Some Aspects of the Livestock Credit Problem
in the Current Economic Situation

Remarks by Chas. N. Shepardson, Member, Board of Governors, Federal Reserve System, at the annual convention of Texas and Southwestern Cattle Raisers Association, Houston, Texas, on March 20, 1957.

It is always a pleasure to return to Texas and I truly appreciate the honor of being invited to address your Association, especially since you have had a little rain. When Mr. Stewart wrote to me, he failed to suggest a topic but I assumed by reason of my present position that he expected me to say something about the money and credit situation. Frankly, I would have hesitated to accept if it hadn't rained for it was beginning to look as though neither credit nor anything else would do much good if the drought continued. And, here, let me say that I know as do you that, welcome as these rains have been, they are only a start on what we need. But they do give some basis for hope of better seasons ahead and some justification for forward planning.

First, I would like to discuss briefly the general economic picture. For the past two years we have had a high level of economic activity in most sectors of the economy with demand for goods and services exceeding productive capacity in many lines, especially in the metal industries. We have had virtually full employment and a rising level of wages, which have meant increased consumer purchasing power. This, coupled with the easing of consumer instalment credit terms in 1955, resulted in increasing demands and a corresponding pressure on prices. This in turn stimulated demand for expansion of plant and equipment and a further pressure on prices, particularly on industrial raw materials.

The problem confronting us in this situation can best be illustrated by comparing it with the beef cattle situation ten years ago. You will remember that with the end of rationing, following the war, beef consumption rose from 58 pounds per capita in 1945 to 68 pounds in 1947. This rising demand led to rising prices of beef, which in turn stimulated the interest in beef production and rising prices for cattle to enlarge existing herds or establish new herds. I do not need to tell you that if you hold back more animals for herd expansion you temporarily have less available for current marketing. With a strong consumer demand, this automatically results in higher prices, which in turn tends to curtail marginal consumption. Eventually, however, increased production from the expanded plant, in this case the expanded cow herds, begins to hit the market and the price trend is reversed, the severity depending upon the degree of over-expansion. This is what happened to cattle.

As post-war consumer demand outran production, beef cattle population dropped 9 per cent from January 1945 to December 1947, while beef and cattle prices rose. Then expansionary forces began to dominate the picture. Slaughter of cattle dropped 23 per cent and calves 37 per cent in the next four years while total numbers rose 29 per cent. The price of cows rose 100 per cent, steers 122 per cent, and calves 147 per cent above 1945 levels. Faced with shrinking supplies of slaughter beef and rising consumer prices, per capita consumption dropped from 68 pounds in 1947 to 55 pounds in 1951. In that year the increased production from this expanded cow herd began to hit the market in a wave that was augmented by the increasing pressure of drought in many areas. Slaughter rates increased about 45 per cent and the price of cows dropped 50 per cent in two years.

Unfortunately, it is difficult to reverse such an expansionary trend over night. Cattle population continued to increase until this past year when drought and other factors finally brought about a reduction of about 2 per cent. The fact that prices have been fairly stable over the past four years, in spite of the increasing supply, is due in large measure to the high consumer buying power which permitted an increase in per capita consumption from the low figure of 55 pounds in 1951 to 84 pounds last year.

Here I want to pay tribute to the cattle raisers generally and to this Association in particular for the outstanding job that has been done in promoting beef consumption. Certainly, one of the major problems of agriculture is that of increasing per capita utilization of animal products with their higher land requirements and thereby facilitating the diversion of more land from the production of surplus crops to the production of meat, milk and poultry products.

But let us turn back to our general economic situation for a moment. The boom phase of the cattle cycle which I have just recounted took place in a period of abundant money and credit and with no restraint whatsoever in the excessive expansion which ultimately proved so disastrous to cattle producers. What took place in this relatively small sector of the total economy is illustrative of the problem facing the economy in general during the past two years. In referring to this as a small sector, I fully realize its importance to you and yet the fact remains that the gross income from beef cattle amounts to less than 1.5 per cent of the gross national product. Demands on productive resources both for expansion and consumption have exceeded current productive capacity in most sectors of the economy with resulting inflationary pressures on prices.

The relatively stable level of prices in 1953 and 1954 appeared to continue in 1955 largely because of the drop in farm prices, which tended to offset the rise in industrial prices. With the slight up-turn in farm prices in 1956, consumer prices, which had held fairly stable through 1953, '54 and '55 at an index of about 114.5 based on 1947-49, rose to an index level of 118 in December 1956.

It was in the light of this situation that the Federal Reserve has attempted over the past two years to resist these inflationary pressures. This has been done by retarding the rate of growth in the money and credit supply of the country. Contrary to the belief of some, there has not been a reduction in available credit. But to have met all of the demands for credit would only have increased the competition for available goods without increasing the supply and the effect would inevitably have been a further increase in prices and a corresponding further shrinkage in the value of the dollar.

