# AEI PREMIUM

**AEI Presents** *Nothing Borrowed, Nothing Gained*: How Farm Financing Works, and When it Doesn't or The Countercycle and the Future of Ag Lending

**Episode 2 | Earning Extra Credit**

**Sarah Mock: This is *Nothing Borrowed, Nothing Gain* episode 2 - the story of ag lending; past, present, and future.**
**I'm Sarah Mock.**
**I want to start today by tackling an inconvenient truth about this podcast season. Namely that I've talked to a lot of ag bankers. I point this out for a number of reasons. Mostly though, it's because if I were in your shoes, I'd be pretty skeptical of hearing a bunch of stories about ag lending, mostly from the perspective of bankers.**
**And setting aside the bias that I, and probably many of you, have towards bankers, there is a more obvious reason to be skeptical because bankers only represent one side of the lending story. But at the same time, I've found that idea to be almost universally not true when it comes to ag lending.**
**Take Jim Farrell, for instance. Jim has had a long career in ag and ag banking -- including serving on the board of the Federal Reserve Bank of Kansas City. So, we sat down with Jim to talk about his career, and the deeply personal origins of his interest in lending.**

**Jim Farrell:** I started farming in '77 with no money. My dad died. I bought the equipment from the estate. I have four sisters and a brother. And my mom, and she was building the new house - she needed the money. She was going to move off the farm and I was going to move on the farm. I borrowed all that money on floating interest rates from production credit that was on term loans on 7-year terms. And all the operating capital was borrowed too because hell, I just came out of college. I hardly had a thousand dollars to my name and, I was farming, at that time, just under 600 acres.
So, basically, I was borrowing all my capital. And when I started, I was able to make money at that. And that was roughly an interest rate in the 7% range, somewhere around 7. 8%, 7.5% - long about '79, when Paul Volker took over the Fed, then interest rates shot up in a very quick timeframe.
And I think I'd have to go back and look at my records, but probably by the end of '79 and it could have been earlier than that even, I was paying 19.5% on all the money I'd

borrowed up till that point and on any future borrowing. And farming's a margin business. So whatever margin you had was being sucked up by interest. So, when we got done farming, we were just able to pay off our debt, had about $500 left over when we moved to Minnesota, and had two kids and went up there and started over.

**Sarah Mock: Looking back, I can make sense of a story like Jim's -- a person whose life and career were dramatically shaped by their experience with leverage spending the rest of their career putting their hard-earned lessons to use. But I wonder too about the barriers this kind of experience creates -- putting myself in Jim's shoes I wonder, when you've seen what he's seen, how do you unlearn the lesson that debt, and therefore ag lending in general, is inevitably bad, destructive, even predatory?**

**The funny thing is -- when you dig into the history of ag lending, it's not the long story of reining in greedy bankers and advocacy for debt-free farming that you might expect. Quite the opposite, in fact. Ag lending, for a few hundred years now, has been a hot button issue for populists, a sacred cow for those who fight for laborers in agriculture and beyond, who've argued that regular people are best served not by less credit, but by more, less expensive credit.**

**This is the history we're going to explore today, and to guide us, I tracked down a banker who moonlights as an ag lending historian:**

**John Blanchfield:** My name is John Blanchfield and I'm the owner of Agricultural Banking Advisory Services.

**Sarah Mock: John's career -- and his passion of this very niche flavor of history -- started about 40 years ago, when he was working at a regional bank in Central New York, one with its own deep history.**

**John Blanchfield** Some of their first ag loans were made in the 1830s, to farmers to buy mules to of course, obviously to work fields, but also when those mules weren't working fields, they were hauling barges on the Erie canal.

**Sarah Mock: Mules aside, the fascinating thing about this oft forgotten period, around the 1850s or so, is that it marks kind of the beginning for ag lending in the U.S.**

**John Blanchfield:** It isn't, well-known that agricultural lending, farm lending created many of the innovations, many of the products that we accept today. For example - and I'm not a 100% sure this is true, but it's a great story - Cyrus McCormick of all people, the inventor of the combine, essentially, is credited with creating installment lending. He wanted to sell his product. Farmers didn't have cash to buy it outright. So, he figured out a way that they could buy it on time.

