AGRICULTURAL CREDIT IN TODAY'S ECONOMY

Remarks by Chas. N. Shepardson, Member, Board of Governors, Federal Reserve System, at the annual directors' conference, Production Credit Association, Sixth Farm Credit District, at St. Louis, Missouri, on August 6, 1959.

First, let us take a brief look at the current economic situation. The economy as a whole is trending upward and most broad measures of economic activity are at or near new high levels. Industrial production at 155 per cent of the 1947-49 average in June was 6 per cent above the previous peak in 1957. Gross National Product reached an estimated annual rate of $484 billion in the second quarter and disposable personal income is at an all-time high annual rate of about $337 billion. Construction activity continues at a high though somewhat moderated pace and employment is at the record level of over $67 million although we still have some aggravating spots of technological unemployment.

While wholesale prices of industrial commodities have risen about 2.5 per cent in the last year, the effect has been largely offset by lower farm prices. As a result, the wholesale price index is not much above the level of a year ago. The consumer price index has reacted in similar fashion and in June was about .6 per cent above a year earlier. Real estate and consumer loans continue to expand at or near record rates and demand for business loans is at an unusually high level. Notwithstanding a 4 per cent increase in the money supply in the past year, the pressure of credit demands both in the private and government sector has exerted rising pressure on the money market. It is true that we still have too much unemployment and some unutilized productive resources and that the outcome of the steel negotiations is still uncertain. On the other hand, the trend of most recent demand developments and wage negotiations portends a further upward pressure on prices. The Treasury's needs for refunding and for new cash are tremendous and stock market activity seems to continue unabated. These factors, together with the general exuberance of the economy, all tend to increase the inflationary psychology of the country and to call for some prudent restraint on the rate of credit expansion.

Now let us turn to the agricultural situation. Throughout the agricultural community there appears to be increasing recognition that the farm is a productive unit rather than a group of separate and independent enterprises. This has led in turn to growing recognition that the extension of credit needs to be geared to the requirements of the farm unit as a whole and its repayment potential as a business enterprise. There is also need for a credit "package deal" where one lender arranges and supervises the farm unit's entire line of long, intermediate, and short-term credit requirements.

Merchant credit is usually expensive in itself and frequently restricts the borrower's freedom of action to procure his needed supplies and services on the most advantageous price or quality basis. The long-term lender may be interested only in the long-term preservation of his collateral with little or no concern for the current operating or improvement and expansion needs of the borrower. And the intermediate term lender may be circumscribed in his ability to serve the needs of the borrower by the restrictions of the long-term lender and his lack of control over the short-term debt of the borrower.

Despite the terrific expansion in need both for investment and operating capital on the modern farm in recent years, few farmers have the financial background and experience to plan their own needs most constructively. It is here that the package lender can make a real contribution in meeting the credit needs of agriculture. Organizations staffed and equipped to do this job are in position to locate and arrange sources of credit beyond their own capacity to extend. They are better able to keep touch with current trends and developments and to counsel with the borrower regarding his activities. Your organizations deserve congratulations on the progress you have made in this direction toward meeting the changing needs of the times. The history of the cooperative farm credit system is itself a story of response to new challenges and developing needs.

The extent to which the production credit system has met the credit demand of farmers is indicated by loan data from published records. In 1934 loans made by the associations totaled $107 million. By 1940 advances had increased to $350 million, and by 1950 to $1,066 million. Last year the total was $2,205 million.

The quality of the job performed by the associations may in turn be indicated by growth of total production in agriculture since credit is a method of supplying capital to agriculture as a productive agent.

Certainly the associations and other nonreal estate credit agencies can justly take pride in productive and technical accomplishments in American agriculture. Output rose about 60 per cent between 1930 and 1957. The high production of American farms was a vital factor both in winning World War II and in aiding the free nations of the world to restore their economies following the destruction of productive capacity during that devastating conflict.

The trend in farm output per man-hour of labor, another measure of accomplishment in agriculture, also has shown a steady upturn since prewar years. Between 1940 and 1957 output per man-hour more than doubled. Furthermore, the upward trend is doubtless continuing at this very moment. For although the farm labor force is down, production of farm commodities is expected to continue this year at a high level.

