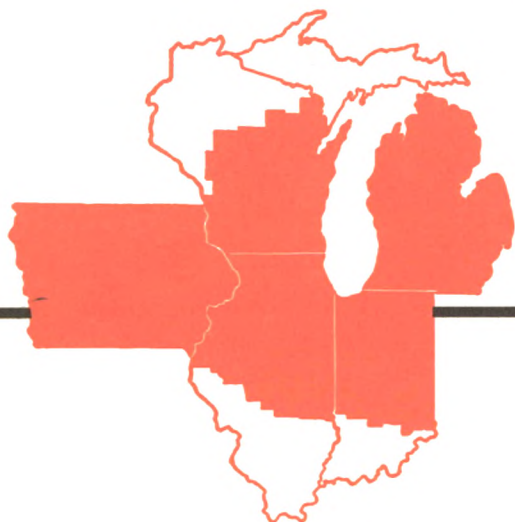


Business Conditions

October 1971



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Checking account costs—

Trends and composition among small banks, 1966-70

If you were a banker you would know:

- Demand deposits subject to transfer by check (checking accounts) are the unique feature of the commercial banking business.

- Checking accounts play the key role in the nation's payments mechanism—they are used in about 90 percent of all transactions by dollar volume.

- Approximately half of all personnel at banks with deposits under \$50 million are employed in processing checking accounts.

- Checking account costs have a decisive influence on the profitability of any bank.

Obviously, checking account costs are a matter of prime concern to all bankers. This article provides a brief account of recent trends in these costs and traces their movement and composition over the period 1966-70. An attempt is made in the article to isolate some of the factors that have a systematic influence on checking account costs. It is hoped that the information contained herein will be of value to Seventh District bankers in assessing their own checking account costs and, where necessary, bringing them under better control.

The data

Most of the data in this article are derived from the Functional Cost Analysis Program initiated by the Federal Reserve Bank of Chicago in 1965. Eighty-three Seventh District member banks with average deposits under \$50 million participated in the program continuously from 1966 to 1970. The descriptions of recent trends in the demand deposit function in the analysis that follows are based on aggregates of these banks. Figures relating only to 1970 are based on reports of 133 banks with deposits under \$50 million participating in the program last year.

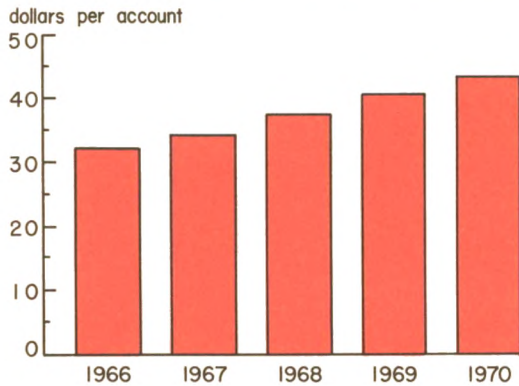
The Functional Cost Analysis (FCA) Program is a bank-oriented, standardized cost accounting system designed primarily for small banks lacking the personnel and resources to develop their own systems. The basic approach of the FCA is to subdivide the bank for accounting purposes into a number of distinct "functions" and then to determine the level and composition of the costs and revenues associated with each function. An important byproduct of the FCA Program is a wealth of detailed data on each of the important bank functions.

Trends in checking account costs

Not surprisingly, costs relating to checking accounts have increased steadily during the past five years. This has been almost entirely a matter of inflation, with each of the inputs into the demand deposit function—labor, capital, and materials—increasing sharply in

price. Between 1966 and 1970, the 83 FCA banks' average annual cost of maintaining and servicing a checking account increased 35 percent, rising from \$32.23 to \$43.48. This increase was large even in relation to increases in costs and prices in most other areas of the

Although costs per checking account rose steadily from 1966 to 1970 for FCA banks . . .



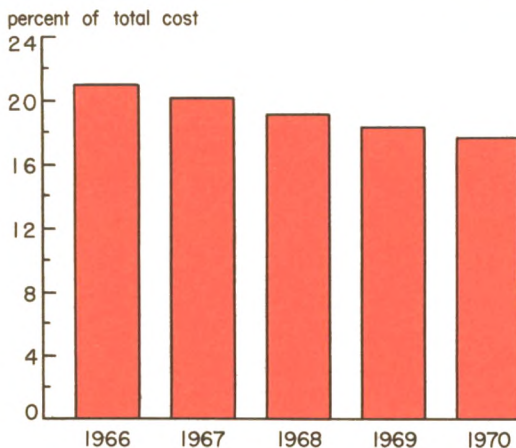
economy. It has occasioned deliberate efforts by bank managements to achieve greater efficiency in order to offset continued increases in the cost of funds and thereby to maintain bank profits. These efforts fre-

quently take the form of introducing more capital-intensive technology.

