BANKS AND RURAL DEVELOPMENT

Remarks by Chas. N. Shepardson, Member, Board of Governors of the Federal Reserve System, at the Conference on the Rural Development Program at Memphis, Tennessee on June 17, 1958.

It is a real pleasure to have the privilege of participating in this Rural Development Conference.

In nearly forty years of Land-Grant College work, I have had many opportunities to participate in various phases of our agricultural development. While it is impossible to pick out any one phase as having made the greatest contribution to agricultural progress, I can think of no previous program so directly oriented toward solving the basic problem of these low income farm families and of the small towns and rural communities that are dependent on them for their existence. Nor can I think of one that holds more promise of success if we can but bring about a realization of the fact that the problem, as a whole, is made up of a series of local community problems, the solution of which depends primarily on local community action.

Obviously, a problem of such diversity and complexity has many facets, some of them overlapping and some standing by themselves. Many of these facets and the specific responsibilities of different groups have been or are still to be discussed in the course of this conference. Furthermore, most of those present have been interested in and associated with this program from its inception so it is unnecessary for me to dwell on its broad aspects. I shall therefore confine my remarks to the interest and responsibility of the local banker in the financial phase of the program.

In exploring this subject, let me mention at the outset what I consider to be one of the basic causes of the whole problem, namely, a plethora of unutilized or underutilized resources. This includes both land resources and human resources. In either case the missing resources are capital, either investment or operating capital, and enterprise. Where these exist in proper balance, all will be utilized; each complements the other.

Here, let me digress for a moment to make this assertion, which I believe to be true -- that the increase in the productivity of human labor, on which all material improvement in our modern standard of living is based, has stemmed from the substitution of capital for human labor. Whether this capital investment has been in the substitution of mechanical power for manpower or in education and research, makes little difference; the result has been the same -- the development of new and better methods or materials. If we accept this assertion as true, it follows that any improvement in the situation with which we are dealing inevitably involves additional capital in some form, which in turn means that bankers and other financial interests have a vital part to play.

First, let us consider the human resources. It is an inescapable fact that productivity in agriculture has outrun effective demand for agricultural products with the result that for some time we have had a surplus of agricultural labor. This has resulted both in underutilization of farm labor, especially on many of our smaller farms, and in a constant migration from farming to other types of economic activity. While many are inclined to deplore this latter movement, we should not overlook the fact that without it we could never have achieved our present level of industrial development. If it still required as big a proportion of our population to produce our basic agricultural requirements for food and clothing as it did a hundred or fifty or even twenty-five years ago, we would not have had the available manpower to produce all of those industrial products and services which constitute such an important part of our present standard of living. No, it is not the transfer from farming to business or industry that we should deplore but rather the migration from the rural environment, which we cherish as the foundation of our American way of life, to the overcongested and artificial conditions of our cities.

Our major challenge, then, is to provide opportunity for the fuller utilization of these unused human resources. In part, this may be done through more efficient use of our land resources. In the main, however, while this will permit the more efficient use of labor needed on the land, it will inevitably release additional labor to nonfarm activities. This means that, if we would retain these people in the rural environment which they prefer and if we would afford them an opportunity to make their contribution to the upbuilding of their own rural community, we must provide local opportunity for more nonfarm employment -- in other words, more rural industrial and trade development that usually accompanies it.

Now let us consider the problem of land resources. Starting with the premise that gross income from present holdings under present methods of utilization is inadequate to provide a reasonable standard of living, the farmer has three alternatives. He may seek to enlarge his holdings to a size that will permit optimum utilization of his labor and of modern methods and equipment. This will depend on the availability of additional land, on his managerial capacity to operate a larger unit, and on the availability of additional capital or credit. Second, he may change to a more intensive type of farming, calling for increased utilization of labor per acre of land. This, too, will depend on his managerial ability, also on the suitability of the land for the new enterprise, the availability of a satisfactory market for the new product, and again on the availability of additional capital. Third, he may turn to a less intensive type of land utilization which will require less human labor and afford more opportunity for off-farm employment.

Failing any of these alternatives, the farmer may retain his homestead, dispose of his farm land to a neighbor who needs to enlarge his own unit, and seek local full-time, non-farm employment. Or, if worst comes to worst, he may even find it advisable to dispose of all of his holdings and seek employment elsewhere. Even this may not be as undesirable as it seems. In this connection, I would like to quote from a news letter put out by a country banker in Missouri, who has done an outstanding job in the rural development of his community.

