Our Common Interest

Remarks by Chas. N. Shepardson, Member, Board of Governors of the Federal Reserve System, at the Farmer-Banker meeting of the New Jersey Bankers Association at Trenton, New Jersey, on January 29, 1959.

After forty years in the field of agriculture and now four years in the field of central banking, I can think of no group that I would rather address than a joint meeting of bankers and their farmer customers. I say this partly because of the tremendous change that has taken place in agriculture in the past twenty years and the problems that this change has brought about, and also because of our mutual interest in growth and stability of our total economy.

Never have we seen such an explosive development of technology as has occurred in agriculture since the beginning of the second World War. Better methods, new or better materials, and increased mechanization of production, processing and marketing have all served to increase productivity at an unprecedented rate. As a result, production for farm workers today is practically double that of 1940.

During the war this was a godsend in helping us to meet the food and fibre needs of ourselves and our allies. Since the war it has been a relief to consumers that the abundance of agricultural production at reasonable prices has tended to offset in part the rising cost of other consumer items in less abundant supply. It has also enabled this country to contribute to the feeding of other countries whose production was curtailed by the ravages of war pending the reestablishment of their own production.

On the other hand, it has brought some real problems. Increased productivity has increased the amount of land or livestock that each farm worker can handle. As a result, the size of farms has increased and the need for farm workers has decreased. From the standpoint of the economy as a whole, these developments have been fortunate for they have released to the general labor pool an appreciable number of workers in a period when the demand for all other types of goods and services has been burgeoning.

For the farmer, however, these developments have presented some real problems. Here, let me point out that increased productivity, that is, increased output of goods or services per man-hour of labor, is basically the result of the substitution of capital in the form of physical resources, such as land, machinery, mechanical power and materials, such as fertilizer, insecticides, improved seeds and breeding animals for human labor. This process of substitution goes on in farming as in any other phase of our economy.

Many farmers, with access to added resources and with funds or credit with which to procure them, enlarged their operations. As a result of this move, average farm size increased 40 per cent and number of farms decreased 25 per cent, part of the decrease in small farms being offset by an increase in part-time and residential farms. With the benefit of increased productivity and enlarged operations and the resultant decrease in cost per unit, most farmers who have enlarged the scale of their operations have been able to improve their incomes even in the face of rising costs and stable or even falling farm prices. Indicative of the significance of capital in this change is the fact that average investment in productive assets per farm increased from $6000 in 1940 to about $30,000 last year, part of which was due of course to price inflation. For example, farm land prices have practically trebled over this period.

Other farmers without access to additional resources or with limited managerial capacity have found themselves in a dilemma. Their limited holdings will not support the overhead of modernization and their old methods will not meet the competitive cost of modern production. Many of this group have sold their holdings and found employment in urban areas, thus providing land for those seeking to enlarge their operations. In this connection, it is interesting to note that over 40 per cent of farm land purchases last year were for the purpose of enlarging existing farms. Others have continued to live on their farms but have sought full or part-time, off-farm employment while still others are continuing the struggle on submarginal units. It is this last group which constitutes a major portion of our national farm problem and for whom Federal farm programs have offered little assistance.

Within recent years a new program, known as the Rural Development Program, has been developed, not as some people think, to run the farmer off the farm, but rather to help provide an opportunity for the farmer to find a more productive outlet for his talent and capacity than he has had on some of the limited physical resources existing on many of these small farms. This shift to other types of occupation has been going on not just for five years, or ten years, or twenty years -- it has been going on throughout the history of this nation. But, as I said, in recent years it has become explosive in its rate. Heretofore, much of that shift in occupation has been accompanied by a shift in location, especially migration to the cities with all the attendant problems. To me, the bright thing in this Rural Development Program is the bringing of alternative employment opportunities to the area where these people live, providing them an opportunity to maintain the rural residence that they prefer, yet to find employment that will give them the standard of living that they and we want them to have.

I have had occasion to visit a number of areas in connection with that program and I want to congratulate the bankers and business men of those areas who are giving not only support but leadership and inspiration to these Rural Development Programs. One of the good things about them, it seems to me, and I hope they can be kept on that basis, is the fact that they are not looking to Washington for all of the answers. They are local programs devised to take advantage of local resources, both material and human, organized under the leadership and guidance of local people.

