# SOME ASPECTS OF OUR AGRICULTURAL PROBLEM

Remarks by Chas. N. Shepardson, Member, Board of Governors, Federal Reserve System, at luncheon meeting of Agricultural Credit Conference, Arkansas Bankers Association, at Hotel Marion, Little Rock, Arkansas, on January 18, 1956.

This country has just finished one of the most prosperous years in its history. Gross national product, industrial production and personal income were all at record levels while consumer prices generally maintained an even keel. In spite of drought and flood in some areas, production of crops and livestock was also at record levels. With bounteous production and a high level of consumer purchasing power, this should have been a top year for agriculture. Instead, we saw agricultural commodity prices continue to decline while non-farm commodity prices rose at an offsetting rate. The drop in farm prices more than offset the bounteous production with the result that farm income continued to decline in contrast to a material increase in non-farm income.

In many respects the farm picture is not too bad. As of January 1, 1955, total farm assets were three times as large as in 1940 and total debt represented only 11 per cent of total assets compared with 18.5 per cent in 1940. Net farm income for this last year was over two and one-half times the net farm income in 1940 and, due to the shrinking farm population, per capita farm income was approximately three times that of 1940. Farm land values have actually risen during the past year and are now about even with their post-war peak and two and one-half times their prewar level.

Notwithstanding this very appreciable gain over the past 15 years, our problem lies in the fact that agriculture has fallen steadily behind in the last five years and that farm commodities are now at a parity ratio of about 82 compared with a ratio of 107 in 1951.

What, then, is the cause of our trouble? Basicly, it stems from two things -- over-expanded production facilities compared to effective demand and unrealistic pricing. During and immediately following the war, we had an abnormal demand for farm commodities and the American farmer responded magnificently in meeting that demand. New land, much of which is normally unsuited for cultivation, was brought into production and, during a series of unusually good crop years, it produced bountifully. The needs of the time also stimulated further progress in agricultural technology, and the increased productivity in terms of output both per acre and per man-hour have been tremendous.

After the war, as other countries recovered, we found many of our foreign demands curtailed and surpluses began to accumulate. This situation was further aggravated by the continuation of a wartime incentive price structure after the need for that incentive had disappeared. As a result, we find ourselves with a burdensome volume of price-depressing surplus commodities.

Perhaps we should consider some of the reasons for this discrepancy between farm commodities and other consumer goods. Apparently, the demand for items other than food is limited only by consumer purchasing power. If we have the money, there is always something for which to spend it -- bigger and better houses, more household equipment and gadgets, a second or even third car, more travel and recreation, and so on ad infinitum. With food, the situation is different. The capacity of the human stomach is limited. Once we have enough food for our bodily needs, we are not interested in any more regardless of price. Fortunately, we have little real hunger in this country.

Most of our people have enough food. In fact, with many of us the problem is too much food rather than too little and the "battle of the bulge" is one of our major health problems. Consequently, the opportunity to increase domestic food consumption is limited to the rate of population growth.

It is true, however, that many of our people have an inadequate plane of nutrition, not from the standpoint of quantity but rather from quality. We do need more health foods, especially in the form of meat, dairy and poultry products. In this respect, increased purchasing power has improved the quality of our diet although there is still room for further improvement and the efforts of meat, dairy and poultry producers to increase consumption of these foods should be continued and intensified.

The situation with other farm commodities, such as cotton, is different. Here we are confronted with a problem of competition. While the potential outlet for cotton in the form of clothing and other items is much more expansible than that for food, it is also subject to much more competition from other fibers, both natural and synthetic. Furthermore, a big part of our cotton production has heretofore gone to export markets. Developments in foreign production in recent years have curtailed that outlet materially, largely as a result of the competitive price situation.

Obviously, then, we must continue to increase productive efficiency to the end that we may be more competitive price-wise and we must either curtail production or increase consumption, both foreign and domestic or probably both. These changes involve government policy and programs which it is not my purpose to discuss at this time. They also involve problems of land use and productive efficiency, which are the direct responsibility of the individual farmer.

The high level of living that we enjoy in this country is primarily a result of our productive efficiency. Agriculture, along with other segments of our economy, has made tremendous strides in this respect, especially in the past fifteen years. In the main, this increased productivity has come through the substitution of capital for human labor. Mechanization has resulted in more land per farm worker. This calls for increased investment capital for land, building, livestock and machinery. Investment in these items has increased nearly three times from an average of $6000 in 1940 to about $23,000 at present. While these averages mean little when we consider the wide variety in size and type of farms in the country, they do indicate the magnitude of the change.

At the same time, the increased use of mechanical power in place of horse or man-power and the increased use of fertilizer, insecticides, herbicides and improved seed has increased the need for operating capital to an even greater extent. As a result of these increases, the capital required per worker in agriculture now exceeds that required in industry and other off-farm activity. Furthermore, this capital must usually be obtained and controlled by one individual. This means that his need for credit has been expanded greatly and with it the need for wise counsel and guidance on the part of his banker.

This is particularly true here in Arkansas and throughout the South. While crop land farmed per worker in the South has increased 20 per cent since 1940, it has increased 33 per cent nationally. This means that greater attention must be given to the improvement of productive efficiency. In many cases this will call for increased size of operation in order that the operator can have a unit that will justify the use of modern methods and equipment. In other cases it may call for a change in type of farm enterprise to more effectively use available labor and facilities. In cases where it is impractical to increase the size of the unit to a level that will afford full utilization of available labor, it may necessitate a type of operation which will permit seasonal or part-time, off-farm employment.