**Sarah Mock: This is a very nifty origin story, and some elements seem to be verifiable. McCormick did offer an installment payment program for those buying his mechanical reaper. Lending money has been around as long as money has been around. And even though farmers weren't always at the center of debt debates, they have been a driving force in the world of American credit for hundreds of years. For John these debates really hit paydirt at the end of the 19th and early-20th century.**

**John Blanchfield:** In the 1890s, we had a major depression in this country – 25% unemployment. And it was a fairly lengthy depression, not as long as the Great Depression of the 1920s, but in the 1890s, it lasted quite a long time. Factories were idled, et cetera, et cetera. There became a big debate about what caused that depression. And one of the things that most average Americans thought created the depression was the lack of credit and the cost of credit. And this was tied directly to the insistence that we remain on the gold standard for our currency.

**Sarah Mock: So, a big part of the reason that people -- ordinary Americans -- were so upset about the gold standard was because of a little-known act passed by Congress two decades earlier, which would later be called the Crime of '73. This action ended bimetallism, which in the simplest possible terms, meant that the U.S. went from having a gold *and* silver standard - the money supply was limited by the amount of gold and silver in our holdings, to having a strict gold standard, stranding many holders of silver, but more importantly, significantly curtailing the supply of dollars in the economy. Fewer dollars meant less credit, less credit means the credit that was available got way, way more expensive.**

**John Blanchfield:** And so, during the presidential campaign of 1896, a politician from Nebraska, who represented many of the farming interests of the Midwest, at the 1896 democratic national convention in Chicago. Gets up and gives what's been called the greatest political speech of all time - the "Cross of Gold" speech.

**William Jennings Bryan:** If they dare to come out in the open field and defend the gold standards as a good thing, we will fight them to the uttermost. Having behind us, the producing masses of this nation and the world supported by the commercial interest, the laboring interest, and that follows everywhere. We will answer the demand for a gold standard by saying to them, you shall not press down upon the bow of labor, this crown of thorns. You shall not crucify mankind up on a cross of gold.

**John Blanchfield:** The speaker was William Jennings Bryan, who was a young man at the time who was, living in Omaha, Nebraska. He was called the boy orator of the Platte. He gets up and gives a 30-minute speech -

**Sarah Mock: It was actually less than 10 minutes. You can get al ink to the full speech in the show notes.**

**John Blanchfield:** Decrying why the gold standard was limiting and hurting the American economy. And he was talking, especially because of the interest of agriculture and having a more permissive supply of credit and a lower cost of credit. Well, his speech was so spectacular that the delegates at the convention lifted him upon their shoulders and carried him around the arena five or six times. They just went nuts for this speech. And, Bryan, won the democratic nomination for the presidential campaign of 1896.

**Sarah Mock: William Jennings Bryan ran for President, but he lost to William McKinley, not once but three times, and the gold-and-silver standard was lost forever. But Bryan's ideas, and a general animosity towards the gold standard, did not die with his political ambitions. In fact, it's been speculated today that even L. Frank Baum's beloved story The Wizard of Oz, which was published in 1900, is a popular allegory for the end of the gold-and-silver standard. The imagery is pretty direct, actually.**
**In 1964, Henry Littlefield argued that the story recounts how Dorothy, representing the American people, was swept up in a political and economic cyclone and deposited unwillingly on a yellow brick road -- gold bricks, one could say. Along her path to the money-green city, she comes upon the scarecrow -- for farmers, a tin man-- for miners and other hinterland laborers, and a cowardly lion-- perhaps a stand in for ineffective politicians, maybe even William Jennings**