I think that this national endeavor can be the answer over time -- we hope not too long a time -- to the problem of this big number of submarginal farmers. It affords them the opportunity to get their units on a better economic basis and if that not be possible, either due to limitations of physical resources or the capacity of the individual, it affords them opportunity for alternate employment within the area of their residence. In this way we can hope to see some of these withering rural communities changed into revitalized, healthy, happy communities. It is one of the great programs that has been started in connection with this whole farm situation which has concerned us for so many years.

Another problem growing out of our increased productivity has been the fact that total production of many commodities has outrun effective market demand at existing prices. In a free society the natural inquisitiveness of man will continue to lead him to probe for new ideas, new methods, and new materials. As these are developed and proved practical, people will use them.

It is this principle that has served in large measure to defeat the objectives of our price support programs and which has resulted in the burdensome surpluses now held by the government at a carrying charge alone of close to a billion dollars a year. In theory we should be able to control volume and, hence, price by acreage controls. But with the phenomenal advances in technology, productivity, in terms of production per acre, has risen faster than it has been possible to cut acreages with the result of a continuing increase in production. The program is also self-defeating in that each reduction in acreage quotas tends to nullify the gains in productive efficiency resulting from large scale mechanized operation.

As I see it, the answer to this phase of our problem lies in a readjustment of our land utilization, shifting from the production of surplus commodities to those for which there is a more effective demand. It is easy to sympathize with the man who would like to continue production of a given commodity but it is questionable whether society is justified in supporting him in the production of something for which it has no need. Ours is a progressive society and progress means change. A few years ago many farmers had a prosperous business in the production of horses and mules for work stock. The automobile, the truck, and the tractor killed that market and those farmers turned to other enterprises as did the horseshoer, the harness-maker, and all allied business. Much of the land formerly used for production of horse feed is now in soybeans, a relatively new crop in this country which itself has forced or is forcing other changes in land use. In addition to their use as an industrial raw material, soybeans produce an edible oil which has gone far in displacing lard and cotton seed oil as a cooking compound. This, in turn, has reduced the total demand for pork and changed the remaining demand to one for a leaner hog, which means a reduction in the outlet for corn unless we can find increased use for corn as an industrial raw material and can learn to produce it at a price competitive with other raw materials. In this connection, it may be pertinent to ask if we should not have a reorientation of our agricultural research program with more attention to new products and uses and less attention to production until such time as we achieve a better balance between supply and demand.

I cite these examples only to point up the inevitability of change. Even our diet changes. With the increased use of mechanical power and the reduction in manual labor, our need for energy foods in terms of fats and carbohydrates decreases and per capita consumption of such foods as bread and potatoes decreases. On the other hand, our need for health foods, such as meat, milk and poultry products together with fresh fruits and vegetables, is increasing and more land might well be devoted to the production of these products. In that connection, New Jersey is fortunate that so much of her farm land is adapted and devoted to the production of these commodities rather than to the so-called basic commodities which are in such surplus. Even here, however, there are doubtless some lands that might better be in grass or timber rather than in submarginal crop production.

Let me close this portion of my discussion with one more observation. The problems I have mentioned all involve change. This change involves vision, imagination and courage. It also involves capital which in turn requires the sympathetic and understanding cooperation and support of our financial institutions and ultimately the savings of a great many people. This joint meeting of bankers and farmers is evidence of that wholesome relationship and I congratulate you on it.

Now for a few moments I would like to talk about money and credit policy as it relates to the economic growth, development and stability of this country -- of common interest to all of us.

First, let me go afield. We are concerned today as we have never been before in the history of this country with international relations. Many of us may wish that we were not in our present position. We are somewhat in the position of the big brother of the family who finds himself with the responsibility of looking after the rest of the family. He didn't ask for the job but he shoulders it and attempts to meet that responsibility. This country didn't ask for the responsibility that we hold in the family of nations today. But regardless of asking, we are in that position and we have been attempting to face that responsibility in many ways, particularly since the war.

There is one thing we must not lose sight of in connection with meeting that responsibility. There has been a lot of talk of the danger of armed conflict and I don't minimize that danger for a moment. Likewise, I don't minimize the necessity of adequate preparation against such an eventuality. But I do call your attention to the greater, or at least as great a threat, i.e., economic warfare, and to the vital importance of maintaining in this country a sound, vigorous economy.