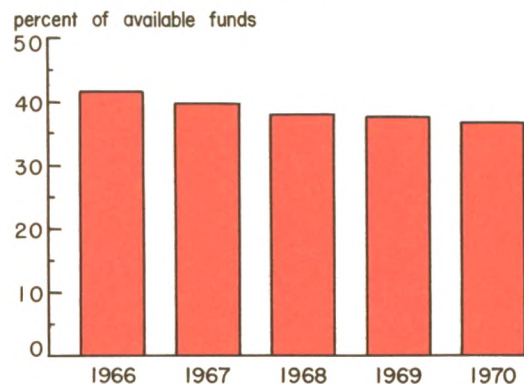
For reasons largely unrelated to the demand deposit function itself, checking account costs for the 83 smaller district FCA banks declined relative to other bank operating costs between 1966 and 1970. For the most part, this was a consequence of the declining relative importance of demand deposits as a source of bank funds and the recent emergence of interest on time deposits as the largest single expense of commercial banks. In 1966, time deposits at the typical district member bank exceeded total demand deposits for the first time in 30 years. The trend has continued, and in 1970 time deposits constituted 57 percent of the total deposits of the typical district member bank. As a proportion of the total available funds of the 83 FCA banks under discussion here, deposits in checking accounts decreased from 42 percent in 1966 to 37 percent in 1970.

Contributing to these trends has been the sharp rise in interest rates paid on time and savings deposits in recent years. The more attractive return to depositors prompted a

checking account costs fell relative to total bank costs . . .



as checking accounts declined as a proportion of total available bank funds

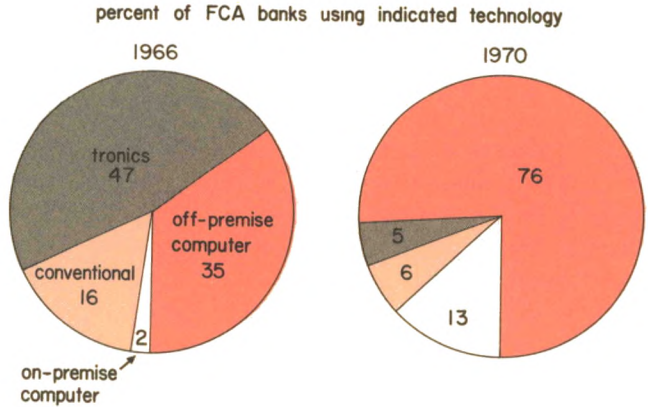


rapid growth of time deposits and at the same time gave depositors an incentive to economize on demand deposits. The increase in the proportion of time to total deposits and the sharp rise in the unit price of time deposits resulted in an increase in the proportion of interest on time deposits to total expenses from 42 percent in 1966 to 48 percent in 1970 at the 83 FCA banks. This alone was almost sufficient to account for the decline in the relative importance of checking account costs.

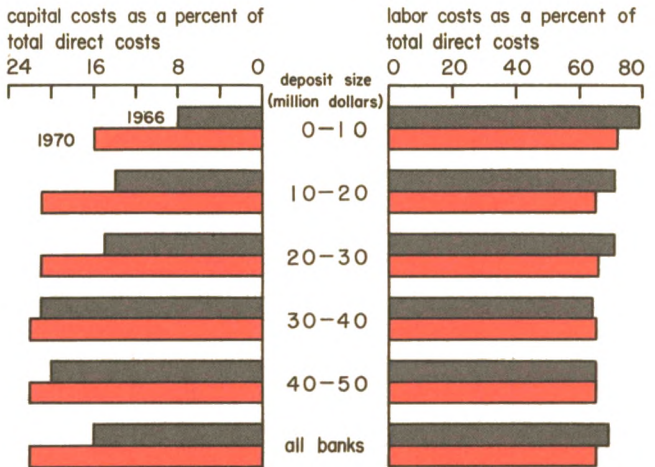
The composition of costs

Bank costs can be classified in a number of ways to make them more meaningful for purposes of analysis. One of the more useful distinctions that can be made is that between direct and indirect costs. Direct costs are those that are clearly assignable to a given banking function and usually vary in a fairly systematic manner with the volume of activity in that function. Indirect costs are incurred for services essential to the operation of each and every function. However, causal responsibility for them is imbedded in the overall operation of the bank, and can be assigned only arbitrarily to any particular function. The importance of the distinction between direct and indirect costs is that, as a general rule, only direct costs are affected to any appreciable degree by changes in the volume of activity or organization of any single function. The direct costs

Revolutionary changes in the technology of processing checking account activity . . .



led to capital costs rising faster than labor costs between 1966 and 1970



related to the demand deposit function, therefore, are the costs most germane to decisions affecting that function only. The significance

of any error in classifying particular costs as direct or indirect is minimized by the fact that indirect costs amounted to only about 20 percent of the total costs of the FCA banks.

