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Remarks by

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at the meeting of the

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AGRICULTURAL CREDIT

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It is a privilege to have the opportunity of discussing with this group some phases of the agricultural credit situation. While I can claim no special competence or experience in the field of farm lending, I have long been concerned with the problem of farm credit as it relates to our future agricultural development.

First, I would like to review briefly the general credit situation in agriculture as it exists at present. As of November 12, the Agricultural Research Service estimated that the January 1, 1958 Balance Sheet of Agriculture would show a continued increase in owner equities. Total assets were estimated at $188.3 billion, an increase of $11.2 billion or 6.3 per cent over January 1, 1957. Of this amount, real estate accounted for $8.5 billion, other physical assets $2.6 billion, and financial assets $100 million.

On the other side, real estate debt was estimated at $10.6 billion, an increase of $700 million or 7.1 per cent over January 1, 1957. Nonreal estate debt other than CCC loans increased $100 million or slightly over 1 per cent. If these estimates are borne out by year end figures, it will mean that owners' equities have increased $10.8 billion or 6.9 per cent while total debt though rising $400 million has actually dropped from 11 per cent to 10.6 per cent of total assets.

While these totals obviously do not reflect the varying conditions in different parts of the country or in the affairs of different individuals, they do indicate a strong credit position. This position is supported by the relatively small number of foreclosures, delinquencies, and carryovers that are being reported.

In the aggregate, realized net farm income in 1957 is estimated to have changed little from the $12.1 billion received in 1956. On a per capita basis, there was some increase due to the continuing decline in number of farms at the rate of about 2 per cent a year and an even faster decline in farm population.

Again, I would call your attention to the fact that averages do not reveal the wide variation among individuals. A U.S.D.A. survey last fall revealed that while most of the larger and more efficient operators were doing well financially, the less efficient and marginal farmers were suffering a further decline in net income.

Several factors had a bearing on this financial picture during the past year. The small rise in average prices received by farmers was largely offset by rising unit costs thus emphasizing the importance of larger, more efficient farm units. This in turn resulted in a continuing though lessened demand for land and a further rise in farm land prices which varied from state to state, but averaged 8 per cent for the year ending July 1, 1957. In addition to the rising cost of land, cost of production and cost of living also rose. Farm property taxes continued their steep rise and prices of farm machinery and motor vehicles increased some. Interest rates on farm loans averaged one-half to one per cent higher than a year earlier.

Demand for short-term credit increased in most areas due (1) to rising costs of production, (2) to restocking in some of the earlier drought areas, and (3) to some use of short-term credit for long-term purposes due to higher interest rates. On the other hand, the demand for long-term credit fell off some, partly due to interest rates as mentioned but probably more largely due to the smaller number of farm transfers. While many farmers still need to enlarge their units for most efficient operation, we may have passed the peak of expansion and extensive capital improvement which has gone on at a relatively high rate in recent years.

Looking ahead for the coming year, the situation may not differ much from the past year. Agriculture as a whole starts the year in a strong financial position notwithstanding the weak spots in some areas that suffered crop losses from drought, flooding, or freezes in the past season. According to the U.S.D.A. Outlook for 1958, farm prices should hold about even with total agricultural output about as high or possibly higher than last year. Production and other expenses may rise further although there are indications in recent weeks that the continuing rise of recent years may level off or even turn down some in coming months. What effect any downturn in consumer income may have on farm prices is problematical. In recent years, farm prices have been held down more by burdensome surpluses and nonfarm competitive substitutes, particularly in fiber goods, than by any lack of consumer demand which has been at a high level. Conceivably, any downturn in consumer spending may be felt more in consumer durable goods than in foods.

In any event, the need for increased efficiency will continue though expenditures for increased land holdings will doubtless be scrutinized more closely if land prices continue to rise at last year's rate. Incidentally, land prices which stood at an index level of 49 on January 1, 1941, based on the 1947-49 average as 100, have risen without interruption except for minor dips in 1950 and 1953-54 to a level of 154 as of

November 1, 1957. This long-sustained rise reflects several factors, some of which have at times seemed inconsistent. For example, land values rose 20 per cent from early 1954 to November 1957 in face of a 13 per cent drop in net farm income from 1953 to 1956. Actually, this apparent inconsistency only serves to emphasize the strength of the other factors in the picture.

Without attempting to evaluate their relative importance, I would like to mention three. One is the factor mentioned earlier, namely the pressure of the cost-price squeeze and the need for increased efficiency resulting from mechanization and larger units. Tremendous progress has been made along this line in recent years. Large commercial farms, that is, those with gross products sales of $5,000 or more, in terms of 1954 prices, increased in number from 897,000 in 1939 to 1,290,000 in 1954. During the same period, medium-size farms with marketings of $2,500 to $4,999 dropped from 1,015,000 to 811,000, and small scale farms with marketings under $2,500 and little or no off-farm income dropped from 2,857,000 to 1,174,000. While these are the latest estimates available, the high percentage of farm land sales reported as being made to farm operators in recent years would indicate that this program of consolidation and enlargement of holdings is continuing. Such purchasers properly can and probably do pay more at times for contiguous or otherwise advantageously situated land to round out an economic unit than would a purchaser of the entire unit, and hence this demand is apt to continue to support land prices.