**Bryan himself. Together they make their way to see the Wizard, who Littlefield guesses is William McKinley himself, and discovers him a fraud.**
**But of course, it turns out, Dorothy had the power to get back to normal all along, in her silver shoes. That's right, in the original story, those sparkly little pumps were silver, not red. The color was changed for the 1937 film, which was shot in technicolor, where silver would be less impressive.**
**This metaphor goes deeeeep -- with theories that even the name, Oz, is the abbreviation for ounce, as in the common unit of gold, and the wicked witches represent, respectively, Eastern industrialists and the Western trusts... that one is interesting because one proposed solution to the trust problem at the time was to dissolved them, by, I don't know, throwing a bucket of water on them maybe?**
**All to say, though ordinary American workers and farmers lost out in this round of the money, and therefore credit, availability war. Bryan's speech and political career were successful in drawing attention to the fact that Americans both wanted and needed a more permissive supply of credit. And the long echoes of Bryan's address rang on.**

**John Blanchfield:** Woodrow Wilson gets elected president in 1912. Who does Wilson pick for his secretary of state? William Jennings Bryan. What does Woodrow Wilson sign into law in 1913? The Federal Reserve Act, which was created to supply liquidity to the banking sector. Then 1914, a large militaristic power invades Western Europe. Does this sound familiar? And it created food shortages, because this power invaded, the farmland of Belgium and France was the breadbasket of Europe at the time. It kicked off an enormous farm boom in the United States and asset prices increased and commodity prices increase and so, we had a tremendous farm boom from like 1914 to 1922 - then a crash.

**Sarah Mock: Obviously John is skirting over a lot of history here but it's worth thinking about the other factors too. Beyond the farm and food system, the 20s were roaring. The war was over, Germany had been defeated -- if only temporarily - and for many, life was looking up.**
**For agriculture, the war and immediate post-war years boomed, due to elevated wartime prices, but as Europe began producing crops and feeding themselves again, and U.S. commodity prices plummeted, and lenders pulled back from lending to agriculture in response.**

**John Blanchfield:** The 1922 farm crash led to the 1929 stock market crash. And again, the government intervenes and comes up with more permissive credit and regulates interest rates. And you can just see how these things roll through our history, by the 1970s, we have another great boom in the farm economy. We have a grain deal with Russia, prices go up like crazy, farmland values go up like crazy, speculation and farmland values just go off the charts - all of a sudden, we have inflation in the general economy and the Federal Reserve, chaired by, Paul Volcker decides we've got to regulate inflation. And so, he steps in and raises interest rates.

**Sarah Mock: If you're a longtime listener, this isn't news to you, but it's worth talking about the 1970s and 80s again in terms of how they fit into the broader historical pattern. When we use words like "once in a generation," it sounds like a rarity, but in reality, these cycles recur every 30 years or so.**

**John Blanchfield:** So, by the time I showed up as a novice ag lender in central New York, we were lending money to farmers at 12% and 14% and telling them, "Hey, you're getting a great deal because you can at least get credit."
Well, that led to the next crash in the farm economy, which then moderated by 1989. And we have the beginnings of the current farm boom that we have today. And I believe that from roughly 1990 to today, we've been in a fairly sustained farm economic boom, and there's been some ups and downs, but the overall trend to this day has been upward.
And you see that today in farmland prices, farm machinery prices, in the prices of commodities farmers are receiving. And right now, people are absolutely giddy about the potential for the price of corn and soybeans and any other thing we can produce, because, oh yeah, a giant militaristic power has invaded Europe again.
Now does history repeat itself? Now, I don't think it does, but there are certain things that do kick off farm booms in this country and war is a big one.

**Sarah Mock: Today, the invasion of Ukraine by Russia is still ongoing, and the question of what that means for grain production in Europe's new breadbasket, not just this year but for years to come, remains uncertain.**
**And we're seen ripples of this conflict reach the U.S. already -- both in terms of commodity prices, and by extension land prices, which were already elevated thanks to multiple years of high farm incomes, most of which were the result of policy changes, rather than market effects.**

**But however unprecedented the last few years have seemed, John advises to not be fooled by our recency bias -- the reality is, the last few years generally fit smoothly into a pattern that's about three decades in the making.**

John Blanchfield: From the 1990s to today, it's been a generally positive, at different times, boom, farm economy. Interest rates. I believe have played a significant role in that farm boom in that by 1990, we were off those horrible high rates. Rates moderated, and essentially from 1990 to today, have declined in a how economists call real interest rates.