Direct costs consist primarily of labor and material costs and those capital costs attributable to equipment and furniture used specifically by the function in question. Like most other service industries, banking has traditionally been labor-intensive in its technology. Of all the banking functions, however, the demand deposit function is the most capital-intensive. While capital costs constitute only 3 to 10 percent of the total costs associated with other bank functions, they have accounted for more than 15 percent of the costs of the demand deposit function at FCA banks in recent years.

Checking accounts alone—which in recent years have accounted for between 93 and 95 percent of total demand deposits—grew steadily more capital-intensive during the period between 1966 and 1970. In 1966, the 83 FCA banks' ratio of capital costs to total direct costs of processing checking accounts was 16 percent; by 1970 it had risen to 22 percent. Most of the change occurred in banks with less than \$30 million in deposits, perhaps reflecting the lagged adoption by smaller banks of technology in use at larger banks for many years. This substitution of capital was at the expense of both labor and materials. Although each category of costs grew in absolute terms, labor costs declined from 69 to 65 percent and materials costs from 15 percent to 13 percent of total costs. Only in the case of banks with less than \$10 million in deposits did capital costs increase entirely at the expense of labor costs.

This marked increase in the capital intensity of checking account processing was associated with a virtual revolution in the

technology of the demand deposit function. In the 1966-70 period, the percentage of the 83 FCA banks using computers rather than conventional or electronic bookkeeping machines ("tronics") rose from 37 percent to 89 percent. Concurrently, a considerable number of the banks already using the services of off-premise computers, usually on a time-sharing basis, leased or purchased computers for on-premise use.

Occupancy costs—rent, taxes, and depreciation and maintenance on the bank's premises—were the largest component of the 83 FCA banks' indirect costs, accounting for nearly half the total in 1970. Advertising costs, only a small portion of which are specific to individual banking functions, accounted for roughly 18 percent. The remainder consisted of: legal, audit, and directors' fees; insurance; and professional association membership dues. Although indirect costs allocated to checking accounts also increased over the five-year period, they increased less rapidly than direct costs.

Revenues

The only important revenues directly associated with the demand deposit function are service charges and penalty charges on checking accounts—often referred to together as "activity income." Although pricing practices vary greatly, both between banks and between different categories of accounts within banks, the common practice is to tie service charges to account activity. Thus, there may be a certain charge for each check written or each deposit made. Some banks also levy a small monthly charge that is independent of activity and which is designed to cover the bookkeeping and other costs of maintaining the account.

While both activity income and costs per checking account increased at smaller FCA

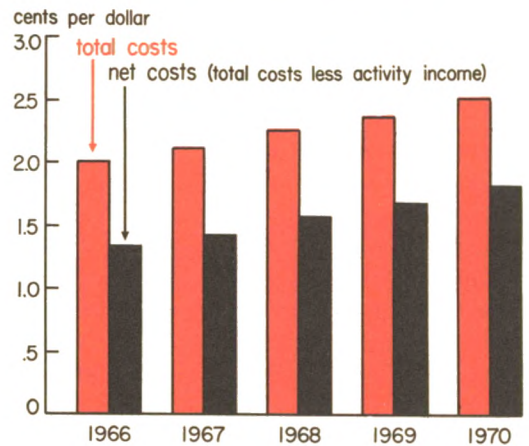
banks between 1966 and 1970, costs increased considerably faster, with the result that service charges covered a smaller proportion of costs at the end of the period. The \$11.25 increase in costs per checking account was more than ten times as large as the \$1.03 increase in revenues. Thus, in 1970 the 83 FCA banks' explicit revenues from checking accounts covered only 26 percent of the cost of maintaining them, as opposed to 32 percent in 1966.

All of this adds up to what, at first glance, appears to be irrational and damaging pricing. Actually, it is the inevitable result of a competitive pursuit of profit subject to regulatory constraints. Since 1933, banks have been prohibited from paying interest on demand deposits—in essence, and contrary to the facts of the marketplace, Congress declared such deposits to be a “free good.” As long as banks have profitable outlets for funds, they would find it remunerative to pay a positive price for demand deposits rather than forego them. They find it necessary because most deposit customers can employ their funds in alternative ways that promise higher returns. Consequently, banks have taken to competing for demand deposits by a variety of means that do not constitute the “payment of interest” in a narrow legal sense.

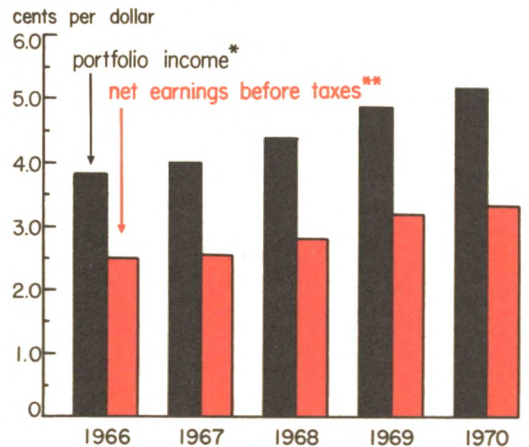
The permissible alternatives have included the provision of various services free to depositors and the reduction to minimal levels of service charges on checking accounts. Many banks, including some of the FCA banks, have eliminated service charges on accounts maintaining a specified minimum monthly balance. Others have gone to the limit permitted by law and completely eliminated charges on all regular checking accounts, without regard for balances or activity. Whatever the legal classification of this absorption of the costs of account activity

6

Although costs per dollar of checking accounts rose . . .



net earnings also increased between 1966 and 1970



*Portfolio income equals total revenue from the investment of checking account funds less the costs of lending and investing these funds.

