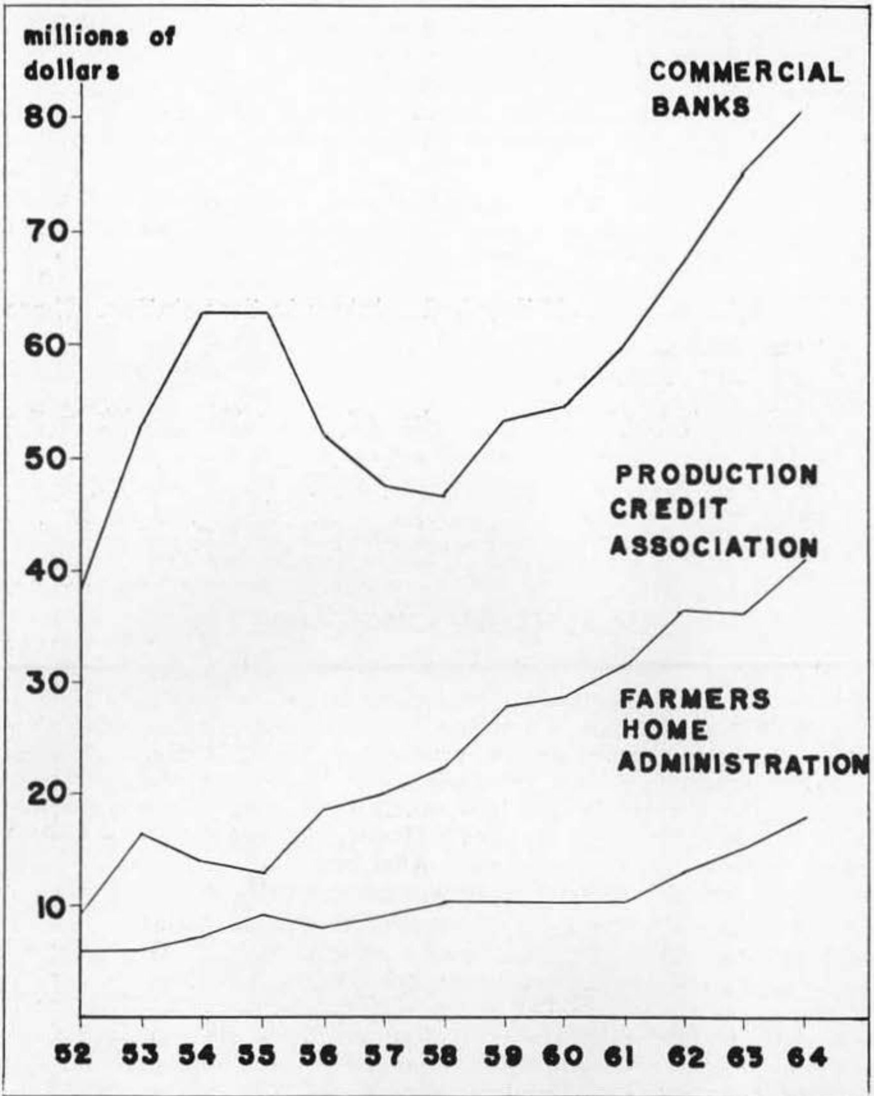

Figure 1. Non-real estate farm loans outstanding in Idaho by major lenders as of January 1, 1952-64. (From *Agricultural Statistics* and American Bankers Association *Agricultural Credit and Related Data*, 1963 and 1964.)

Table 1. Production Costs Per Acre For Selected Crops Grown in Southern Idaho

Crop	Acres in Enterprise	Variable Cost	Fixed Cost	Total Cost
Potatoes[1]	140	$153.51	$55.48	$208.99
Sugar beets[1]	57	100.64	62.62	163.26
Grain[2]	65	24.57	24.34	48.91
Alfalfa[2]	78	48.11	24.94	73.05

[1] Withers, R. V.; "Sugar Beet Costs for Eastern Idaho", Unpublished Data, Dept. of Agr. Econ., University of Idaho.
[2] Jones, Elwood Crawford; "The Relationship of Farm Size to Costs and Returns from Alternative Crop and Livestock Systems on Irrigated Potato Farms in the Upper Snake River Valley of Idaho", Unpublished Master's thesis, Agr. Econ. Dept., University of Idaho, 1958.

Farmers in the sample indicated that they borrowed an average of $50.92 per crop acre if they had potatoes in the rotation. Those who borrowed but raised no potatoes borrowed only $31.56 per crop acre. Estimated production costs for four principal crops are given in Table 1.

