THE CHANGING AGRICULTURAL CREDIT PICTURE

Remarks by Chas. N. Shepardson,

Member, Board of Governors, Federal Reserve System,

before the

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The change in credit requirements of agriculture is but a reflection of the changes in agriculture itself. Prior to one hundred years ago, agriculture had changed relatively little since Colonial days. The next fifty years saw improvement in machinery but relatively little change in source of power or production technology. Farmers were largely self-sufficient, producing most of their own requirements with a minimum of cash outlay either for capital investment or for operating expenses. Most farm work was done by hand or with home-produced horsepower raised on home-produced feed. Industry, too, was largely on a hand labor and horsepower basis.

Since the turn of the century, the rate of change has been accelerating. Science and technology have played an increasing part in all segments of our economy. As mechanical power and mass production technology gained headway in industry, it increased man-hour productive efficiency and earning power. This, in turn, led to the development of new industries with new jobs to meet the ever-widening demand for new or better consumer goods and resulted in a rising level of our American standard of living. It is true, of course, that these technological changes brought many temporary dislocations. In some cases these became severe and widespread. Most of us can well remember the situation in the thirties when maldistribution of income caused widespread concern over the effects of "technocracy" and the attainment of what was

described as a "mature economy" with no opportunity for further growth. But progress will not be denied. Levels of employment, consumer purchasing power and the supply of new goods and services to meet the ever-widening scope of consumer wants have all reached heights undreamed of twenty-five years ago and they continue to expand. To a large degree, this change has been accomplished through the substitution of capital for manhours in the more laborious jobs, resulting in a great increase in the use of credit.

A similar though more erratic change has occurred in agriculture. Mechanical power has largely replaced horsepower and greatly reduced the need for manual labor. Most farm operations are done today with power machines that release from fifty to as high as ninety-seven per cent of the manhours formerly required for the same job. Developments in our knowledge of soil fertility, plant and animal breeding, and disease and insect control have further increased farm productivity. While these developments were somewhat retarded during the depression years of the thirties, they have proceeded at a tremendous rate under the stimulus of the price incentives that have prevailed since the beginning of World War II. In fact, what had been a gradual evolution from hand labor to mechanical power, coupled with a new technology of production, has become in fact revolutionary in scope in the last fifteen years.

Many people deplore this change and the attendant decrease in farm population and yet it is a change that has been going on at varying rates throughout our history. Truly, the high standard of living that we enjoy in this country is a direct result of this increased productivity per manhour of labor not only in agriculture but throughout all segments of our economy. Man's need for food, the principal product of agriculture, is limited by the relative

inelasticity of the human stomach. On the other hand, his need or desire for other goods and services is limited only by his imagination and his purchasing power. As efficiency of food production increases, it is only natural that men collectively devote less time to food production and more to other pursuits, establishing in our type of specialized activity a pattern of fewer men in farming and more in other industries. This is inevitable unless we wish to deny the farmer the same right to modern methods and machines and the same standard of living that his neighbor in industry enjoys.

To accomplish this, however, each man in farming must control more in the way of land, equipment and facilities and he must be able to buy more of the supplies and services that he formerly produced or did without. In other words, he must substitute ever increasing amounts of investment and operating capital in the form of land and equipment, mechanical power, agricultural chemicals, and technical knowledge for human labor. Actually, the average investment per worker in agriculture now exceeds the average per worker in industry. A few figures will illustrate the tremendous increase in farm investment in the last fifteen years.

For example, the average investment per farm in productive resources, including land, buildings, livestock and equipment, in 1940, was approximately $6,000 compared with $24,000 in 1955. The $24,000 does not include the value of a modern dwelling and modern household equipment, which have become an essential part of the farm equipment needed to hold capable and ambitious young farmers and their families on the farm. This may well add another $6,000 to $8,000 to the total.