**Net earnings before taxes equals portfolio income from checking account funds less the net cost—total costs less activity income—of processing checking accounts.

by banks, it is clear that in the economic sense, it is tantamount to the payment of interest.

What the waiver of service charges on some classes of accounts indicates is that the market rate of interest on demand deposits—the rate that would prevail in the absence of regulation—now exceeds by a considerable margin the service charges that would prevail under the same conditions. Presumably, these charges would cover the full costs of servicing the accounts. This interest rate, in turn, is linked by market forces of supply and demand to the prevailing rates on both bank loans and other types of credit. The higher the interest rates on loans, open market credit instruments, and competing deposit-type liabilities—including commercial bank time deposits—the smaller the proportion of checking account costs that explicit service charges can be expected to cover. If one looks at the annual net cost of available funds acquired through deposits in checking accounts—total costs less all activity income—per dollar of such funds, it is clear that it in-

creased between 1966 and 1970 at the 83 small Seventh District FCA banks. In view of the pronounced increase in market interest rates over this period, this is what would be expected.

In order to determine the profitability of checking accounts in any meaningful sense, it is, of course, necessary to calculate the bank's earnings net of all expenses, including money costs on investments or loans made possible by the funds derived from these accounts. Judged by this criterion, and taking the existing prohibition of interest on demand deposits as given, the present structure of service charges appears much more reasonable than it does when only explicit activity income is taken into account. Bankers have been wont to complain that they are "giving away" their services. This is simply not true. Indeed, because changes in deposit rates tend to lag behind changes in lending rates and because bank lending is relatively short-term, the rate of earnings on funds derived from checking accounts actually increased over the past five years.

Interbank differences

The preceding discussion of trends for the 83 smaller FCA banks as a group did little more than hint at the differences that exist in the level and nature of checking account costs among these banks. These differences, which are extremely large, are partly under the control of bank managements and partly beyond their control. An understanding of why they exist is a prerequisite to any effective program for reducing costs.

Probably the figure of most interest to the banker viewing his checking account costs is the cost of obtaining and retaining a dollar of checking accounts. The cost per account

is a subsidiary consideration which, though obviously related, is one step removed from a bank's cost of funds as such. Data for 133 FCA banks for 1970 reveal an extremely broad range of costs per dollar of demand deposits.

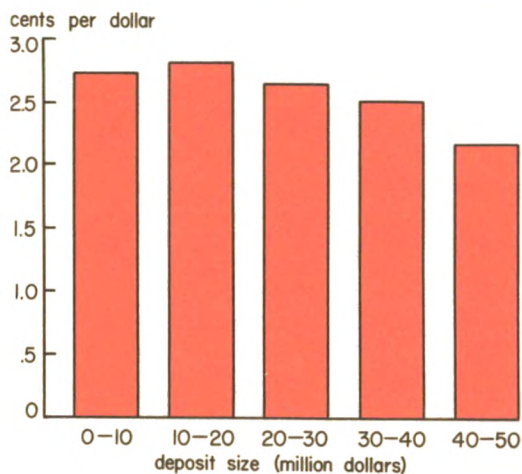
Bank size and costs

The data also indicate the existence of a pronounced inverse relationship between costs per dollar of checking accounts and deposit size of bank. This might be taken as evidence that larger banks are somewhat more efficient in processing checking ac-

counts. To be sure, it is a presumption of long-standing that there are economies of scale in banking. However, the data as presented reflect more than the inherent efficiencies of larger size. They also reflect such factors as average size of account, composition of deposit accounts between regular and special checking accounts, and—perhaps most important of all—the amount of activity per account.