Another factor in the price rise has been the use of farm land as a hedge against inflation by nonfarmer investors. This has been brought about by the varying but almost continuous inflationary pressures in our economy for the past fifteen years. It may also have been intensified by the fear of ultimate food shortages as a result of our rising population. and the continuing urban encroachment on farm lands. The present indications of some abatement of inflationary pressures and the inexorable advance of technology with the resulting increase in farm productivity may soften this phase of the support for rising land prices.

A third factor has been the marked trend toward more residential and part-time farms. In the '39 to '54 period, such farms increased in number from 1,181,000 to 1,507,000. This increase can be attributed in large measure to a shift from full to part-time farming on the part of the small farmer who, lacking opportunity to enlarge his operation in agriculture, has devoted his time more and more to off-farm employment. This shift has depended to a considerable extent on the availability of off-farm employment, and hence its continuance will be affected by the general level of economic activity and employment. The same will be true to some extent with respect to movement on to the farm of urban dwellers who prefer rural living and have provided part of the market for small farm holdings by buying them for use as homes rather than as a source of income. This type of demand for farm land also will depend in part on general level of business during the coming year.

Pressure of urban encroachment will doubtless continue. Generally speaking, the greatest part of this pressure falls in our less productive farming areas but it is nevertheless an effective price stimulant where it occurs. On balance it appears that while farm land prices are at record levels, they may continue to edge up during the coming year.

Another important factor in the agricultural credit outlook for the coming year is the effect of the various government programs. While there is increasing evidence of dissatisfaction with the present programs, there is little indication of agreement as to changes in these programs. It seems reasonable to assume, however, that at the minimum, there will be a continuance of some type of cushioning program that will preclude any severe break in farm prices even if business undergoes recession. It is also worthy of note that while we lack a picture of individual debt situations, farm land is strongly held. On January 1, real estate debt at $10.6 billion amounted to only 9 per cent of real estate assets compared to a debt to asset ratio of 19.6 per cent in 1941.

And now I would like to call your attention to some of the long range problems in agricultural credit. Throughout our history, agriculture has increased in productivity. Yet never have we witnessed such a rapid advance in agricultural technology as in the period from 1940 to the present time. New methods, new materials, and new machines have all combined to increase production per acre, per animal, and per man-hour of labor. For example, on a slightly reduced acreage, crop production in 1957 was up 24 per cent above that of 1940. Livestock production has made equally impressive gains with the total output of meat, milk, and eggs up 40 per cent on an increase of only 8 per cent in number of breeding units. As a result of these two factors plus increased mechanization, productivity of manpower has doubled in the same period. This tremendous increase in productivity of farm labor, as in the rest of our economy, has resulted primarily from the substitution of capital for human labor. For example, mechanization increased investment per worker in farm power and machinery from $220 in 1940 to $1,894 in 1957. This enabled the farmer to handle more land and, in turn, land investment per worker rose from $2,461 to $12,187, excluding the value of dwellings. Investment per worker in other production assets rose from $732 to $2,732. Altogether, this amounts to an increase in average total investment per worker from $3,413 to $16,813 or nearly 5 times the prewar figure. To be sure, part of this larger figure is the result of inflation but even allowing for the depreciation in the value of the dollar during this period, it still represents a tremendous increase and presents a real financial problem for the farm operator and a real challenge to the farm lender.

Like all averages, these figures fail to reflect the magnitude of the problem for some of the component groups. Out of the 4.8 million farms in the country, approximately 2.1 million commercial farms turn out over 90 per cent of our agricultural production while the remaining 2.7 million residential, part-time and submarginal commercial farms account for less than 10 per cent. For example, the average Central Northeast dairy farm approximates the national average investment per farm worker, the Great Plains sheep and cattle ranches average $30 to $35 thousand, and Midwest corn and wheat farms average $55 to $65 thousand, while the average Southern Piedmont cotton farm requires less than $8 thousand. Without minimizing the social contribution of the part-time and residential farms and their credit needs, it is to these more efficient commercial farms that the country must look for its food and fiber, and it is on these farms that the greatest need for adequate and appropriate credit has developed.