Production expenses have also increased from an average of about $1050 per farm per year in 1940 to $4500 last year. I do not have comparable figures for the Ninth District but the trend is similar to the national average. For example, from 1940 to 1950 the number of farms in this District decreased about 11 per cent but average size increased about 20 per cent, ranging from an increase of 12 per cent in Minnesota to 52 per cent in Montana. Value of lands and buildings per farm increased 115 per cent in Minnesota, 173 per cent in North Dakota, 198 per cent in South Dakota, and 231 per cent in Montana. These values amounted in the four states respectively, in 1950, to $15,750, $18,000, $20,830, and $27,660.

The percentage of tenant operators decreased 36 per cent in Minnesota, 51 per cent in North Dakota, 42 per cent in South Dakota, and 47 per cent in Montana, indicating an increasing proportion of owner operators who need both investment and operating capital.

Changes in operating costs are illustrated by the following: wage cost increases ranged from 150 per cent in Montana to 330 per cent in South Dakota, feed from 287 per cent in North Dakota to 530 per cent in Minnesota, and fuel and oil from 197 per cent in Minnesota to 328 per cent in South Dakota.

These figures do more than illustrate the tremendous increase in credit requirements of the average farmer today. They also emphasize the increasing complexity of farm operations and the need for increased managerial ability, including business and financial acumen as well as production knowledge. The need for long-range planning and sound financing becomes of increasing importance.

Agriculture, more than almost any other segment of our economy, is subject to the vagaries of nature. While there is little that we can do about the weather, there is much that we can do to mitigate the effects of weather cycles. We have vast acreages of land that, with favorable weather, will produce bountifully. Yet the weather records of half a century show that many of these lands are normally submarginal for crop production. Many farmers overlooked this fact in the lush crop years of the late forties and are now faced with investments in land and equipment that cannot pay off under average conditions of the area, to say nothing of the drought conditions of recent years. Other areas are subject to flood, hail or other vagaries of nature at varying intervals. All of this means that farmers and farm lenders must give more attention to the long-range potential of a piece of land in determining its value and the justifiable investment in equipment to operate it.

In addition to long-range weather cycles, more attention must be paid to the economic cycles of the country as a whole and of the particular commodities to be produced. The short supply and high price of cattle in 1950-51 induced many people to go into the cattle business, including Main Street cowboys as well as many ranchers who enlarged their herds without regard to available feed. Many of the Main Street men took their loss and got out when the bubble broke but a lot of small operators got caught with a high investment on a falling market when the flood of beef from these new or enlarged herds hit the market. Some established operators incurred increased costs of operation and living that could not be sustained even on a normal market, to say nothing of the low level of the last two years. Writing down these inflated values is obviously a difficult and painful process.

A somewhat similar situation occurred with hogs. With consumer buying power and per capita meat consumption at record levels, the present price of cattle and hogs is strictly a result of over-supply rather than lack of purchasing power.

Because of these swings of weather and markets, the effects of which the individual farmer can mitigate by careful long-range planning but which he cannot entirely control, it is imperative that his operations and his financial program be based on long-range averages.

There is need for more flexible mortgage terms on an amortization basis that permits reduced or deferred payments in off-years but also requires compensating heavier payments in better than average years. Many of the farmer's investments in equipment, breeding livestock and land improvement need to be scrutinized more carefully to determine whether or not they promise to be profitable investments that will increase his average net income over a reasonable period of years. In this connection, it is well to remember that while farmers want and must have or have access to efficient equipment, it is easy to over-invest in equipment during good years that will not pay off over a period of average or lower years. What looks like an added and worthwhile convenience this year may become a source of burdensome overhead next year.

Since returns on investments of this type accrue over a period of years, it is not only reasonable but imperative that credit terms likewise be extended over a period of years with similar provisions for flexible payments based on yearly variations in income due to causes beyond the operator's control.

Obviously, credit extended on the basis suggested will call for much closer scrutiny in the beginning and much closer supervision during the

life of the loan than has usually been true under the older type of lending. Some lenders in the past have been satisfied to extend credit as long as the collateral was adequate regardless of the soundness of the operation or proposed expenditure. Such practices contribute little to the development of sound planning either for the borrower, the lender or the community which he serves. Liquidated collateral, in the event the operation fails to pay off, usually means a liquidated customer and too many such cases may mean a declining community even though the lender comes out clear in each liquidation.

