THE BANKER'S INTEREST IN RURAL DEVELOPMENT

Charles N. Shepardson,
Member of Board of Governors
Federal Reserve System
Washington

(Before Agricultural Conference, Tennessee Bankers Association at Nashville June 20.)

It is certainly gratifying to one who has spent most of his life in the field of agricultural education and the study of farm problems and who is now involved in the monetary and credit problems of the entire economy to attend and participate in a program such as this. I was especially pleased to note the attention that is being given to the impact of industrialization on agriculture and to the role of bankers in rural development and farm credit.

Never in the history of agriculture have we seen such an evolution—yes, almost a revolution—in agriculture technology as we have seen during and since World War II. New methods, new materials, and new machines have all combined to increase productivity per acre, per animal, and per man-hour of labor. This, in turn, has brought a series of important changes that are affecting both agriculture and the general economy.

First, let us consider the impact of increased productivity per acre and per animal unit. Since 1940, per acre production of major crops has gone up approximately 30 per cent for wheat, 55 per cent for corn and 65 per cent for cotton. Meat, milk and egg production have increased in proportion. Beef production per head of cattle on farms has gone up over 35 per cent, milk per cow 30 per cent, and eggs per layer 68 per cent. In the aggregate, production per acre is up about 20 per cent and per animal breeding unit 27 per cent.

The increase in human productivity is even more striking. While gross farm production for human use increased 37.5 per cent from 1940 to 1956, farm employment dropped 31.5 per cent, which means that production per man practically doubled in that period. This tremendous increase in productivity of farm labor has produced and is continuing to produce social and economic changes which are of concern to all of us but they are of special concern to bankers and other lenders.

Why, you may ask, is this of such concern to lenders? The answer lies in the fact that this increased productivity in agriculture, as in the rest of our economy, stems from the substitution of capital, both investment and operating capital, for human labor. For example, mechanization, including improved machinery and the substitution of mechanical power for human and horse power, increased the investment per worker in farm power and machinery from $220 to $1,748, or approximately eight times as much in 1956 as in 1940.

This increased productivity also enabled the farmer to handle more land and the size of farms increased. This resulted in an increase in average land investment per worker, excluding dwelling, from $2,461 to $10,793, approximately 4.5 times the 1940 figure.

The increased productivity was also a result of increased use of improved seeds, feeds, and breeding stock and more and better fertilizers, insecticides, herbicides, and other agricultural chemicals, together with increased use of purchased fuel. All of this increased cash operating costs and the necessity for additional capital. As a result, per capita investment in other production assets rose from $750 in 1940 to $2,622 in 1956, an increase of almost 250 per cent.

In the aggregate, this amounts to an increase in total investment per worker from $3,461 in 1940 to $15,163 in 1956, or roughly 4 1/3 times as much as in 1940. Naturally, this investment per farm worker varies widely with different areas and different types of farm enterprise. It ranges from $59,000 for the Corn Belt grain farm to $35,000 for a North Plains cattle ranch, $14,000 for a Northeast dairy farm, and $8,000 for a Southern Piedmont cotton farm.

This tremendous increase in investment per worker presents a real problem to the farm operator and an equally real challenge to the lender. Farming has become more than a way of life.

Commercial farming, on which we depend for most of our agricultural production, has become big business and requires sound business methods both in managing and in financing the operation. Unfortunately, not all farms have attained a satisfactory level of efficiency. Out of approximately 4.8 million farms in the country today, about one-third might be classed as commercial farms, producing about 85 per cent of our farm commodities. About one-third are what might be classed as residential farms whose owners are largely or entirely dependent upon off-farm income. The remaining third is made up of marginal or sub-marginal farms too small to provide even a minimal standard of living and the owners of which have little or no off-farm income. In a way, it might be said that it is this group that is at the root of our whole farm problem. The cost of production per unit on these small, poorly equipped farms is so high as to be unprofitable at almost any conceivable price yet even their relatively small part of total farm production contributes to the surplus and the consequent depression of all farm prices.