Size of account is a crucial factor because most costs associated with the administration of a checking account are independent of the account balance. Hence, the larger the average size of account held by a bank, the lower its costs per dollar of checking accounts will appear to be. But the fact that a bank deals with large customers keeping large deposit balances is no indication, in and of itself, of the bank's efficiency. The widely acknowledged fact that large customers tend to pa-

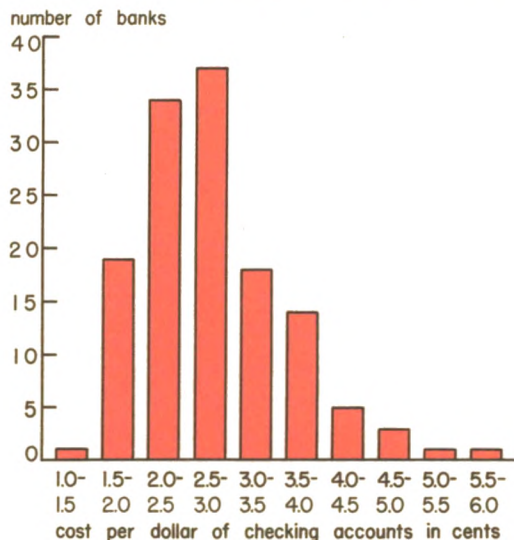
appeared to be closely related to deposit size of bank in 1970



tronize large banks makes somewhat spurious the observed relationship between costs per dollar of deposits and size of bank.

Another factor often cited as having an important influence on checking account costs is the mix of accounts between regular and special checking accounts. Special checking accounts are typically low average balance, low activity accounts that are offered to individuals unable to qualify for regular checking accounts. They normally carry a fairly substantial charge for each check written but either no monthly maintenance charge or a small one, depending on the minimum balance in the account. That regular checking accounts normally have somewhat higher per account costs than special checking accounts is probably due more to their greater average level of activity than to any difference between the two types of accounts in the cost of processing a given amount of activity. In 1970, the average cost per account of regular checking accounts for FCA banks was

Interbank variation in costs per dollar of checking accounts . . .



\$47; for special checking accounts it was only \$25.

For the 133 FCA banks under consideration here, average dollar balance per checking account increased more rapidly with size of bank than did activity per account. This was true despite the fact that the larger banks had a larger proportion of special checking accounts, as measured by either dollar volume or number of accounts. The upshot is that, although certain systematic relationships between costs, size of account, composition of accounts, and activity can readily be observed, the relationships so far considered do not provide a firm basis for judgments regarding the relative efficiency of banks of different size in processing checking accounts.

Measuring efficiency

It is only a small step from recognition of this problem to the conclusion that the proper measure of efficiency in administering checking accounts is one that relates checking account costs to the total activity generated by such accounts. In a very real sense, this activity—the processing of home debits, deposits, and transit checks and the book-keeping expenses associated with preparing monthly statements—can be considered the “output” produced by the checking account function of the bank. It would, therefore, appear entirely reasonable to use costs per unit of activity as a measure of efficiency. A problem that must be overcome before this is done, however, is that activity is not a homogeneous category. For example, it requires more separate operations to process a home debit or deposit than a transit check, and still more for a monthly statement.

In an unregulated and fully competitive banking system, banks would impose a charge per unit of each activity that would reflect customers’ evaluations of the utility of

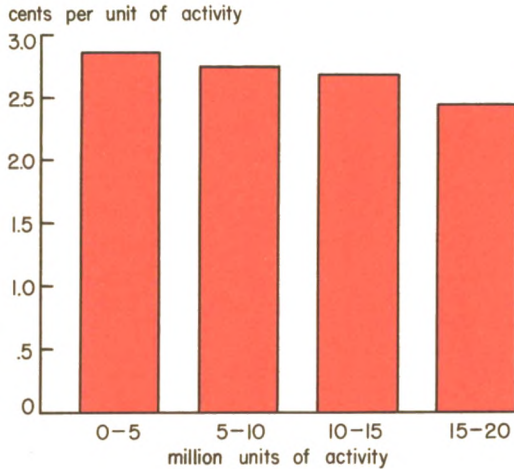
the activity. These charges could then be used to weight the units of various types of activity to obtain an overall dollars-and-cents measure of the “output” of the checking account function. Lacking an explicit market valuation of the various types of activity, weights reflecting the relative handling costs per item relative to the cost of handling a transit check have been used. These weightings, which have been in use in the FCA program for several years, are based on time studies carried out by the National Association for Bank Audit, Control, and Operations (now the Bank Administration Institute). They are as follows:

Activity	Weight
Home debit	2.73
Deposit	3.82
Regular checking account maintenance	722.00
Special checking account maintenance	60.16
Transit check	1.00

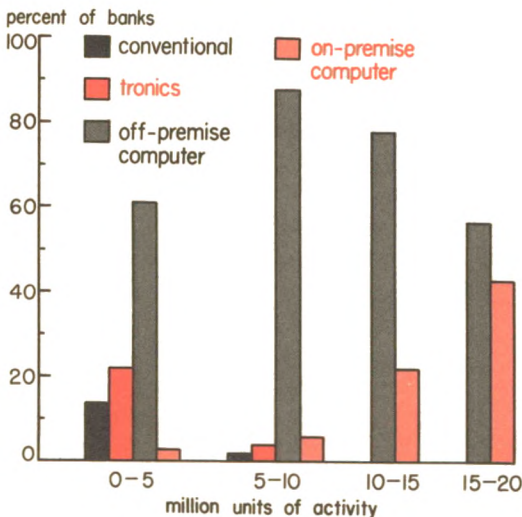
The use of weight units of activity as a measure of output associated with the checking account function suggests that it may also be the appropriate measure of bank size for the purpose of measuring the relationship between size and efficiency within the checking account function. One would, of course, expect to find a fairly high correlation between a bank’s size as measured by total deposits and its total checking account activity.