Another factor in the expansion of production credit is the increase in the average farm size. Very often, all of the capital needs of the small farm were supplied by the operator. Larger farms, however, needed much more capital and it was customary to supply part of this capital with credit. The study indicated that as farms increased in size the portion borrowing production capital increased to almost 100 percent for the very large farms. Eighty-two percent of the farms 100 acres or larger used some production credit, while only 27 percent smaller than 100 acres used this type of credit. All of the farms in the sample of 400 acres or larger used production credit.

A third reason for the expansion of credit use was changing technology on farms. Machinery and labor costs have been increasing quite rapidly. Use of commercial fertilizers has become common which also has its effect on credit needs. Technology together with expansion in farm size has had a significant effect on capital and consequently credit needs.

There was a definite relationship between credit use and age of the operator. Over 80 percent of all farmers 30 years of age or less in the sample used production credit while only 38 percent of the farm operators 55 years old or over used this type of credit. Older farmers usually had more capital reserves, were not expanding the farm operation and had a more conservative attitude toward credit than did the younger farmers. Over 90 percent of the farmers between 35 and 40 years of age used production credit.

Production credit was used more in newly developed areas than in the older established farming areas. Nearly all farmers on the new land used production credit while only 48 percent of those in the older areas used it.

There were three probable reasons for this. One is that a higher proportion of row crops was raised in the new areas, thus increasing the need for capital. Another reason was that farms tended to be larger in these areas. And finally, the younger farmers tended to move into these areas rather than the older farmers who were nearing retirement age.

SOURCES OF PRODUCTION CREDIT

The three major sources of agricultural production credit in Idaho were commercial banks, production credit associations and the Farmers Home Administration. No doubt individuals also supplied a considerable amount of credit but no estimate was made of the relative amount. Small amounts of credit are probably loaned farmers by other agencies, but no data were obtained from them.

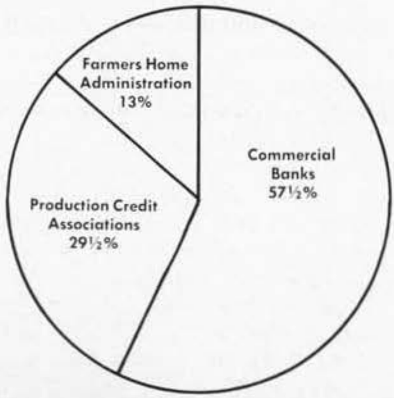

Figure 2. Proportion of production credit outstanding on Idaho farms, January 1, 1964. (From American Bankers Association *Agricultural Credit and Related Data*, 1964.)

Commercial banks held 57.5 percent of the production credit outstanding with the three major lenders in Idaho January 1, 1964.[1] The usual interest rate charged by the banks was between 7 and 8 percent per year.

Production credit associations were second to the banks with 29.5 percent of the agricultural production credit outstanding January 1, 1964. The interest rate charged by these associations ranged between 6.25 and 6.50 percent per year. In addition farmers getting credit from this source were required to invest 5 percent of the loan in stock. The local production credit association is a farmer owned cooperative and is financed with stock purchased by the borrowers.

The third major source of agricultural production credit was the Farmers Home Administration with 13 percent of that outstanding January 1, 1964. The Farmers Home Administration is an agency of the Federal Government providing a stable source for farmers unable to get adequate financing from other established sources. Most of these loans were closely supervised and borrowers were required to work up a satisfactory farm plan with

[1] American Bankers Association, "Agricultural Credit and Related Data", New York, 1964.

the help of a Farmers Home Administration representative. Many of the management decisions were influenced by this representative. The interest rates for this type of credit were betwen 5.0 and 5.5 percent[2] annually. Direct comparison between interest rates for this and other sources of credit can not easily be made, however, since the Farmers Home Administration furnishes both long- and short-term capital. Interest rates for long term loans are customarily lower than for production credit.

All of the major lending agencies used a budget of some sort as a basis for lending. Farmers who wanted to borrow production credit filled out a farm budget form that included such items as products they expected to produce, estimated cost, and esimated income. This budget, together with the individual credit rating and personal character evaluation, provided the lender with necessary tools to decide whether or not to make the loan.

Another source of production credit which is important is merchant and dealer credit. This type of credit is extended to individuals when they purchase production supplies and do not pay cash at the time of purchase.