The operators of these submarginal farms, traditionally, have abhorred debt, especially mortgage debt on the farm. Frequently, they have limped along, either from choice or necessity, with an inadequate or inefficient operation that lacked gross earning power to pay off debt or to provide a reasonable standard of living. Sometimes this is due to lack of judgment or initiative on the part of the operator and sometimes to lack of judgment on the part of the lender, who failed to see that an increased line of credit for an enlarged or altered operation might actually improve the credit worthiness of the borrower. A farm operation that cannot produce a fair return on the investment is a poor risk for either borrower or lender. The borrower will either sink further in debt or he will drive himself and his family to drudgery and poverty. In either case the farmer will have lost part or all of his equity, the banker will have lost a customer, and the community may have lost a potentially productive citizen.

The farm borrower usually falls in one of three classes. He may be a capable and experienced operator who needs to enlarge or alter his farm program so as to provide a more efficient utilization of his labor and equipment and a greater gross and net income. This may require increased extension of credit and probably on longer terms. With the increased capital requirement in many types of farm operations, he may find it advisable to continue to operate indefinitely on a certain amount of borrowed capital. In fact, many of our better tenants find it more profitable, with fair rental contracts of long tenure, to continue to rent and conserve their available capital for equipment and operations rather than to tie it up in land. In no event should a farmer tie up so much capital in land or so much of his income in the payment of land debt that he lacks operating funds to enable him to operate efficiently.

In addition to his land, he may require considerable sums for investment in livestock or equipment. Breeding livestock pay out over a period of years and not only require but justify longer term credit than feeder livestock which can be fattened and marketed in a matter of months. A man going into dairying, for example, must have a certain minimum herd to justify the equipment and production facilities essential to the production of Grade A milk. If he is burdened with unduly onerous payments on his cows and equipment, he may curtail feed and care expenditures only to find that he has cut production and hence his whole debt payment potential.

Likewise, some of the major farm equipment with productive life of several years may well merit longer credit terms than have commonly been extended. If there is justification for extensions of 30 month terms and 25 per cent down payments, which are becoming increasingly common on automobiles, perhaps longer terms than commonly prevail would be justified for such things as tractors, combines, and cotton pickers in the hands of good farm operators.

Of course, any mention of terms on agricultural loans raises the question of the hazards in farming. Having spent close to thirty years combating the droughts, floods and insect hazards of Texas, to say nothing of the vagaries of the market, I am well aware of this problem. This awareness, however, only strengthens my conviction that there must be more long-range business planning in our farm operations. This planning should include sound analysis of each enterprise, including projections of income and expense, provision for adequate reserves in favorable years to tide over the poor years, and a realistic appraisal of the adequacy and adaptability of the man and his plant to the operation contemplated.

Unfortunately, many farmers lack the training or business experience to make such an analysis. They seek credit as they need it on a piecemeal basis and frequently from several different lenders, including banks, mortgage lenders, equipment dealers and suppliers. No one lender has a picture of the total operation in such a case. Each depends primarily on the integrity of the borrower and the adequacy of his collateral with little attention to the debt repayment prospects of the farm as a whole.

The government is attempting to meet this problem through the supervision and guidance extended by Farmers Home Administration to its borrowers. I am sure, however, that we would all prefer to see the need for government lending reduced rather than expanded. This then presents a challenge to the commercial banks and I am glad to say that a gradually increasing number of banks are establishing agricultural departments to handle this problem. So far, this activity has been limited mostly to the larger country banks. The smaller country banks feel, and frequently with justification, that they cannot afford a competent agricultural credit man. Many city banks, on the other hand, feel that they have little direct farm loan business and hence no need for such a man.

I would like to suggest that many city banks might find that the establishment of an agricultural department to serve their country correspondents would be a profitable investment in more ways than one. In fact, I know of one large city bank with a strong agriculture department that has picked up enough trust business involving farm estates, both of its own and its country correspondents' customers, to more than pay the cost of the department, in addition to the increase in its participation-loan business.