> "In 1910, Ozark County had 12,000 people; today we have around 8,500. In 1910, virtually all but a very small percentage were farmers. Today, a large number are in the tourist and resort business, the automobile business, or in many different service trades. Today our most prosperous farmers

and stockmen own what was once perhaps half a dozen homesteads, 1910 style. Isn't it better to have ONE FAMILY with a modern home, electric power, a radio and TV set, a deep-freeze, an automobile and a pick-up truck, modern farm machinery, a good bank account, and able to send their children to college -- instead of having half a dozen families making what was called in 1910 "a good living"but what today would be called a bare existence? At any rate, this IS HAPPENING and Ozark County business men must run their affairs in harmony with this trend if they expect to be successful. And -- by the way -- supplying EXTRA CAPITAL to alert, ambitious business men and farmers so they can meet the challenges of today and take advantage of their opportunities, that is OUR BUSINESS."

In any of the first three alternatives the farmer is sure to need additional credit. In fact, he will probably need three types of credit. He will need long-term mortgage credit for the acquisition of land, the construction of new buildings, or other permanent farm improvements. He will need the usual short-term credit for operating expenses, and he will need intermediate-term credit for major equipment, breeding livestock, pasture, timber or orchard development and similar major expenditures that cannot reasonably be repaid out of one year's operations. The first two are well understood and accepted by both borrowers and lenders. Intermediate-term credit is relatively new and not well understood in its application to agriculture although it has been used in business and industry for some time. Its adoption would be no more of a radical or hazardous inovation than were the personal and consumer installment loans long shunned but now eagerly sought by most commercial banks.

While I have mentioned these three types of credit, I would like to suggest a different approach. An efficient farm enterprise today is more than a way of life. It is a business and, compared to earlier days, it is big business. In fact, the average capital requirement per farm today is approximately four times what it was less than twenty years ago. In the past, the farmer secured his credit from several sources, including the various financial institutions, private individuals, and merchant credit of all types. Too often this credit has been extended on the basis of available collateral or the individual's credit-worthiness, with little knowledge of his total financial picture, including the repayment potential of his farming operations as a business enterprise.

I would like to think of his credit needs as a package with amounts and terms geared to the needs and earning potential of the enterprise as a whole. This calls for real business and financial planning for which the individual farmer, and more especially the low income farmer, is often inadequately prepared. Here, then, is a tremendous opportunity and challenge for the country banker to provide the counsel and assistance essential to the working out of an appropriate package program. True, he may not be able to handle the entire requirements through his own bank but he can help to make arrangements for assistance with overlines through his correspondent bank, other financial institutions, or local private lenders. He can also assist the farmer in keeping more adequate business and financial records on which to base his plans.

For example, a small State bank in Tennessee, with an unusually effective rural development program, developed a farm record book and a special farm check on which to note the purpose of expenditures. With this information on purpose of expenditure plus information from the farmer as to the farm source of his deposits, the bank provides a journal recap of his financial activities each month. Thus the farmer is encouraged to keep up a record book from which he can derive a more adequate financial statement on which to base his credit requests.

To render this type of credit service, bankers must be in position to know the needs and possibilities of their farm customers. They must know both the current and potential agricultural resources of their community together with the availability or potential for development of new or improved markets if they are to counsel wisely on changes in farm enterprises. They must learn that a good loan business is not just a matter of an office, some loan forms, and a bank official to make them out; it requires expense in cultivating good loan customers as a part of the cost of the lending business.

Many banks have established agricultural departments, staffed with competent, agriculturally-trained men. Unfortunately, many others have not yet recognized the need for this service. In fact, some banks seem to have overlooked one of the principal functions of commercial banking. Certainly, one function is to provide a safe repository and a checking service for their customers. The other and more important function, it seems to me, is to marshall temporarily idle funds of depositors and use them to provide the credit needs of the community. In other words, banks are in the business of selling credit.