The data indicate that the per unit costs of checking account activity do, in fact, vary inversely with total checking account activity. To be sure, the influence of all factors other than the amount of activity that might produce this relationship has not been accounted for, and any conclusions must, therefore, be tentative. Nevertheless, the regularity of the decline in unit costs from one activity level

Costs per unit of activity in 1970 varied inversely with the level of activity . . .



suggesting that efficient use of computers requires high levels of account activity



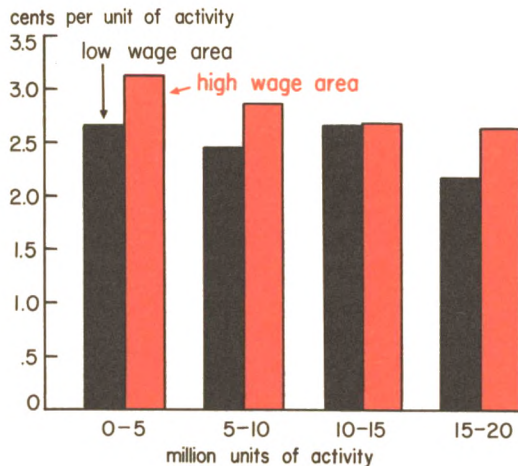
class to the next suggests that there may, in fact, be economies of size in the administration of checking accounts.

To say that unit costs vary inversely with the level of activity does not explain why this should be so. In general, economies of scale result from the fact that some means of production—e.g., certain machines or processes—are indivisible and can be used economically only when total output exceeds some minimum level. Thus, the decline in checking account unit costs as activity expands may reflect the progressive adoption of successively more efficient types of demand deposit accounting technology. As has already been seen, this is reflected in the higher ratio of capital costs to the total costs of processing checking accounts in large banks than in smaller ones. It is shown more directly in the greater proportion of large banks that utilize on- or off-premise computers for demand deposit bookkeeping, as opposed to electronic or conventional bookkeeping machines.

Greater activity also enables the bank to utilize personnel more efficiently. Not only can there be greater specialization of tasks when output is greater, but the proportion of the time that tellers and other personnel can be expected to be idle during the day varies inversely with the number of customers and transactions.

Despite its importance, the level of activity is only one of many factors that help to account for interbank differences in checking account costs. Another is the organizational structure of the banking firm—whether it is a branch or unit bank. Although it would be reasonable to expect branch banks to have higher occupancy costs and, because of the distribution of personnel among two or more locations and consequent limited specialization, higher labor costs, the independent in-

Wage levels had an important influence on checking account costs in 1970



fluence of branching is hard to discern from data on the 133 FCA banks. In the aggregate, the cost per checking account in 1970 was 4.8 percent higher for banks with branches than for unit banks. The erratic behavior of the differences in the costs of unit and branch banks in the same deposit-size classes may be due to the failure to account for major variations in the number of branches. In addition, branches vary greatly in the scope of their operations, some functioning simply as paying and receiving stations, others being operated virtually as individual unit banks. Because of these weaknesses in the data, the relatively insignificant differences found here do not preclude the possibility that branching

may have an important influence on costs.

Finally, the large, if declining, proportion of labor costs to total costs of processing checking accounts suggests that inter-area differences in wages may explain an important part of the differences in costs. The local areas in which the FCA banks were located were classified into low and high wage areas, and the costs per account of banks of similar size in the two types of areas compared. The results support the thesis that banks in high wage areas experienced higher costs than banks in low wage areas.

Conclusion

Despite attempts to explain interbank differences in checking account costs by relating them to a number of factors commonly believed to affect costs, the remaining variation is still quite large. The level of activity was found to account for a large proportion of the variation in cost per account between banks, while differences in the average balance per account explained much of the difference between costs per dollar of deposits and costs per account. The seemingly unsystematic character of the remaining variation in costs suggests that it may be the result of major differences in the quality and cost-consciousness of individual bank managements. To the extent that this is true, there is considerable scope for cost reduction by deliberate measures under the control of bank management that are independent of such given and fixed conditions as the size and location of the bank.