**Sarah Mock: We've got to take a beat to talk about real interest rates here.**
**At a most basic level, the real interest rate is the interest rate adjusted for inflation. Take today, where the nominal interest rate-- what a bank would lend me money at, is about 6%. But if inflation is say, 5%-- the real interest rate is actually 1%.**
**The real interest rate is most important for lenders, savers, and investors, because they are the folks who, though they are charging the people they lend money to 6% are actually receiving only a real fraction of that, because prices are going up, so their dollars are becoming, relatively, less valuable all the time.**
**If you're anything like me, these concepts can get pretty nebulous. My favorite illustration is to imagine a dollar to candy bar exchange. Say in a terrible hypothetical world, a candy bar today costs $10. If you lend me $10 today, and I pay you back today, I could pay you back $10 or 1 candy bar. But say I pay you back in a year instead, and inflation, over the course of that year, is 10%.**
**That means in a year, the same candy bar will be worth $10.10.**
**That means in a year, when you receive back your principle from the loan you gave me, you'll only be able to buy about 95% of the candy bar with it. Your $10, in other words, has gotten less valuable.**
**But that, to John's point, is also good for borrowers. It means that you're borrowing money that you'll pay back with dollars that are a bit less valuable.**
**Low and declining real interest rates, in short, make borrowing more attractive.**
**Okay back to John.**

John Blanchfield: We've had a very stable to declining interest rate picture that has encouraged farmers and businesses and consumers and homeowners to borrow money. So, we've lived off this credit-sustained economy since the late 1980s.

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Now what the Federal Reserve gives, the Federal Reserve can take away. And right now, there's inflation in our economy and people are concerned. How much will the Federal Reserve raise interest rates to try to control inflation?
And we've just had several shocks of interest rate increases by the Federal Reserve. And no one knows where that's going to go. Now, is it a repeat of the 1980s? Certainly not, but there are similarities - inflation driven by high energy costs responded to by the Federal Reserve with raising of interest rates and farmers in particular have taken on a considerable amount of debt as a result of this permissive credit environment that we've been in.

**Sarah Mock: John isn't the only expert we talked to who have marked, and worried about, the similarities between the 1970s and today. Mike Boehlje, last week's Purdue economist, he and others noted that there are worrying signs that today's commodity markets, farmland markets and yes, debt markets, are beginning to look a little too familiar.**
**Jim Farrell, that farmer we met at the beginning of this episode, has felt it too.**

**Jim Farrell:** We're in a really bullish agricultural market right now, 1977, the market looked really bullish. We'd come off $10 soybeans. We'd had the Russian wheat deal. Cash rents had gone up, almost 2.5 times in a three-year timeframe. Things were really hot, but that was the peak. Nobody really saw that as the peak, but if you looked at a graph of the profits from the day I started farming until I quit, profits went down pretty much every year, and it was just the way it was.

**Sarah Mock: It's worth pointing out here that when Jim here refers to year-over-year declines in profit, that was no short-term phenomenon. The trend last for more than a decade. The lesson for Jim from this period was clear --**
**avoid borrowed capital at all costs, and when borrowing is essential, only carry fixed interest rates.**
**But there are other critical learnings from this history -- ones that should be shaping the way you think about ag lending for your operation.**
**That's after the break.**

COMMERCIAL

**Sarah Mock: I turned to David and Brent to hear what they thought are the most important lessons to learn from this history of ag lending. And our conversation revolved around two key ideas - the first being what this story reveals about the nature credit broadly beyond the ag sector.**

David Widmar: There are times in history like the farm financial crisis, or the housing crisis, that it becomes difficult to get financing and I think that's what causes folks to have a lot of concern. I guess there's individual reasons, but there's also these broader market trends that can make the credit cycle or the credit markets, easier or more difficult to get access to.