Obviously, the price increases that have occurred are evidence of the fact that this policy was not as effective as might have been desired. In fact, this rise in prices accounted for approximately half of the almost $24 billion increase in Gross National Product this last year. Part of this slippage may have been due in part to misjudgment as to degree or timing of credit and monetary restraint. On the other hand, it must be remembered that credit and monetary policy is not the only factor in the picture. Fiscal policy of government and labor-management negotiations of wages are also important contributing factors. Wage increases adjusted to productivity increases may have little or no inflationary effect but those in excess of productivity increases can be inflationary in periods of strong demand, at least until further advances in productivity bring costs back in line.

Of course, all segments of the economy and all areas of the country are not subject to the same demand pressures concurrently. It is much like the surface of the ocean. We speak of sea level yet no one ever saw the sea level. It is always in motion with waves and troughs that are constantly changing. So with the economy; automobiles and housing had a boom year in 1955. They were both down in 1956, but this was balanced in a large measure by an extraordinary rise in industrial plant and equipment.

True, agriculture has been in an unfavorable position for several years. There is no evidence, however, that its difficulty is in any way due to cost or availability of credit. With a rapidly rising population, an increasing per capita consumption of food, and an unsurpassed level of consumer purchasing power, it is quite evident that agriculture's principal problem is excess productive facilities. In fact, the rise that has taken place in the price of farm land in the face of falling prices of farm products over the past several years may be in part a result of too easy credit. Present land prices in many areas may not reflect realistic appraisal of the long-time earning capacity of the land. This is especially true in some of the drought areas. Unusually favorable seasons, plus abnormal world markets during the war years, brought a lot of land into cultivation that should normally be in grass. Capitalization of that land on the basis of wartime yields and prices has retarded readjustments that must be made sooner or later.

Reverting submarginal cropland to grass has been going on for some time, especially in the Southeast, as you well know. It is not improbable that this may ultimately have some effect on the price of western range lands. On the other hand, observation of the inflation that has taken place in the last fifteen years and fear of further inflation have caused many people to look at land as a good hedge against further attrition in the value of the dollar. This, together with the need to enlarge existing units to a more efficient size, has created a demand for land that continues to exert an upward pressure in prices. While this rise in land prices may add to the book value of a man's holdings, it also adds to his overhead costs on land purchased and it certainly increases the difficulty of a new man getting into business if he hopes to pay for the land from his operations on it.

Again looking at the broad economic picture, it has seemed to be the best policy, and in fact the only policy under present law, to combat these inflationary pressures by restricting the total amount of available credit and allowing the market to determine the allocation of that credit. Lenders are forced to become more selective in their extension of credit. Marginal borrowers, both for current consumption needs and for speculative investment in expansion of plant and equipment, are forced to curtail their expenditures, thus reducing the demand pressure on prices. This means that some wants must be deferred until an orderly and sustainable growth can increase our productive resources to meet demand. Of course, no one likes the restraints that impinge on his freedom of action but without some restraint and pruning of the more speculative expansions we could well have a mushroom growth that would ultimately collapse of its own weight, just as happened in the cattle business a few years ago.

Naturally, this credit restraint has resulted in a rise in interest rates. Money is like any other commodity and when demand exceeds supply the price or interest rate goes up. Credit costs, however, are but a fraction of the total cost of operation and to the extent that credit restraint is successful in minimizing rising prices for the goods and services that make up the bulk of operating costs, some rise in interest rates would seem to be a small price to pay for general price stability.

And now let us turn to the situation confronting the cattle industry at this time. The drought may not be broken but certainly it is cracked and the future looks more promising than it has in some time.

There are several things that should be considered as we look ahead. The first of these, particularly in the worst of the drought areas, is the reestablishment of range and feed reserves. Everyone familiar with the livestock business realizes that adequate feed supplies are the basis of a sound operation. Unfortunately, drought is different from many other types of natural disasters. In case of a flood or a tornado, for example, the event is soon over and it is possible to assess the damage and proceed with plans for rehabilitation. In the case of drought, the condition may run on for several seasons and there is no way of predicting its duration or intensity. In an area susceptible to frequent drought, the prudent man will maintain a conservative stocking rate on his range and a roughage supply adequate to provide at least one and preferably two years' reserve. Some men have done this consistently in the past. When drought began to impinge on their reserves too heavily, they reduced their herds rather than accumulate excessive debt for feed. In this way they avoided unnecessary damage to their ranges and conserved their assets so as to be in position to restock as conditions improved. These men should have little difficulty in getting back into business as their ranges recover and they have opportunity to rebuild their feed reserves.

Other men let their optimism run away with their better judgment. They were running too close to the line for comfort to start with. At the first sign of drought, they were short of feed but, with more optimism than judgment in many cases, they bought feed hoping for a better day soon. As the drought continued, they went further into debt and their stock fell off in condition as they tried to stretch limited supplies of expensive feed too far. Some of these have already been squeezed out of business. Others are still hanging on but they have incurred feed bills that exceed the value of their herds. In addition, their ranges have been so badly depleted as to require several favorable seasons to reestablish themselves. In many cases, it will take not only time but money for reseeding and other range rehabilitation measures. In fact, it may be a question as to whether some of them shouldn't take their losses and get out rather than to incur further debt that would impose an impossible burden on any future operations.