For several years we have had a seller's market where sellers could be passive in the acceptance of orders for either goods or services. Today we are in a buyer's market and the need in all phases of our economy is for a constructive and aggressive sales program. For banks, this means actively looking for places to extend constructive credit that will be mutually profitable to both borrower and lender and to the community. Many of our country banks are doing an excellent job along this line. Others, however, seem to have the philosophy of sitting at their desks, examining all credit requests with an ultra-conservative eye, granting the gilt-edged, over-secured loans and putting the rest of their funds in governments. Such an attitude is typified by a certain local bank whose advertisements proclaim what a service it renders to its community, yet whose statement consistently shows less than 20 per cent loan ratio with most of its deposits invested in governments. I am sure its depositors' funds are safe but I wonder if it is measuring up to its responsibility to serve the credit needs of its community.

I have spoken of the need for adjustments in the utilization of our farm resources in order to provide more efficient utilization of human resources. Now let us consider the place of industrial development. This may take either or both of two lines, one an integral part of the agricultural adjustment, the other largely unrelated to agriculture except as a source of employment for surplus farm labor. The first relates to the establishment of new processing plants or marketing facilities to handle new farm products or to provide a better outlet for existing farm production. Such plants can usually be handled best as local projects. In some cases the financial needs can be met by the local banks. In others, where relatively large amounts of long-term funds are needed, it may require the mobilization of local investment funds to meet the need. Whatever the situation, the local banker is usually the best qualified to spearhead the evaluation of the proposal. This will include appraisal of the natural resources and the adaptability of soil, climate and people to the production of the contemplated commodity; analysis of potential markets and, in the case of seasonable perishables, the timing of production as related to that of competitive sources; determination of the plant and equipment requirements; and, finally, estimation of financial requirements to activate the project.

Illustrative of this type of banker activity is that of a banker in Henry County, Alabama. In this case the banker concerned is also head of a large mercantile company in the community. The two institutions have worked jointly in promoting and financing a peanut processing plant, a fertilizer plant, and a cooperative livestock marketing organization. Normal credit requirements are handled through the bank. Nonbankable needs for long-term or equity capital or otherwise promising though somewhat speculative prospects are handled through the mercantile company.

Another banker in Hale County, Alabama, has had an unusually ambitious and successful program. Some years ago he saw the need for a Grade A milk supply in the county as a potential opportunity for a new farm enterprise. To stimulate such a program, he extended 100 per cent loans for the purchase of dairy cows, on 36-month terms at 6 per cent interest. Today the 124 Grade A dairies in the county, 90 per cent of which were financed by this bank, produce more fluid milk than any other county in the State and provide an annual gross income of more than 4 million dollars. Since then the bank has fostered and financed a beef cattle project and a broiler project. On the latter project it is interesting to note that the producer pays for his chicks, the bank provides mortgage credit for buildings and equipment and production credit for all operating expenses. Producers, thus enabled to buy feed on a cash basis, have been able to cut production cost 1 to 2 cents per pound under competing areas.

This bank has also financed a milk plant, an ice cream plant, a poultry processing plant, a hatchery, a meat-packing plant, and a feed mill, all of which have provided nonfarm employment in addition to facilitating the marketing of farm produce. It is reported that the activities of this bank and its leaders are largely responsible for the fact that the agricultural income of Hale County is greater than that of sixteen other counties in the Sixth Federal Reserve District.

Both of the above banks make their farm loans on terms tailored to fit the needs of carefully planned and analyzed farm programs.

A report from Indiana calls attention to the fact that there may be situations where too much credit may delay desirable adjustments. Certainly, it is no contribution to the welfare of either the community or the individual to extend additional credit to a losing operation regardless of the collateral or credit-worthiness of the individual. It can only end in the gradual attrition and ultimate loss of equity in the business.

Nor should all requests for credit for the establishment of a new business be granted. A banker in Tennessee reports the case of a G. I.

seeking financing for a store in a field already well served by two stores in the small community. The town had no milk plant and dairymen were hauling their milk to a neighboring town for processing while local consumers had to get their bottled milk shipped back. On advice and with the financial assistance of the bank, the G. I. abandoned his original idea and opened a milk plant, which is prospering, and at the same time is affording local producers a better market for their milk.

In one county in Mississippi a local banker promoted and helped raise interest-free capital to finance a badly needed local milk plant and, in addition, financed all qualified dairy farmers who had approved farm plans.

In a seven-county area around Glasgow, Kentucky, where total financial resources are rather limited, banks of the area are cooperating in giving counsel and leadership for the development of new projects.