Brent Gloy: One thing with credit is that it exacerbates the cycles that are natural. When times are good, you want to have more capital, so you borrow it and you put it to use, and it earns a high rate of return - you make a lot of money. And then when times aren't so good and you can't earn enough to pay it back, then you've got to come up with the funds somewhere else. So, it tends to be very contractionary when that credit is withdrawn and very expansionary when it's added. And it tends to follow the good times the bad times. And so, it makes those cycles, all the bigger than they would be otherwise. So, it's a wonderful tool. But it can also, lead to these, big swings in markets.

**Sarah Mock: When it comes to overall debt markets, big downward market swings have generally reduced the availability of credit. But one of the key issues in ag lending specifically is that in the past, lending hasn't just been reduced in the ag sector during bad times, it's often withdrawn altogether.**

Brent Gloy: So, there was a view and I think accurate, that no credit would be provided because nobody wanted to take the risk. It was a very specialized type of lending. And so, people just wouldn't make that investment to provide that credit and that, we needed an agricultural sector. So, having more of an agricultural sector was a good thing for the country. And there's this view based on evidence, in those days, that banks would just all of a sudden say we're just not going to make any loans to agriculture at all, or we're going to leave that space.

And I do think, not so much in the Midwest, but in parts of the country, you still see that today. The large banks will get involved in agriculture, they'll have some hiccups or something or a new president will come in that isn't familiar with that specialized type of lending and just go on and say, “Let's just get out of that. We don't need that. We've got plenty of other things we can loan money to.” And so, then all of a sudden, if you're in that geography, you're without. And so, there was I think in those days, the market failure, so to speak that justifies intervention.

**Sarah Mock: The intervention that Brent is referencing is not only the Federal Reserve Act that John mentioned previously, but also the 1916 creation of the farm credit system, the 1933 Farm Bill, and the 1987 creation of Farmer Mac, and countless other interventions along the way that aimed to ensure that America's agricultural system would not fail due to lack of credit. And from Brent's perspective, things have by and large, over the course of this long history, going okay.**

Brent Gloy: I think that's, that might be an important part of the whole discussion that the system works pretty well. It's important and, it's needed.

**Sarah Mock: We've focused a lot today on the benefits but there's also tradeoffs. The last 150 years of ag history have been a long series of policy changes that have, in effect, subsidized credit, in the agricultural sphere at first, and more recently, throughout the whole economy. But subsidization, as always, comes with tradeoffs.**

Brent Gloy: People have this love, hate, relationship with credit. They need it to be able to operate their businesses and they want it, and they want it cheaply. But then when it gets too much then it's a big problem. And you see it everywhere across the economy. We need to make more people be able to go to college so, we give them subsidized debt or access to student loans and then, all of a sudden, we can't pay that back so it a creates a lot of stress. And it's not a phenomenon that's unique to agriculture,
One of the first things you learn in economics is that when you subsidize something, you get more of it than you would otherwise, and credit is no different. And credit has a way of feeding through. So, there's a lot of people that have interest in having a lot of credit in the sector because it, it makes everything work it's not just more credit it's more activity. More farming activity gets done because of extra credit.
We get more stuff because of more credit, just like higher education, you have more people in higher education because of federally subsidized student loans more students are able to go to college. That means more professors have jobs that means more universities have more people and inflation and tuition and all kinds of other things.

**Sarah Mock: The assumption that credit feeds through the financial system**

**has been there since the beginning.**
**Cyrus McCormick wasn't carrying his customers through the season because of his passionate love for American farmers. He did it because it allowed him to sell more implements than he would have if he'd insisted on cash up front.**
**It's pretty clear this creates a lot more stakeholders in the world of ag credit than just farmers, which is almost certainly why so much policy has come to fruition to support ag lending. Because it's not just farmers who benefit, everyone who does business with agriculture is affected and sometimes, in ways that farmers probably don't appreciate.**

Brent Gloy: There's no doubt the availability of credit influences - yes, we have more equipment and agriculture and more expensive equipment in agriculture because of availability credit, I don't think there's any doubt about it. And back to the most simple economics like capital and labor substitution, you make capital cheaper, you get more of it. And so, we have a lot more of it and that feeds into, more suppliers of capital equipment producing more stuff than they would otherwise, [which] allows them to increase their prices. And it, yeah, it feeds through the whole system.