Now, what about the man who lacks the opportunity or talent to enlarge his operation but who might advantageously reorganize his program so as to permit more off-farm employment. For example, he may not have the talent, land or resources to enlarge an inadequate ten cow dairy to a potentially profitable 25 or 30 cow Grade A dairy. On the other hand, a ten cow beef herd might be carried on the same land with a greatly reduced labor requirement, thus affording him time to engage in a considerable amount of off-farm work. Or he may be attempting row crop farming on a scale too small to justify the investment in modern equipment. Possibly his land is unsuited to crop production but might well be put to trees or pasture. The need of such men may be not for more credit but for counseling on the wise use of credit and in the planning of their operations. In many cases, however, they will need additional credit to convert their operations, especially in the case of the man converting from crops to livestock and needing to finance the establishment of pastures, construction of barns, and purchase of livestock. Here I suggest consideration of his off-farm earnings as well as his farm income in determining his repayment capacity. This is in line with the recently authorized changes in the FHA lending program and would seem to be fully justified.

The third alternative applies to the man who lacks the talent to manage his own business or whose land or land potential is totally inadequate to support a profitable farm enterprise. If his trouble is lack of land, he might be advised to dispose of his inadequate holding and find a larger unit elsewhere. If it is lack of talent, he might better be denied credit and advised to seek full-time, off-farm employment rather than encouraged to continue on a losing operation. This also may necessitate selling his farm and moving to a source of other employment. A better plan might be to retain his home, sell or lease his land to a neighbor who wants to enlarge his operation and find work in the community.

This latter alternative, together with that of the part-time farmer, presupposes employment opportunities in the area and brings us squarely up to the significance of a rural development program. While the technological revolution in agriculture is increasing the capital requirement per man engaged in farming, the resulting increased productivity per man is constantly reducing the number of men needed in the farm labor force. This is not a new problem. It has been going on for years. As the surplus labor from the farm has migrated to the city, we have deplored the withering of the farm community and the increasing congestion of the city. In the past our principal approach to the problem has been that of trying to find some way to keep this labor employed on work which is no longer needed.

In fact, this approach has been one of the basic causes for the continuation of our farm surplus problem. Fortunately, we seem to be coming to a recognition of the fact that what amounts to encouraging production for government storage rather than consumption is no solution to the problem. For that reason it is most encouraging to see the interest in this rural development program. It is properly aimed at drawing off the surplus farm labor which has had a depressing effect on our whole farm economy. At the same time, it is aimed at providing local employment that permits people to continue to live in the rural environment that they prefer and to contribute not only to the maintenance but to the actual upbuilding of the rural community.

Such employment opportunities may come by securing branches or even main plants of well-established industries. But not all of our rural communities are going to be able to secure such plants. Many of them are going to have to use their ingenuity and initiative in establishing small local industries geared to the potentials of the community. Here again the local banker has a part to play in providing leadership and merited financial backing to such a program. Here also there is a real place for the city correspondent banks to render a real service through the counsel and assistance of their industrial departments.

There is one other phase of this total program in which the bankers may have a less direct but still a highly important part. I refer to the local school program, particularly in the field of vocational training.

As a former Dean of Agriculture, I have the utmost respect for and interest in the vocational agriculture program. Nevertheless, those of us who are specially interested in agriculture must have the realism to reconize that a large percentage of our farm youth and particularly those from our smaller farms must and actually do look to off-farm employment for their future occupations. Hence, it is important that they be afforded educational opportunities that will prepare them for such employment. Furthermore, the development of a pool of skilled manpower is almost an essential in securing or developing industrial activity in a community.

The objective of the Federal Reserve System, in its responsibility for monetary and credit policy, is that of providing a financial climate favorable to the sound development of all elements of our economy, including small business, small farms, and rural communities. We realize, however, that the initiative in such development must always lie in the hands of local community leaders. Traditionally, we have looked to our local bankers for leadership in such programs.

In conclusion, I want to congratulate the bankers of Tennessee on the fine contribution that you are making to the rural development program in many parts of your State and on your continuing interest in the problem as manifested by your presence and participation in this meeting.