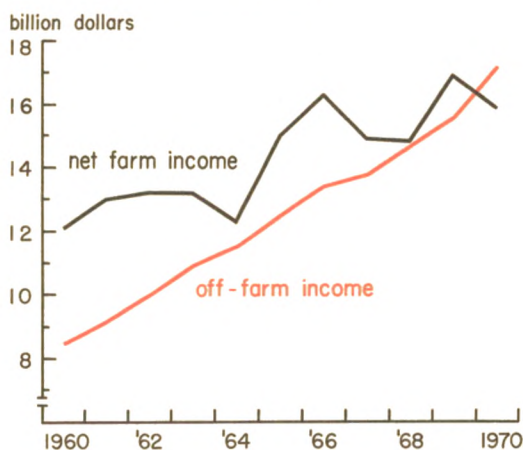
Farmers' off-farm incomes exceed farm earnings

Two out of three American farmers receive over half their annual income from off-farm sources. Most operators of small farms rely almost entirely on off-farm earnings to provide their livelihood. And even those who operate the nation's largest farms receive a significant proportion of their total incomes from off-farm sources.

Record of the Sixties

The off-farm income of farm operators doubled over the decade—rising from \$8.5 billion in 1960 to \$17 billion in 1970, when it exceeded total net farm income for the first

Off-farm income outstrips income from farming



SOURCE: U. S. Department of Agriculture. See July 1971 Farm Income Situation.

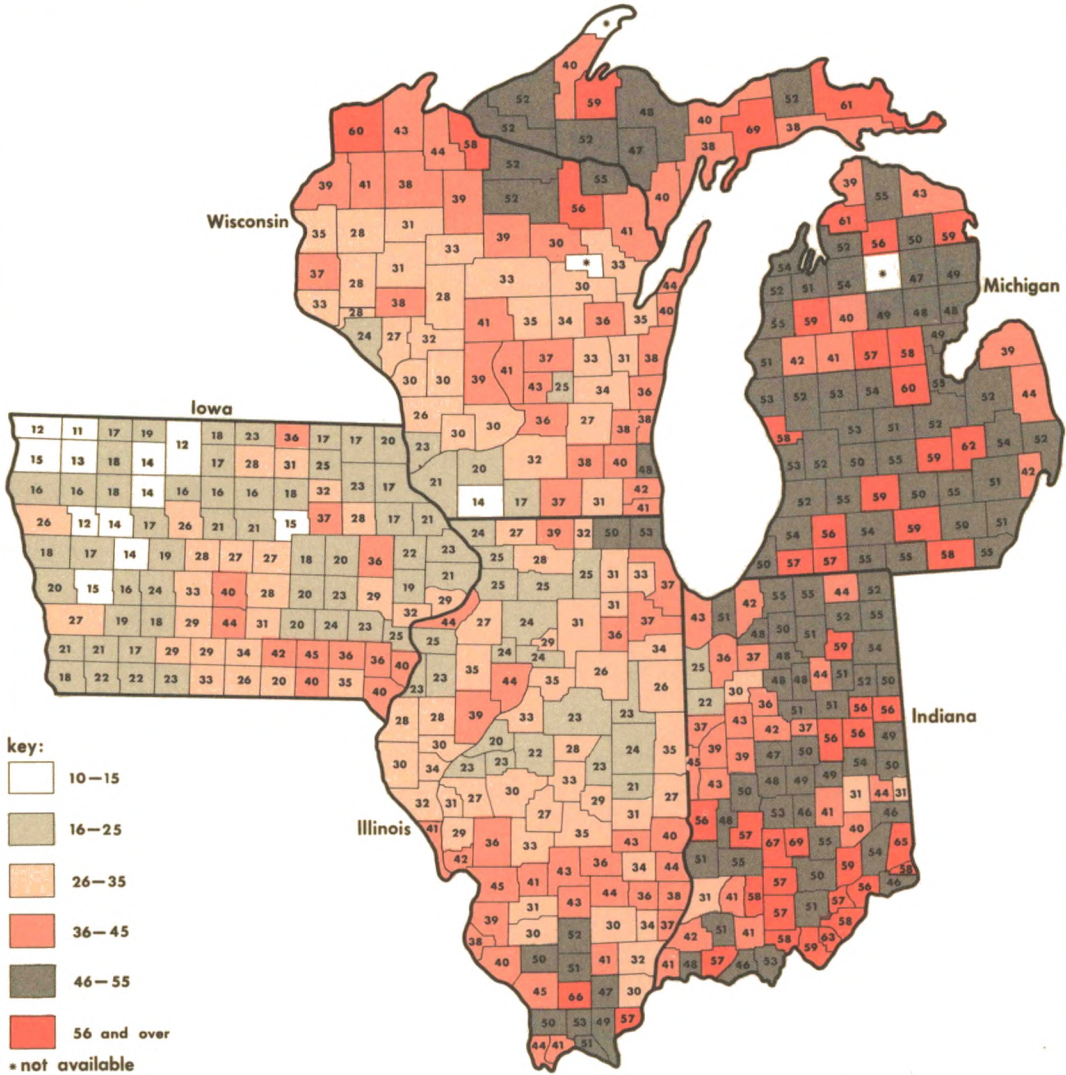
time. Operators' income received from farming increased only 44 percent during the same period, from \$11.7 billion to \$15.9 billion.