In this connection, it is interesting to note that industrial development throughout the South is affording increased opportunity for such employment. In most cases, it means improved methods and increased knowledge of modern technology if the farmer is to achieve the level of productive efficiency he must have.

Many of these changes call for additional credit. While it is not to be expected that the banker will provide the necessary technical training, it is incumbent on him to assure himself that the prospective borrower is not only honest and industrious but that he has the know-how to operate successfully the new or enlarged undertaking for which he is seeking credit.

Many of these credit needs are for major expenditures on new equipment and facilities or land improvements on which the returns will accrue over a period of years and for which longer term credit than the normal seasonal loan will be required. Some banks have been doing an excellent job in this field for several years. Others, which are equally interested in serving their farm customers, have felt they were restrained from making such loans due to some regulatory restriction.

In this connection, the Federal Reserve Board has recently stated in a letter to all Federal Reserve examiners that there is no Federal law or regulation which prevents commercial banks from making intermediate term loans for agricultural purposes and that such loans, made on a sound credit basis, are not to be considered as undesirable.

Some bankers have attempted to meet this situation with annual renewals of short-term loans. It is entirely possible that such loans may have been criticized by examiners if the terms of the note were not being met even though the lender and the borrower both understood that renewals might be necessary over a period of years before the loan could be liquidated. It is also possible that some bankers may not have realized the needs or potential opportunity for profitable service in this field.

Lenders, of course, need protection against unforeseen developments in these longer term loans. This protection can be afforded with a loan agreement that embodies the necessary safeguards. It is much better that these safeguards be written down specifically and accepted by both parties so the borrower, as well as the lender, knows exactly what is expected. The borrower is thus assured that the financing will be available in the amounts and on the terms promised if he meets the terms of the agreement.

Obviously, such credit, if it is to be used constructively by the borrower and safely for the lender, must be based on a sound and carefully analyzed plan and backed by the knowledge and ability as well as willingness of the operator to carry through the plan to a successful conclusion.

In appraising the borrower's proposed plan, there are several points to be considered. First, is the unit large enough or can it be made large enough without prohibitive cost to provide an adequate living for the operator and his family and still leave enough margin to repay the loan over a reasonable number of years? Second, is the land adapted or adaptable to the contemplated use? Much of our present farm problem comes from the misuse of land. In spite of years of concentrated emphasis on soil conservation and proper land use, we still have vast acreages with a low or hazardous crop potential that should be returned to grass or timber.

Is the borrower's schedule of anticipated income realistic in making due allowance for weather cycles and market fluctuations? The present difficulty of many wheat farmers and cattlemen is in no small measure due to the unwarranted optimism generated by the unusually good weather and abnormally high prices during the war and early post-war period. A sound plan for term credit should make provision for years of uncontrollable adversity but it should also require off-setting prepayments in years of higher than anticipated returns. It should also take account of the possible effects of quotas and acreage allotments and have sufficient flexibility of alternative enterprises to meet such conditions.

The farm plan should be a living document, laying out the broad outlines of the farm operation for the period ahead. It must not be regarded by the borrower as a useless paper which he signs to get the loan and then promptly forgets. A properly prepared plan is a joint product in which the borrower and lender are both vitally interested and which will, in fact, be referred to frequently. It should be subject to appraisal periodically, based on actual achievements, and should be flexible enough to be modified by mutual agreement if conditions require such change.

Banks with agricultural representatives are ideally suited to making such loans and they appear to be increasingly interested in this development. Other banks which are not staffed with agricultural specialists may find it somewhat more difficult. Banks with agricultural people and those without them should avail themselves of the assistance of county agents, SCS personnel and other Federal and State agricultural people in developing such plans.

City banks can be of much assistance to their correspondent banks in helping them to develop this phase of their farm lending service. In addition to the technical assistance which the city banks can provide, they may at times be asked to participate in the larger loans for which the local banks' resources are not adequate. A sound farm plan and loan agreement make a highly desirable, if not absolutely essential, basis for appraising such participations.

It is of doubtful value to the individual or the community to assist him in continuing on an inadequate unit which shows little promise of being substantially improved and where the applicant runs the risk of seeing his lifetime savings and possibly the land itself gradually dissipated. Those borrowers who cannot develop an economically profitable unit, either because of lack of physical and financial resources or because of insufficient managerial capacity, should be encouraged to supplement their farm earnings with part-time, off-farm jobs or, in some cases, even to consider full-time, off-farm employment. This latter move often results in the individual improving his own position and at the same time allows the land to be recombined into larger and more efficient units. With the present cost price situation in agriculture, everything possible should be done to promote greater efficiency.

Let us look again for a moment at the general credit situation. As I mentioned earlier, our national economy has been running at nearly full capacity. In many areas, demand has crowded capacity to the point that shortages have developed with a resultant inflationary pressure on prices. This has been further augmented by a relatively high level of employment in most areas. These conditions have stimulated a tremendous demand for available credit, resulting in a need for some measure of credit restraint.

With agriculture already suffering from a cost-price squeeze, some fear has been expressed as to the adverse effect on the farmer of any credit restraint. As a matter of fact, the reverse would seem to be true. With little immediate prospect for material improvement in farm prices, any further increase in costs would only accentuate the squeeze. The cost of farm credit represents less than five per cent of total farm costs and even some increase in cost of credit would be a small price to pay for some restraint on the other 95 per cent of his farm costs.

Certainly, availability of credit is also a factor to be considered but it is assumed that bankers will continue to meet the legitimate needs of farm borrowers for farmers generally are still in a strong credit position and worthy of credit needed for furthering productive efficiency.

There is a real challenge to country bankers to meet this need and to continue their financial leadership in the farm community. I am sure you will meet this challenge.

- - -