Others who may scrutinize a current situation carefully are reluctant to extend longer term credit because they fear it may limit their freedom of action to terminate loans that at a given time seem less attractive. This is certainly true and yet we have a problem to face. With the present complexity of farming and the tremendous requirement for investment and operating capital, the farmer can no longer depend on a hand-to-mouth line of credit. Knowing that he is in a business that inevitably fluctuates from year to year, he and his banker must be willing to chart his credit needs and repayment ability on a long-time basis, putting in such provisions for periodic review and adjustment of operations as may be warranted but also giving assurance that justifiable credit based on a considered projection of the business rather than the short-term outlook of an unfavorable year will be available.

Fortunately, many bankers have recognized this need and have established agricultural departments in their banks to provide this service. I want to congratulate the banks of the Ninth Federal Reserve District for your activity in this line. I understand that over sixty-five banks have established agricultural departments or employed farm service directors in the past

ten years. However, when we consider that there are 1,287 banks in a primarily agricultural district, such as the Ninth, it is easy to see the potential for expansion in this field of activity.

In this connection, it should be pointed out that city banks can render a real service in this field. Many small country banks lack the resources either to employ a competent farm service director or to meet the credit needs of some of their larger farm and ranch operators. A number of large city banks with few direct farm customers of their own have found it profitable to set up a strong agricultural department to assist their country correspondent banks in appraising and servicing their farm loans and, when desired, in taking a participation in loans beyond the local bank's limits. In addition to meeting a real farm need, this type of service can be a big factor in building correspondent business. In some cases, it has also led to valuable business for the trust department in managing farms that pass into estate trusts.

In summary, agriculture has become a large and complex business requiring business management and financial planning. While credit needs have expanded greatly, the credit base and the potential earning power of the good operator have expanded proportionately. Furthermore, while careful analysis may indicate the profitable use of more credit than requested in some cases, it may also indicate the prudence of restraint in capital expansion or other credit extension in others. In other words, the biggest need in the agricultural credit field is not necessarily more credit but more intelligent use of credit by both borrower and lender. This type of credit can best be extended by banks staffed with competent agricultural lending officers who have the ability and vision to project the credit needs and repayment prospects of a

farm or ranch operation and to adjust amounts and terms of credit to meet those needs.

Some banks are making real progress in developing new lending techniques to meet the situation. Other banks recognize the need for new techniques of farm credit administration but have not been able to develop them. Too many banks, however, seem satisfied to continue along traditional but out-moded lines.

Perhaps one of the greatest unsolved problems is that of how best to help the new young farmer get started. As a former Dean of Agriculture, I have heard repeatedly the cry that we are losing our best young men and especially our agriculturally trained college graduates from the farm. As a matter of fact, it is harder for the college graduate to get started on his own than it is for his high school classmate who has been working for four years accumulating something in the way of tangible assets while the college boy has been investing his time and money in a potentially more valuable but nevertheless intangible asset in the form of "technical know-how." We need to find a constructive way to help the honest, capable and industrious young man capitalize this intangible asset of technical competence. A few banks with a real interest in this problem have set aside a limited amount of their loanable funds each year for the purpose of making an admittedly high risk investment in one or two promising young farmers with little or no tangible collateral.

This much is sure. There is a need for a broader understanding of the whole farm credit problem and for the development of more adequate techniques in this field. A number of recent studies and reports from various sources have been critical of the adequacy with which commercial banks are

meeting these farm credit needs. Present data are inadequate to evaluate some of these reports.

Under the mandate of the Act creating it, the Federal Reserve System, from its inception, has been concerned with this problem. Unfortunately, however, no comprehensive survey data have been made available on specific characteristics of bank loans to farmers since the agricultural loan survey in 1947. That survey was taken at a time when net income of farmers was at a record high and both real-estate and nonreal-estate loans to farmers were near their post-World War II lows.