We have become, in a large measure, the banker of the world and around the world free countries are looking to America, to this country, to maintain a stable anchorage for the value of the dollar. Over the past fifteen years, in our attempt to help other countries, we have also given those countries advice about fiscal and monetary responsibility and about adjusting their economies to a sound basis. Over the past months we have gone through somewhat of a recession and today we are facing a large deficit in our national fiscal program in consequence of fiscal adjustments to that recession. In a number of countries the question is now being raised as to whether or not the United States can take its own medicine, whether or not we are going to do what we have been telling them to do as they came to us for aid and for loans over the past fifteen years -- whether we are going to show the fiscal responsibility that we have been advocating for others.

Realizing the position that we hold in world affairs, a position which we cannot shrug, we cannot afford to lose sight of this phase of our problem.

As you all know, there are strong indications of a resurgent fear of inflation. As we contemplate this threat, I think it is important to consider two phases of inflation. One we might call the real inflation resulting from an actual shortage of goods and services. Many folks will say, "I don't see why you are concerned about inflation now with all of the unutilized resources that we have." True, we are not operating many of our plants at capacity, we are not utilizing our full labor forces, we are not utilizing all of our resources, and so there should not be an inflationary threat from that standpoint.

Nevertheless, we have in the most recent figures, a situation that we had and that many of us did not recognize three or four years ago when the general price level that looked fairly stable was actually made up of two divergent components. We base a lot of our actions on averages but averages can be most misleading. We have now, as in the earlier period, a drop in agricultural and food prices, masking a rise in other prices that may give us the complacent feeling that this average is doing all right.

Those of us who are interested in agriculture should be doubly concerned about this but I also think that the entire country needs to be concerned. Even with unutilized resources, we are still getting price pressures in some sectors that make up the average. While inflation, due to actual shortages, is not serious at the moment, we must be alert to the possibility of its recurrence for we can print money faster than we can produce goods.

The other phase, more ephemeral and yet just as vicious in its effects, is the inflationary psychosis, the growing belief - in fact, the conviction on the part of some people -- that inflation is inevitable. Having accepted that philosophy, they begin to take steps which they hope will hedge against it. One evidence of that is what is happening in the stock market. Apparently, a large number of people -- not only individuals but businesses and organizations responsible for trust funds, retirement funds, endowment funds of one kind or another -- have been switching more and more of their funds from debt to equity securities. Why? Because of present earnings? No. Because of prospective improvement in earnings? Well, maybe, but I think they are discounting quite a ways ahead if they are. But mainly because of this feeling that inflation is inevitable and that we had better do some hedging against it.

Now, certainly if we look at the long-range picture we know that over a long period of time we have had a gradual and sometimes not so gradual crawl in prices. But also we have had corrective periods. It is true that they seldom backed down very far before taking off on a new level although there have been some occasions when the downward correction was quite severe. However, there were enough corrective periods so that there was always the discipline of possible correction which made most people cautious in their long-range judgments.

But consider what happens if we accept as inevitable the belief that we are going to have a continuously rising price level without reverses. The minute we all decide that this is inevitable and begin to gauge our actions accordingly, inflation won't proceed at a gradual rate. It will compound itself for every added person who decides to follow that line.

Folks say that we must have continuing growth. Certainly, we want continuing growth. We have before us a growing population which of itself is a partial insurance of a continuing growth, a continuing growth of demand for personal goods and services. We also have under way an accelerating growth in technology that serves both to create and satisfy demands as ingenious Americans continue imagining and developing new things and offering them to a public equally ingenious at putting new things to use. Yet if we are going to achieve the further advances of which we are capable, we must do it on a basis that provides confidence of stability for the future, recognizing that growth in productivity results basically from a substitution of capital for labor, and capital comes primarily from somebody's savings.

How then are we going to get the necessary savings? Well, before a man puts aside some money for future use instead of spending it now, his first requirement will be a reasonable assurance that the money he saves is going to be worth when he wants it as much as it was when he decided to save it. He has got to have confidence in the future value of that money.

Second, before he is going to make that money available for somebody else to use, he is going to have to have an incentive in terms of price, just the same as you have to have incentive in terms of price to encourage a man to produce any of the things that make up our economy. We live in an incentive economy, we believe in an incentive economy, and we need an incentive for the accumulation and use of capital, even as we do for these other things.

Why am I saying that? Because we hear from time to time talk about the cost of money, about high rates of interest? Well, I am just as much opposed to excessive prices for money as I am for the suit of clothes I have to buy or the groceries I eat every day. But, comparatively, looking at what has happened to prices of other things over the years, the price of money has remained on the low side. Nobody wants to see a higher price of money than is necessary but when we talk about controlling the price of money we are up against as difficult a problem as we would have in trying to control the price of anything else that we use.