Unfortunately, there are also some operators who, through lack of ability in this type of business or because of inadequate holdings to provide an efficient operation, can never hope to make a satisfactory living in their present situation. It is no kindness to encourage such individuals to continue an unsound operation rather than to seek other opportunities for the more profitable employment of their time and talent.

Many, however, are potentially good operators and are deserving of help in getting back on their feet. Part of this help may be through some form of Soil Bank or Deferred Grazing program for drought-stricken range lands. I understand that the Department of Agriculture is still considering the possibility of such a program. Any such program, it seems to me, should have several safeguards. It should be limited to the drought-stricken areas of traditional range land; it should require a minimum term equal to the continued duration of the drought plus the necessary time to rehabilitate the range, possibly two or even three years to prevent too early and too heavy grazing of immature growth; and it should provide safeguards for the interest of tenants.

There will doubtless be need for additional credit for restocking on an intermediate term basis. Personally, I favor the proposal to extend the maximum term on FHA livestock loans beyond the present three-year limit. In many cases, collateral for such loans will be slim at best. In such cases and even in cases of fully adequate collateral, loans should be based not only on the collateral and the integrity of the borrower but also on the soundness of his operation and the probability that it can produce an adequate return to liquidate the debt under normal conditions. Certainly, there is no advantage to the borrower or the community to extend credit that can only be repaid through liquidation of the operation.

In connection with this need for credit, I would hope and expect that private and cooperative lenders would meet that need in all credit-worthy cases to the maximum of their ability as they have in the past. To the extent that additional credit is needed from FHA, I would hope that it would be available at reasonable rates but not at rates so far below current market rates as to provide an incentive for borrowers to seek to shift from private credit sources to government credit.

Aside from credit and the condition of the ranges, there is another problem to be considered. The heavy reduction in cattle population in the Southwest has not resulted in a corresponding reduction in numbers for the nation as a whole. Many of the cattle lost to Texas and the Southwest have been moved to other states and the national total is still excessive. With our rapidly growing population and a continued effort to promote increased beef consumption, our current rate of production can be absorbed in time at increasingly favorable prices. Even gradual restocking can be accomplished without undue pressures in the market. On the other hand, too rapid expansion could lead to a build-up of speculative fever and over-expansion such as hit the industry just a few years ago. Certainly, we do not want to go through that again so soon. In fact, the present favorable corn-hog ratio may lead to another build-up in hog production next year, which could have an adverse effect on beef consumption.

In this connection, some restraint on the availability of credit may serve as an effective deterrent to the establishment, expansion, or even continuation of too many unsound or inefficient operations. Certainly, there ought to be little credit for restocking available to the man who has abused his range and exhausted his resources. Hard as this may be on the individual concerned, it may be the best thing both for him and the industry as a whole if he can find his opportunity in some other field. In this respect, the situation is far different from that after the dust bowl days of the thirties. Then the entire economy was at low ebb and unemployment was high.

Today, even with some abatement of inflationary pressures in certain sectors, the economy is still running at a high level with full employment and a rising level of personal income, which means increased alternative opportunity for the man who finds himself with inadequate resources to continue a farm or ranch operation.

In conclusion, I want to congratulate the cattlemen of the Southwest on the courageous manner in which you have faced and battled the devastating effect of these past drought years. Most of you have suffered severe losses. Some have failed and others may do so unless we continue to get an improvement in weather. I only hope that everyone will be more conscious than ever of the hazards of drought and the necessity of adjusting operations to feed reserves even if it means decimating herds before feed bills eat up whatever equity there is in them. Credit may bridge a temporary period of losses, but it cannot take the place of income over extended periods without incurring a burden that will be too great even under favorable operating conditions.

I realize that I haven't told you anything that most if not all of you didn't know in the beginning. I know, too, that I haven't suggested anything in the way of easier or cheaper credit - first, because it would only increase rather than solve the problem, and, second, because it is not within the power of the Federal Reserve System to extend or withhold credit in selected areas. Our prime objective in our responsibility to the economy as a whole is to provide that volume of credit essential to the full utilization of our resources and the sound growth of the economy while maintaining a stable value for the dollar. We believe that, in the long run, the most equitable allocation of available credit will be accomplished through the competitive forces of the market and that your local lenders who are dependent on your business for their own existence can more adequately judge your needs and your credit worthiness than can the Federal Reserve Board sitting in Washington. I can assure you, however, that the Board is constantly studying the credit conditions and needs of all segments of the economy, including the rapidly changing needs of agriculture,as it attempts to assess the over-all requirements of the economy. I would point out, however, that as the technological advances of agriculture increase its credit requirements, they also call for more business management, including forward planning and the establishment of feed and financial reserves if agriculture is to merit the credit terms that may be appropriate to its needs.

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