Since then, real-estate loans to farmers have increased by almost two-thirds, while nonreal-estate loans to farmers have more than doubled. The number of workers on farms has declined more than one-fifth while the investment per worker in agriculture has increased by more than two-thirds. In this same period, gross farm income has declined 3 per cent, while net farm income has declined 38 per cent, although the decline in net income per farmer has been partially offset by the 20 per cent decrease in number of farmer workers and by the increasing number of farms that are being operated on a part-time basis. These trends have influenced to a certain but unknown degree the amount, kind, and terms of credit that banks are extending to farmers.

I am therefore happy to announce that the Federal Reserve System, with the cooperation of the Federal Deposit Insurance Corporation and the American Bankers Association through its Agricultural Commission, is planning to undertake a new agricultural loan survey in the near future. The proposed schedule for the survey, in addition to quantitative data on farm loans, will provide information on size and type of farms involved, the tenure, age, net

worth, and full or part-time operation of the borrower. It will also provide information as to the original amount of loans, outstanding balances, interest rate, whether short, intermediate or long-term credit, method of repayment, renewals, type of security, purpose, and whether the loan is on a participating basis with another bank.

Such information will be helpful in analyzing the current credit situation intelligently since banks provide about half of the nonreal-estate farm loans (including merchant credit to farmers) and about 15 per cent of the farm real-estate loans. It can also be used by a number of organizations as a basis for assaying the role of bank credit to agriculture in a period of diminishing farm income and expanding farm debt. Both Congress and the Department of Agriculture recognize the need for information which will permit a more adequate evaluation of the role of bank credit in alleviating the present farm problem.

Information of this type could be helpful to the American Bankers Association, state and county associations, and to individual banks in answering inquiries, accurately telling the banker's story, and determining any gaps in present credit services. It could be helpful to individual bankers and their organizations in answering questions and criticisms pertaining to such items as intermediate-term lending operations, financing young farmers, financing soil development programs, etc. The data also would serve to indicate the need of, and provide background information for, detailed studies of specific credit problems by regions and type-of-farming areas.

We recognize that such a survey is a considerable burden on the respondent banks. On the other hand, we believe that the information developed

from it will more than compensate for the effort and that it will prove of inestimable value in appraising the current situation and pointing up the needs for further development. On behalf of the Board, I bespeak your cooperation.

In closing, I want to say this. We are in a period of delicate balance so far as the stability of the economy is concerned. Consumer disposable income is at a record level. Consumer demands, together with investment expenditures by businesses, by state and local governments, and by home builders, are pressing on productive capacity in many areas with corresponding upward pressures on prices of industrial materials and products. This is a matter of concern to all of us and, more particularly so, to the farmer who is caught between rising costs and a level of prices for his produce which has little immediate prospect of material improvement as long as the market is under the present burden of agricultural surpluses.

This calls for real discretion and unselfish statesmanship on the part of lenders to see that available credit, which is adequate for a continued high level of economic activity and growth, is allocated to the best long-run good of the community. It is especially important, in an agricultural area such as this, that lenders adjust their allocations of credit in such a way as to assure the availability of credit to meet the legitimate needs of credit-worthy farmers. Only in this way can we hope to come out with a strong, vigorous farm economy when the present imbalance of farm production to demand is corrected.

While the present situation, with a falling farm income at a time of rising income in all other segments of our economy, is a cause for immediate

concern and correction, the long-run outlook is encouraging. With our tremendous rate of population growth, an expanding domestic market is assured. As long as we maintain a high level of economic activity, we may expect a continued improvement in the quality of our diet. And sooner or later we will develop improved trade relations and pricing structures which will enable more of our basic agricultural commodities to find profitable market outlets in some of the vast, undernourished countries of the world.

I am sure that commercial bankers will continue to encourage and assist farmers to develop better management techniques and financial planning, to improve their efficiency, and to adapt their production units to the changing demands of our domestic and export markets.

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