We accepted price ceilings during the war under the stimulus of war enthusiasm and patriotism. Do you think we could enforce price ceilings and rationing today? If you do, you are more optimistic than I am. Neither do I believe that we can enforce ceilings on the price of money. Money rates also must abide by market processes if we are going to meet the justifiable needs of the community. Again I say, if we are going to induce the saving of the funds that we need to provide the capital investment for the continuing growth of this economy together with the growing demands on government, there must be assurance of continuing value and there must be incentive in terms of return on the money.

There is another thing aside from money and credit policy that enters into this inflation problem. That is the fiscal problem of our government. I mentioned the fact that we have a tremendous budget at the present time, with what many consider an alarming deficit. We are a rich country; we can afford what we need from government in this country. If we need to spend--and this is up to the judgment of the Congress--if we need to spend the amount that is projected, we can afford to pay for it. Perhaps we can even afford some desirable but not necessarily essential spending. But we have to face up to the fact that it all has to be paid for sooner or later, in one way or another.

It might be paid for by raising taxes to balance the budget. That, again, is a matter for the judgment of the Congress. Alternatively, it might be paid for through borrowing by the government, but this way entails dangers of inflation. Of course that danger is minimized if the government can borrow the funds others have saved. But if the people, for whatever reason, including lack of confidence as to what government securities may be worth in the future, decide not to invest in them, not to use them as a repository for their savings, the government then has to turn to bank credit--and undue expansion of bank deposits means in effect printing press money because bank deposits are our principal money today. That is something we all need to be cognizant of and think about as we face the situation in front of us.

Here, let me interject a word about the farmers' concern with inflation. It has often been said, and there may have been a time when it was true, that the farmer benefits from inflation by being able to pay off debt with inflated dollars. If it was ever true, it certainly isn't today for two reasons. First, in the aggregate farmers' financial assets approximately equal their debts so that any decrease in the cost of their debts is offset by a corresponding decrease in the value of their financial assets in the form of insurance, bonds and savings accounts. Second, with agriculture as a whole in a position of surplus production and with off-farm production items making up an increasingly larger part of his total costs, inflation is bound to have a greater effect on the farmers' costs than on his selling price. Experience since Korea is a glaring illustration of this fact.

Whether we can or should spend the amount we are spending, the Congress is going to do what in its judgment seems best, based in part at least on what you and I and every other constituent tell it we want done, both in regard to spending and in regard to taxes.

I remember a Congressman from Texas writing a story for the local papers a few years ago. The good Congressman was getting letters and resolutions from every Chamber of Commerce in the district about cutting the budget--"Let's get this government expenditure down"--and he was getting an equal number of resolutions to support this and that appropriation for items that they wanted in their district. So he wrote an open letter to the district to the effect that "I would be delighted to serve you if I knew which way you want to go. If you will tell me just which of these two things you want, I'll try to do something about it."

I mention that, gentlemen, because sometimes we sit at home and talk about what Congress is doing or what it is not doing. If we just stop and think and are honest about it, we must recognize that Congress is pretty much reflecting what we in the aggregate want it to.

Why am I saying this? To bring back to you and to the citizens of this country the fact that, after all, when we talk about Uncle Sam doing this or that, we are not talking about that legendary figure in the tall hat and striped pants. We are talking about "US - YOU AND ME." No matter how indirect and remote the approach, the responsibility is still ours. As we communicate our thinking to our representatives, we put them in better position to consider more objectively the needs of the country and how they can best be met. If we decide to spend we can pay for it one way or another but if it is done without subjecting ourselves to the discipline of sound fiscal policy, it can be tragic.

Now it would be incomplete to omit reference to the other phase that is a significant part of this inflationary problem. That is the need to have the consumer share in the benefits of increased productivity, rather than being preempted entirely in wages and profits, or having the consumer set back even more by the granting of wage increases in excess of productivity by employers influenced by the hope and belief, with some justification in recent years, I might add, that they can pass the cost on to somebody else.

I think, my friends, that it is time all of us assume more responsibility as individual citizens in facing up to what this demand for return above what productivity will justify means. Certainly, we want to see everyone raise his standard of living but the mere fact that you want it cannot bring it about over a period of time unless you develop the things that earn it.

We were concerned about Sputnik. We were more than concerned, in some places we were panicked, that we had gotten behind and that something was going to blow up in the sky overnight. I think it is time for us to get concerned as individuals about some of the basic problems of our economy if we are going to hold our place and win the economic war that is threatening us not only at home but around the world today.

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