The dramatic developments in farm production also are evidenced by the decline in the ratio of farm workers to the total population of the nation. In 1930 there was one farm worker to each 10 people in the nation. By 1945 there was one farm worker to each 15 people. Preliminary 1959 data indicate one farm worker to each 27 people. Today one agricultural worker produces food, fiber, and other farm commodities for almost three times as many people as one farm worker did in 1930.

It is this development that has freed labor to move from food and fiber production into job opportunities arising in other activities where demand for products and services is expanding faster than for most farm products. This response to the desires of the American people as expressed by the preferences shown in their purchases, together with the adjustment of the resources for production to meet these new and changing demands, is a symptom of a healthy and dynamic society.

The Sixth Farm Credit District has played a major part in such adjustments. Here in the heart of the nation, extending from the Midwest corn belt to the South's cotton lands, you have assisted in supplying a large percentage of the credit required for the development of farm production technology in the area. You have had a part in the vast mechanization wave that has engulfed the area from the pick-up hay balers, corn pickers, huge combines and multiplow tractors in corn belt portions of Illinois and Missouri to the two-row cotton pickers, liquid ammonia fertilizer distributors, and other modern facilities in the boot heel area of Missouri and south through Arkansas. Such equipment has done away with a great portion of the drudgery in agriculture that most of us were so familiar with in our youth. Capital has been a major factor in these developments, and much of the capital has been supplied through credit of various types to which your forward-looking credit institutions have contributed.

Speaking of credit and your contribution to the farming economy of the district, there is one example of your efforts that deserves special consideration. That is the special effort made in Southeast Missouri and the Arkansas Delta area following the 1957 crop failure caused by excessive rainfall and floods. Although I have no way of ascertaining the amount of planning that was required for executing the job, the accomplishments speak for themselves. Instead of backing away from the problem area in fear after this near catastrophe, local production credit associations recognized that a job had to be done and then proceeded to do it. The magnitude of the job is indicated in estimates that farm product sales were down almost 50 per cent in four Southeast Missouri counties and down almost one-third in ten other Southeast Missouri and Arkansas counties. Throughout the area, business had been damaged and financial institutions adversely affected. At harvest season, the normal build-up in cash balances at commercial banks failed to materialize. Furthermore, many farmer-borrowers were unable to repay their 1957 production notes, forcing farm credit agencies to renew a large percentage of their debt. In the wake of a season of crop failure and heavy loan carry-over, farmers' cash resources were low and at the same time their need for new loans was high. But 1958 credit supplies were not cut back. What happened, instead, is indicated by the following data. Loans made by the Caruthersville Production Credit Association rose from $4.3 million in 1957 to $6.1 million in 1958, an increase of almost 50 per cent. Loans made by the Planters Association in Osceola rose from $3.3 million to $4.4 million, and the Forrest City Association's loans rose from $10 million to $14 million. Similar increases in loan volume were noted for other associations in the problem areas. Earlier, the trend in outstanding loans by these local production credit agencies had been up at the rate of about 5 per cent per year with rising farm production cost and consequently increased need for operating capital. The jumps of 40 to 50 per cent in loans made following the low 1957 farm sales demonstrated dramatically that Production Credit Associations in the Sixth Farm Credit District stand ready and willing to do the job of financing legitimate farm production credit needs.

On the national farm credit scene, the cooperative farm credit system today is no longer an infant. Production Credit Association loans outstanding totaled $1.1 billion on January 1 this year -- more than one-fourth of total nonreal estate loans to farmers held by all commercial banks in the nation. Furthermore, growth in outstanding Production Credit Association credit in recent years has been faster than that of commercial banks.

Growth in the magnitude of production credit operations naturally has been accompanied by growth in what may be termed a sense of community responsibility. Like corporations and labor unions that have grown to great size, the P.C.A.'s must be mindful that policies embraced by large organizations in their operations have an extensive impact, affecting the welfare of the industry they are engaged in and indeed the welfare of the entire community or nation.

Realism requires that we recognize that the tremendous advance in agricultural productivity which we have been discussing has been attended by a tremendous accumulation of surplus farm commodities that has imposed a heavy burden both on the market and on the Federal budget.