There are other instances too numerous to mention of banks sponsoring and financing new farm enterprises or related agricultural industries. On the other hand, there are still too many reports, like one from a county in Maine, indicating that banks there showed little interest in rural development loans, preferring short-term, high-interest, personal or consumer installment loans; or the report from a county in Mississippi to the effect that banks there showed a reluctance to participate in any development programs, preferring to stick with the old short-term, high-collateral type of lending. In West Virginia, it is reported that, while banks have done a good job in taking care of conventional farm loans, most of them have shown little interest or leadership in the Rural Development Program. There are also frequent reports from several States of reluctance on the part of some banks to take account of off-farm employment as part of the credit base for loans to part-time farmers. Incidentally, this same comment was made with regard to certain offices of the Farmers Home Administration.

We have looked at some of the developments in farming and related or supporting industrial activities. Now let us look briefly at some of the problems and achievements in the development of non-related industry as an additional source of employment for unutilized human resources. This subject has been well covered by others and I will confine my remarks to the banker's part in this phase of the program.

First, in connection with the industrial survey of the community, local banks are equipped with or have access through their city correspondent to facilities and know-how in making such surveys and analyses. Since they must inevitably be involved in the financing and credit needs of any new enterprise, it is logical to assume that they will not only be interested but active in such programs. There are numerous instances where local banks have taken the initiative in forming and aiding in the financing of industrial development corporations. Activities of such corporations include the acquisition of blocks of land to be made available as industrial sites at reasonable cost, the construction of industrial buildings for lease or sale to new industries on favorable terms, and, in some instances, even to the acquisition of stock in the new industry. Arkansas, Georgia, Indiana, Missouri, North Carolina and Texas all report activities of this type carried on under the leadership or with the full cooperation of the local banks.

Unfortunately, however, there are occasional reports of failures due to lack of bank cooperation. For example, a local industrial development committee in Missouri developed a plan for a small processing plant. They secured approval of an S.B.A. loan to cover three-fourths of the needed financing on condition that the local bank take the balance of the loan and provide the necessary supervision. Refusal of the bank to participate resulted in failure of the project.

In Mississippi, a local community was negotiating with a manufacturing concern for the establishment of a plant in their county. Under Mississippi law, bonds may be issued to cover the cost of plant construction for approved projects. The law does not provide for financing plant machinery and equipment, which is usually handled through the local banks. In this instance, all plans were made and State approval was secured by the local committee without any participation of or consultation with the local banks. When the banks were ultimately approached on the question of financing the equipment, they declined to participate. The company immediately began negotiations with another community in the State in which the bankers were brought into the picture from the start. While satisfactory local arrangements, including financing, were developed, the State refused to grant the application to establish the plant in the second county after it had already approved the first. The upshot was that the plant was eventually established in a neighboring State.

Of course, it is impossible to explain the reasons for the bankers' attitudes in these two cases. It may be that they honestly considered the projects not credit-worthy although subsequent developments in the second case would hardly support this position. It may have been lack of vision and initiative or it may have been pure pique at not having been consulted in the early planning stage. In any event, it clearly illustrates the importance of soliciting the cooperation and support of the local bankers from the beginning. Fortunately, such cases are the exception.

In conclusion, let me briefly summarize my analysis of this problem:

1. The major problem is unutilized or underutilized human and land resources.
2. More complete and efficient utilization of these resources and the resultant improvement in the standard of living of the people concerned are dependent upon increased productivity.
3. Increased productivity depends upon the substitution of improved technology and mechanical power for human physical labor.
4. This calls for increased use of credit and capital.
5. The banker, as the community's prime source of credit and an important source or locator of capital, must be made an integral part of any local development planning group, and
6. In view of the very nature of his business, namely, that of selling credit, the banker should be and normally is, as the record shows, a good cooperator and frequently is the source of inspiration and leadership in any development program.

To those bankers who have not seen the light, I want to say -- wake up or you will lose out in the race for survival. This is a day of change.

We either progress or retrogress. We cannot stand still. The man or business that is not receptive to new ideas and better methods is on his way out of our competitive enterprise system.

In closing, I want to pay tribute to the magnificent job that many bankers are doing in providing inspiration, leadership and support for this program. To them I say, "Thank you -- keep up the good work."