There was a wide range of terms and rate of interest applicable in this area. Often no carrying charge or interest was levied for short periods, usually up to 30 days. After this period it was customary to charge interest on a monthly basis, although for favored customers this was often ignored. This interest rate usually ran from $\frac{3}{4}$ of one percent to $1\frac{1}{2}$ percent per month. Some dealers, particularly those selling tractor fuel did not charge interest until after harvest time. On the other hand those paying cash at the time of purchase sometimes were given a discount.

A question arose in the analysis in determining whether credit for machinery purchases should be considered intermediate- or short-term credit. Repayment periods ran anywhere from a few months up to three or four years. A variety of terms and repayment schedules were available for machinery purchase. Some dealers provided contracts discounted at the local bank and others financed contracts through the parent company. Interest on these contracts varied from 8 to 12 percent per year.

No estimate was made of the total amount of production credit provided by merchants and dealers but it was thought to be substantial. A recent Montana study indicated that merchant credit amounted to 21 percent of the total production credit used.[3]

Sugar companies provided some production credit for the sugar beet crop. Such items as seed, fertilizer and labor could be financed through the companies for an interest rate of 6 percent per year. A crop mortgage was taken by the company when this type of credit was extended.

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[2] *loc. cit.*

[3] Davidson, Jack R. & T. W. Witzel, "Merchant Credit and Montana Agriculture", Montana Agr. Exp. Sta. Circular 243, Montana State College, Bozeman, 1963.

Table 2. Reasons Given by Farmers for Borrowing from a Particular Credit Agency, Idaho, 1964

Reason Given	Percentage
Borrowed from this agency for many years	45
Only source available	18
Best repayment schedule	13
Most convenient source	8
Friendly people	8
Lowest rate of interest	8
Total	100

Farmers were asked why they borrow from a particular agency. The answers given were grouped under the headings listed in Table 2. The most popular answer was that they had been with a particular agency for a long time and that they were satisfied. The use of credit is quite a personal matter. Once a farmer has established a good relationship with the people of a particular agency he is often reluctant to change unless some problem arises.

Eighteen percent said this was the only reasonable source available. These were mostly borrowers from the Farmers Home Administration.

Only 8 percent borrowed from a particular lender because interest rates were lowest. Probably, since interest rates between the major lenders did not vary a great deal, other factors were considered more important.

ATTITUDES TOWARD PRODUCTION CREDIT USE

Attitude is sometimes vague but still a powerful force in determining the actions of an individual. An attempt was made to assess attitudes of farmers toward the use of production credit. The attitudes and policies of lenders were also studied.

To some farm operators, credit was very undesirable and should not be used except in emergency. Users of production credit, however, had quite a favorable attitude in general. They felt that production credit was an essential part of properly financing and operating an efficient farm unit. A few users were opposed to general credit use but felt they had been forced into using it to keep farming. Young farm operators were less opposed to credit use than older operators.

There was also a relationship existing between farm size and the operator's attitude toward production credit use. About 66 percent of the farmers interviewed who were operating farms of less than 100 acres were opposed to production credit use. Seventeen percent of these farmers had a favorable attitude and the remaining 17 percent were indifferent.

Attitudes of farmers with 400 or more acres were quite different. Fifty-three percent of these were very favorable toward production credit use while 40 percent were indifferent and 7 percent opposed its use.

The major lending agencies felt they were providing a service to agriculture by offering credit. At the same time many saw farming as a large credit user and encouraged expansion in these areas.

The attitude of merchants and dealers toward providing credit for farmers was different. They were primarily concerned with sales and used credit as a means of increasing the volume of business. Some of the smaller suppliers of production items were quite opposed to providing credit since they needed capital to operate the business. They felt that charge accounts beyond 30 days were detrimental to them.

INFLUENCE OF CREDIT ON MANAGEMENT DECISIONS

One of the objectives of the study was to determine whether credit agencies influenced farm management decisions to any extent. Eighty-one percent of the farmers interviewed said that the credit agency had little or no influence in determining what enterprises would be pursued on the farm. Apparently most farmers were able to work out a suitable combination of enterprises to meet the lenders requirements without any assistance from the lender. Also after a farmer had become established and developed a good credit rating the lenders were less concerned about his operating plans as long as they were reasonable.

The 19 percent who said credit agencies did influence management decisions on the farm were mostly borrowers from the Farmers Home Administration. In a few other cases the farmers asked for the advice of the lender. In isolated cases when the lender had some question concerning the borrower's ability but still made the loan, the borrower was required to contract part of his potatoes as insurance against falling prices.

In general farmers who were capable of making reasonable progress in the increase of net worth were considered good credit risks and little or no supervision was deemed necessary by the lender.

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