What are these needs? First, let us look at the long-term area. With the increasing size of farms and the rising cost of land, the investment in land itself for some operations may be more than the average man can reasonably expect to accumulate during his lifetime. This means that he may have need for a mortgage loan that can be amortized down to a conservative level and the balance carried on a continuing basis for a relatively long term. Like any other business, a farm that is adequately staffed, stocked and equipped, and has the necessary working capital for efficient operation, has a far better earning potential and hence is a better credit risk than one in which too much of the available resources are tied up in land or plant with the result that operations are handicapped through lack of equipment or resources to take advantage of fortuitous opportunities that may arise. This is even more important in farming, with its susceptibility to the hazards of nature, than in almost any other business. For these reasons, it would seem important that farmers avoid tying up too much of their resources in land or committing themselves to amortization payments that take so much of current income as to cripple their operating budget. We should never lose sight of the fact that mortgage payments are in effect forced savings and that if we attempt to enforce too much saving at the expense of current living, we sooner or later drive the young farmer, on whom we depend for the future, out of business. In fact, with fair, long tenure rental contracts, tenancy may be preferable to ownership, especially for the young farmer.

Next, let us look at the short-term area. When the farmer shifted from horsepower to mechanical power, he immediately undertook a big cash expense for fuel and for maintenance of his power equipment. The advance in production technology involving the increased use of commercial feeds, fertilizers, insecticides and other agricultural chemicals, together with improved seeds, adds to productive efficiency but it also adds to the cash expense and the need for short-term credit. With all of the unpredictable hazards of nature, time is of the essence and the farmer must be in position to know that he can cover unforeseen expense without having to take time out to make new credit arrangements. In other words, he needs a line of credit that he can count on to meet day-to-day developments.

Obviously, the establishment of such a line of credit must be predicated on a knowledge of the borrower's total financial picture, as I shall discuss later.

In addition to the changes in these long and short-term needs, a new need has developed in recent years in the intermediate-term area. This covers loans for items that have a continuing usefulness over a period of years and that cannot reasonably be expected to be paid for out of one year's operation. The recent Federal Reserve survey of farm loans at commercial banks showed that loans for such purposes constituted 33.4 per cent of the dollar amount of all loans outstanding. These loans may be divided into four principal purpose categories--equipment and machinery, foundation livestock, land and building improvements, and consumer durables.

Developments in mechanization have resulted in increased man-hour productivity but they have also resulted in more complicated and expensive machinery which should be amortized over a period reasonably related to its productive life. Tractors, harvesters of various types and other major pieces of equipment certainly have as long a life and more productive value than most automobiles. If 25 per cent down payments and 30 or even 36 month terms on cars can be justified--and they are becoming increasingly common--it would seem that major farm equipment might well be financed on similar terms. Yet the survey to which I just referred showed that, of the loans on farm equipment representing 16 per cent of the total amount outstanding, 60 per cent had maturities of 12 months or less and 90 per cent had maturities of two years or less.

Production of livestock and livestock products is already a major farm enterprise in this country. Furthermore, the most encouraging prospect for increased consumption of agricultural produce is in the form of livestock and livestock products. This means that we should anticipate and encourage the diversion of more land to livestock production. But here again the farmer is faced with an investment in breeding animals that can pay out only over a period of years. For example, the average productive life of either a beef or dairy cow should be something over four years. However, the bank loan survey showed that 87 per cent of these loans, most of which were cattle loans, had maturities of 12 months or less.

The third type of intermediate-term credit is for land and building improvements. Here again expenditures are large and benefits accrue over a period of time. There has been more general recognition of this situation by lenders as illustrated by the fact that loans for this purpose averaged larger than for any other purpose except acquisition of land and that they were written for longer terms. Forty-eight per cent had maturities of 18 months or more and 36 per cent had maturities of 4 years or more. These longer maturities may be further explained by the fact that 63 per cent of the dollar amount was secured by real estate mortgages whereas over two-thirds of all other loans for intermediate-term investments were secured by chattel mortgages.

With the increasing interest in irrigation, drainage, and clearing and leveling of land, together with building modernization for functional efficiency, there is going to be a growing need for this type of credit. In this connection, it would seem that, as a result of such improvements, more consideration might be given to reappraisal of the farm valuations as a base for mortgage credit. Certainly, land that has been leveled and prepared for irrigation or that has been cleared, terraced and sodded to good pasture, or that has modern, efficient buildings for handling the farm operations has a greater productive value than before and should provide an improved base for credit. In fact, fuller and more prompt recognition of such improved productivity as a base for more credit would greatly increase the opportunity for a man with limited resources to acquire an unimproved or run-down farm and build it into a profitable productive unit.

The fourth category of intermediate-term investments covers consumer durables. In general, this includes household equipment and automobiles which contribute primarily to the living comfort and convenience of the farm family but which may add little to the productive efficiency of the farm operation. While it is true that many demand or short-term loans for intermediate purposes have been renewed, very few carried any commitment for renewal on which the borrower could safely base his future operations.