**Sarah Mock: This is the second lesson of the history of ag lending - understanding the link between cheap credit and the price of assets. The two are inextricably linked, and their linkage goes both ways. When credit is cheap and abundant, prices for capital assets go up, and as credit becomes more expensive and harder to attain, we would expect the prices, and values, of capital assets to go down. Don't get me wrong, prices are sticky, and because of other factors in the ag system - namely federal programs that protect farm income - we wouldn't expect asset prices to fall out of the sky in a day. But as interest rates climb, there will be inevitable downward pressure on prices as the fundamental affordability of the system changes.**
**And that brings us back around to the first lesson, the one that's not unique to agriculture. Credit tends to be expansionary during the good times and contractionary during bad times. It makes the highs higher, and the lows lower. But what causes the expansions and contractions in the first place? When we take a closer look at the history of ag lending it's clear that most of the time, the source of those expansions and contractions have little, if anything, to do with ag at all.**

**David Widmar:** Things can happen in the debt markets that are completely unrelated to agriculture. So, the financial markets can go one way and the ag markets are just really small in the broad context of all the global finance markets. And it can leave you feeling a little bit helpless, because it's not connected to, corn and soybean production. It's not connected to commodity prices. It's not connected to cost of inputs. It is its own market; its own thing and agriculture relies heavily on it. and we have very little control, of what's going on there.

**Brent Gloy:** Yeah, it's completely exogenous.

**Sarah Mock: Exogenous is a fancy word that ag has had to get familiar with, especially over the last few years. So many of the factors that the farm sector has struggled with, from trade disputes to policy changes, global pandemics, and supply chain crunches, shifting work patterns and changing weather trends, and yes, evolutions in financial and debt markets, have all been exogenous to agriculture. And no amount of exceptional decision making, or planning could have allowed farm managers to avoid these issues all together. I think that's a key takeaway of John's story overall. Farming successfully in the U.S. over the last century or more has been much less about how farm businesses have expanded in the boom years, and much more to do with how prepared they were to be resilient through the busts.**

**Reflecting on David and Brent's analysis and on John's history of ag lending, offers some powerful clarity as to why folks like Jim find power and meaning in the world of lending, despite all the damage it can do. The idea of lending to farmers has been a populist touchstone, one of the few and most powerful tools of the little guy to survive and thrive in a dog-eat-dog financial system. For me, this story reshapes that somewhat lame cliche about the ag lender as a pillar of the community, a trusted advisor advocate and partner. This history makes it clear that ag lenders are important and valuable because having access to affordable credit in the farm and ag sector is something that many tenants, farmers, workers, ranchers, and rural communities have fought for, for generations and ag lenders are in part responsible for stewarding that access. At the same time, it's worth keeping in mind, that the intervention that brought about that cheap and abundant credit, has come with tradeoffs in the form of higher asset prices, and that as conditions change, we have to remember that abundant credit makes highs higher and lows lower.**

**A few minutes ago, I rattled off a few of the governmental interventions in the ag credit space that John mentioned during our conversation. Interestingly, very few of those interventions are actually controlled by the federal government anymore, which by extension means that, though past government actions have siphoned much of the risk out of ag lending, farm debt in 2022 is almost exclusively held in the private sector.**

**John Blanchfield:** Today banks have about 50% of all the farm loans in this country. The farm credit system, that thing that was created back in 1916, they've got about 40% of the farm credit market. The rest is held by so many other entities like John Deere credit, like Pioneer credit - input suppliers are major lenders to agriculture today.

**Sarah Mock: Now that we have the history out of the way, it's time to tackle the modern landscape. There are a lot of players to discuss, so where to start?**

**David Widmar:** Often times farmers, prepare themselves to get a loan from the bank. But where does the bank get that money? What does the lender get that money, to make that loan happen?

**Sarah Mock: Following the money, all the way to the bank - next time, on *Nothing Borrowed, Nothing Gained.***

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