Certainly the mounting accumulation of farm surpluses suggests that many of our national programs that were intended to help the farmer have tended to aggravate the problem of surpluses rather than overcome it. The continuance of price supports at what have proved to be incentive levels has only served to stimulate productivity increases at a rate beyond our ability to assimilate, in spite of efforts aimed at production control. As a result, we have had all too little reallocation of our land resources. Much of our land that might better be used for the production of grass or timber is still in cultivation, while some of our most productive land is reduced to lower level use through the acreage control program. Thus, we deprive ourselves of the benefits of lower costs that should result from the more efficient utilization of our gains in productive efficiency.

Furthermore, the growing tendency to capitalize acreage quotas has contributed to the continuing rise in price of farm lands. This adds to the overhead costs of production and it has greatly increased the problem of prospective new farmers with limited resources.

All of this leads me to raise the question as to whether we haven't deprived both the farmer and the consumer of some of the fruits of our truly phenomenal productivity gains through our program of price supports at levels that provided an incentive to produce beyond our capacity to consume at these prices. It also raises the question as to whether we shouldn't increase our efforts to facilitate the further reallocation of our productive agricultural resources rather than to perpetuate the present usage.

In this connection, let me emphasize that growth involves change and that growth cannot proceed at a rate in excess of our ability to assimilate without causing serious or even intolerable dislocations. This is as true for our over-all economy as it is for agriculture. Our over-all economy today is definitely on a rising wave of activity with many sectors at record levels. We must not be swept by the sort of excessive exuberance that would produce in industry an over-expansion of productive capacity similar to that in agriculture. Such over-expansion would bring about, as it usually does, a downturn in general economic activity which we all want to avoid.

Perhaps no one suffers more from wide gyrations in our economy than does the farmer. And perhaps there is no more potent factor in influencing the magnitude of these over-all gyrations than credit conditions. Regulation of the available supply of credit is a responsibility of the Federal Reserve System,as you know, but allocation of credit to the several needs of the economy is the responsibility of the individual lenders. The P.C.A.'s and the Land Banks are important sources of agricultural credit. As cooperative agencies of farmers, you have the responsibility of helping to provide the credit needs of agriculture and also the opportunity of allocating that credit in such a way as to help moderate gyrations in the agricultural sector of the economy.

I have watched with interest the fine job which you seem to be doing in adjusting your lending terms and practices to the needs of a changing agricultural technology. I wonder if you have given equal attention to the possibility of using credit availability as a counterbalance to some of the swings in the agricultural sector which are accompanied by large price fluctuations. For example, land prices have risen steadily since 1940, with only minor interruptions in 1949 and 1953. They now stand at an index level of 168 compared with 1947-49 of 100. I realize the justification for purchase to enlarge units to a more efficient size, but I wonder to what extent the price is influenced by capitalization of allotments whose value may diminish in event of a change in program; or how much by speculation on further inflation which we should all be exerting every effort to contain. I wonder if this is the time to be aggressively increasing appraisals and seeking more and larger loans when land prices are rising and farm income is declining. Yet I note that both the total dollar volume and the average size of farm mortgages recorded by the Land Banks have risen faster than that of any other group of lenders in the last two years.

I also wonder what is being done by P.C.A.'s in the short or intermediate-term areas of livestock and poultry credit. We all know that livestock numbers are building up. The U.S.D.A. has called attention repeatedly in recent months to the increasing number of hogs and the probability of a break in the price of pork next year. They also point out the rapid increase in cattle numbers and the danger of a repetition of the break of the early 50's if this herd build-up continues at its present rate. We also know that average size of loan and per cent of total nonreal estate farm debt financed by P.C.A.'s has been expanding significantly in the last two or three years. This may be due to a more adequate and efficient servicing of the credit needs of farmers, in which case you are to be congratulated. It leads me to wonder, however, to what extent credit might be used to help temper the extremes of some of these livestock and other cycles.

We are all interested in the maximum sustainable economic growth, but we are equally interested in avoiding excessive expansions and the painful readjustments that always follow. The P.C.A.'s, as an increasingly important source of farm credit, have an important role to play in helping to promote changes essential to a sound growth in the agricultural sector of our economy.

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