Fortunately, lenders generally are becoming more aware of these needs and commendable progress is being made. However, there are several things that would seem to justify further consideration.

One is the recognition of the fact that a farm operation is an integrated business. While there is need for long, intermediate, and short-term credit and possibly from different lenders, the amounts involved require that they be based on the earning and repayment potential of the operation as a whole and not on single crop or livestock enterprises or, as has so frequently been the case, on the adequacy of the collateral. This is especially true of intermediate and short-term credit and to an increasing extent of long-term mortgage credit as its use for intermediate purposes increases.

This in turn calls for more business planning in projecting needed expansion and improvements, and more careful projections of earnings expected to result from such investments. It calls for analysis of the over-all financial resources and credit requirements of the operation, including the need for reserves against unpredictable hazards. I realize, of course, the difficulty of such planning, particularly because of the hazards to which farming is subject. On the other hand, I believe the disastrous effects of these hazards can be materially reduced through sound management. Greater use of credit insurance and crop insurance, closer attention to market reports and supply and demand prospects, and the basing of production estimates on long range weather averages rather than on a few favorable years would all contribute to this reduction of farm hazards.

Standards for the establishment of adequate reserves against these hazards need to be developed as well as planned provisions for prepayments in good years against the deferments that must be and usually are granted in bad years. Unfortunately, many farmers lack the business training and skill to do this kind of planning. Here is the great challenge to lenders. Of course, such planning, analysis and loan supervision cost money. This is another argument for a one-stop credit service. Such analysis and supervision can be more effectively and economically rendered by one lender for the entire credit program of the borrower than by several lenders, each covering only one phase of the operation. Of course, many of our country banks are not in position to meet the entire credit requirements of our larger farm operators. They may need to develop connections with insurance companies or other long-term lenders to handle their requests for mortgage credit. They may also need to arrange for some short and intermediate-term loan participations with their city correspondents. Only in this way can they hope to continue to meet the growing needs of agriculture in their area.

To provide the type of service I have suggested, lenders must be staffed with or have access to the services of men with a broad background of training and experience both in credit and in the credit needs of modern farming. Many banks are establishing agricultural departments to meet this need. In some cases, city banks with few direct farm loans of their own are establishing such departments to service the needs of their small country correspondents who are unable to provide this service themselves. Unfortunately, the progress so far is still inadequate to meet the needs of the country.

Another big need of farm lenders is more current and comprehensive research and statistical information on the changing credit needs of agriculture. This might include better current information on the magnitude and type of need in different areas and different sectors of the farm economy; the establishment of more adequate norms for reserves against loss in different sectors based on loss experiences and their causes; and certainly studies as to the implications of the growing importance of vertical integration in several phases of agriculture. While our land-grant colleges and other agencies are working in this field, commercial banks have a real interest in furthering work of this type.

I have talked at some length about the growing need for more adequate farm credit. I would emphasize that this need for adequacy is more in suitability of terms than in amount. Coupled with this is the need for more wisdom in the use of credit. In some cases an increased line of credit is surely justified. Credit invested to improve income over the cost of the credit advanced is profitable to both borrower and lender. On the other hand, credit extended to a losing operation that cannot be put on a paying basis is a loss to all concerned. In such cases, the amount of credit extended might better be reduced or even withheld entirely. The lender may be able to protect himself through liquidation of his security but the borrower who continues to pour credit into a losing business will eventually lose his equity at which point the lender loses a customer.

In conclusion, I would call attention to two trends in agriculture that may have considerable effect on the future of our country banks. One is the growth of vertical integration in several types of agriculture of which the broiler business is an example. In a vertical integration program, large numbers of producers are financed totally or in large part by large suppliers or processors of a particular farm commodity. Under such a program, the farmer enters into a contract which assures him a given price for his product and adequate financing but binds him to follow the instructions of the contractor as to method, timing, amount, and quality of production. The financing provided by the contractor is usually secured from credit sources other than the local bank. While this program may offer some advantages in economy of operation and reduction of risk to the producer, it raises a real question as to his freedom of action as an independent operator. It also raises a question as to the future of the local banker in the farm credit picture in his community.

The second trend I would mention is the growth of P.C.A. loans in recent years compared with bank loans to farmers. In the period June 30, 1950 to June 30, 1957, nonreal estate farm loans rose 81 per cent in P.C.A.'s while loans at commercial banks rose only 52 per cent. In the last year of that period, P.C.A. loans rose 11 per cent while bank loans changed very little. Doubtless there were several reasons for this shift, one of which may have been the greater attention on the part of P.C.A.'s to the need for more comprehensive lines of credit.

Whatever significance these trends may have, I feel confident that commercial banks will adjust to the changing needs for agricultural credit just as they have in the past to the demand for industrial term-credit and consumer installment credit, and that they will continue to serve as the principal source of agricultural credit.