THE BANKER'S PART IN RURAL DEVELOPMENT

Remarks by Chas. N. Shepardson, Member, Board of Governors of the Federal Reserve System, at the Annual Convention of the West Virginia Bankers Association at White Sulphur Springs, West Virginia, on July 24, 1959.

Because of my agricultural background and my continuing interest in the problems of agriculture, I was delighted when Mr. Gans invited me to address you today on the subject of rural development and its contribution to a more balanced economy.

I am sure that this is not a new subject to most of you. The Rural Development Program was initiated in 1955 under the sponsorship of several Federal agencies in cooperation with the land-grant colleges and local groups. Originally limited to a few pilot counties in some of the most depressed farm areas, it has gained widespread recognition and is now being pushed aggressively in all parts of the country. As many of you know, a national rural development conference with representatives from thirty-four States was held at Jackson's Mill only a few weeks ago.

I can think of no previous program so directly oriented toward solving the basic problem of 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. I shall 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 man-power 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. 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 local 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 industry and the trade development that usually accompanies it.

Now let us consider the problem of land resources. Starting with the premise that gross income from many 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. In this connection, I need not remind you that much of the land in these marginal or submarginal farms is too hilly, broken and subject to erosion to withstand continued cultivation. Fields that may have once been productive have lost their virgin fertility and might well be put back into grass or timber. In fact, I understand that land-use studies by the Soil Conservation Service indicate that 11 million of the State's 15 million acres are best suited for timber production and that 1,312,000 acres now in cropland and pasture should be reforested. This would not only help to maintain and eventually rebuild the land but, in this day of widespread concern about domestic, industrial and agricultural water supplies, it would go far in furthering a program of water conservation. It would also form the basis for an enlarged lumber and woodworking industry and for an improved scenic and recreational area with the attendant possibilities of an increased tourist business.

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, nonfarm 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 who has done an outstanding job in the rural development of his community.

"In 1910, _____ 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?"

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 innovation than were the personal and consumer installment loans long shunned but now eagerly sought by most commercial banks.

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.

Today we need 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, 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 marshal 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.

This means bankers must always be on the alert 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 ultraconservative 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 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 who is also head of a large mercantile company in his 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 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.

In this connection, I want to call your attention to the rapidly expanding trend toward vertical integration. This trend is best illustrated by the broiler industry where technological advances have opened up tremendous opportunities for increased productive efficiency through mass production.

Processors and suppliers have been quick to see the possibilities and have developed a variety of plans for financing such operations. These usually involve flat rate or minimum price contracts under which the producer is relieved of much of the risk and responsibility for managerial decisions but at some sacrifice of entrepreneurial freedom and opportunity.

While this choice poses a problem for the individual producer, the whole program poses a problem for the country banker. Unless he is unusually alert to the situation, he may find that the financing is being handled by the processor or supplier through his city bank connections and that the local banks' farm loan business has dwindled. The activity of the bank which I just cited is an illustration of one method of meeting the situation. I might also add that a number of large suppliers have indicated that they would prefer to have the local banks handle more of this credit, thus freeing their own credit resources for the development of their own business.

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 this county is greater than that of sixteen other counties in the same area.

Both of the above banks made their farm loans on terms tailored to fit the needs of carefully planned and analyzed farm programs. There may also 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 and eventual loss of a customer to the bank.

Nor should all requests for credit for the establishment of a new business be granted. I think of the case of a G. I. seeking financing for a store in a line of trade already well served by two stores in the small community. The town had no milk plant. Locally produced milk was being hauled to a neighboring town for processing and the bottled milk shipped back for local consumption. 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.

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 one state, indicating that banks there showed little interest in rural development loans, preferring short-term, high-interest, personal or consumer instalment loans; or the report from a county in another state 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. 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. With the continuing increase in the amount of off-farm employment, this would seem to be a factor worthy of consideration.

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 nonrelated industry as an additional source of employment for unutilized human resources. This problem is of concern not only to the low income rural areas but also to those areas largely dependent on a single industry which, due to technological developments or competitive pressure of other products, finds its employment opportunities curtailed.

First, in connection with the industrial survey of a community, local banks are equipped with or have access through their city correspondent to facilities and know-how for 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 butactive in such programs. There are numerous instances where local banks have taken the initiative in forming or 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.

Unfortunately, however, there are occasional reports of failures due to lack of bank cooperation. For example, one local industrial development committee 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 a second instance, a different community was negotiating with a manufacturing concern for the establishment of a plant in their county. Under the law of that State, 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. Subsequently, the company began negotiations with another community in the State. This time the bankers were brought into the picture from the start, but already it was too late. 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.

And now I want to remind you of an outstanding Rural Development program in your own State, one of which I have heard much and with which many of you are doubtless familiar. I refer to the program of the Beckley Area Rural Development Council. I stated earlier that the Rural Development Program was initiated on a national scale in 1955. As a matter of fact, the Beckley Program was started ten years ago under local sponsorship and actually furnished much of the inspiration for the national program. Financed by 65 local businesses and other organizations, the Council operates through six commissions; poultry, dairy, forestry, fruits and vegetables, live stock, and country life.

I have neither the time nor first-hand knowledge of the situation to give you a full report of their accomplishments. Among the highlights from their annual report, which I am sure they would be glad to send to anyone who is interested, I noted these points: $2 million of new business from an egg project and production of 2.5 million broilers; 650,000 trees planted in a Christmas tree project; establishment of a community forest management demonstration; 50% increase in sales of fruit and vegetables through the Farmers Market in two years; introduction of 1,800 western breeding ewes for a sheep production project, construction of a sales building and organization of a Live Stock Auction Market; an expanded dairy production program which in 10 years has more than trebled the milk production in the area, and finally, a rural community improvement program that has resulted in $1 million worth of new farm, home, and community facilities in 34 communities in the area. The reports I have seen do not indicate the part that the local bankers have played in these developments but I am sure that they have been significant.

In conclusion, there are two additional points which I would like to emphasize. First, in connection with any rural development program, we should recognize that special attention needs to be given to the educational program of the community concerned with a view to providing appropriate training for the employment opportunities that may be developed. Most of our rural and smaller city high schools have strong programs in vocational agriculture although few of their graduates have any hope or expectation of finding employment on the farm. At the same time, there is an appalling lack of educational opportunity for training in the trade and industrial or distributive fields. Every technological advance that we make reduces the employment opportunity for unskilled labor and increases the demand for better educated workers with greater technical competence. This means that any industrial development program intended to provide employment opportunity for unutilized farm labor must carry with it an educational program designed to prepare these people for such employment.

The second point I wish to emphasize is that economic growth, like physical growth, is based on change. With the development of new machines, new techniques or new products come changes and, in some cases, dislocations or replacement of the old. Notwithstanding the general tendency to resist change, we cannot fail to recognize it as an inevitable concomitance of growth and the more efficient allocation of human, physical, and financial resources. This raises a question as to whether any individuals or businesses should expect society to pay a price for their goods or services that will return them a satisfactory profit regardless of their costs or society's need or desire for what they have to offer. This also raises the question as to how much community effort should go into the perpetuation of the production of goods or services which cannot be made competitive or for which society has lost its appetite, and how much should go toward the development of more productive alternative outlets for the efficient utilization of available resources.

As I said earlier, the effectuation of growth through increased productivity is largely dependent on capital. To you bankers then, as your communities' prime source of credit and important source or locator of capital, I leave these questions. The future growth and economic welfare of your communities depends in no small measure on your answer.