The strong gain in off-farm earnings is traceable in large part to the rapid growth in the nation's nonfarm economy, which provided an abundance of good-paying jobs during the period. Nonagricultural wage and salary employment grew by about 16 million persons during the 1960s, and the unemployment rate fell from a high of 6.7 percent in 1961 to a low of 3.5 percent in 1969.

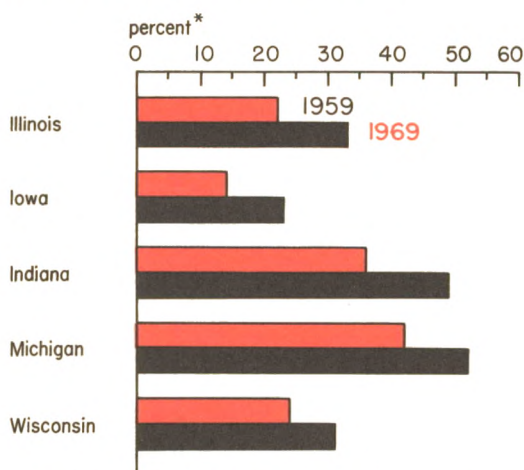
Nonfarm wages and prices spiraled upward during the decade. Average weekly earnings of factory workers rose 47 percent, and the consumer price index advanced 26 percent. More farm operators and their wives probably felt the need to supplement their farm incomes, which were growing much slower than the incomes of the nonfarm population, in order to maintain a desired standard of living. But the foundation of the trend itself can be found in the mechanization and technological breakthroughs that cut deeply into the time required to operate a farm efficiently. Reflecting this, the proportion of the farm population in the labor force working in *nonagricultural* jobs rose from 33 percent in 1960 to 44 percent in 1970. In both years, three-fifths of the farm population over 14 years old were participating in the total labor force—but more were engaged in nonfarming activity.

Farm women, like their urban counterparts, became more active in the labor force. About 38 percent of all farm women were

Percent of farmers working off the farm 100 days or more by counties in 1969



More Seventh District farmers find off-farm employment



*Operators working off the farm 100 days or more.

either working or seeking work in 1970, compared to 30 percent in 1960. By contrast, the proportion of farm men in the labor force dropped from 85 percent to 80 percent between 1960 and 1970. The decline in male participation, in part, reflects the rising proportion of farm men reaching retirement age during the period.

The Seventh District

The rapid increase in off-farm employment of farm operators in the states of the Seventh District is indicated by data collected in the 1969 Census of Agriculture and only recently published. Farm operators in district states working 100 days or more off the farm rose from just over 25 percent of all farmers to nearly 38 percent between 1959 and 1969.

In the highly industrialized state of Michigan, the proportion of farmers working off the farm rose from 42 percent to 52 percent. In Iowa, whose economy relies most heavily

working off farms over 100 days rose most rapidly—increasing from 14 percent in 1959 to 23 percent in 1969.

The proportion of farmers working in off-farm jobs tended to be highest near urban areas and in areas where farm income was lowest. For example, 44 percent of the farmers located in standard metropolitan statistical areas (SMSAs) worked off the farm 100 days or more in 1969. Similarly, 44 percent of the farmers in the low farm income areas of southern Illinois and Indiana and northern Wisconsin and Michigan worked off the farm 100 days or more. These proportions compare to an average of 38 percent for the entire district.

A problem of definition

The Department of Agriculture's definition of a "farmer" bears little relation, in the majority of cases, to how that person earns a living. A farmer, as defined by the Department, is any person who operates a farm. But a "farm" is defined as a place of ten acres or more with at least \$50 in product sales, or a place of less than ten acres with at least \$250 in sales.

Forty percent of the 2.8 million "farms" enumerated by the Department of Agriculture have annual farm product sales of less than \$2,500, and they account for less than 3 percent of total farm cash receipts. It is not too surprising that the operators of these farms receive nearly 90 percent of their income from off-farm sources. But larger farmers, too, rely on off-farm earnings to supplement their farm incomes.

There are approximately 1.1 million farmers with over \$10,000 in annual farm product sales, and together they account for 90 percent of all cash receipts from farming. Nearly half of the farmers in this "commer-

Off-farm earnings increasingly important to all farmers

Size of farm ¹	Number of farms		Proportion of all farms		Farm income ²		Off-farm income		Total income		Off-farm / Total	
	1960	1970	1960	1970	1960	1970	1960	1970	1960	1970	1960	1970
	<i>(thousands)</i>		<i>(percent)</i>		<i>(per farm in dollars)</i>		<i>(per farm in dollars)</i>				<i>(percent)</i>	
Less than \$2,500	1,848	1,184	47	40	850	1,059	2,731	7,954	3,581	9,013	76	88
\$2,500—\$4,999	617	260	15	9	1,961	2,049	1,849	5,465	3,810	7,514	49	73
\$5,000—\$9,999	660	370	17	13	3,305	3,492	1,573	4,984	4,878	8,476	32	59
\$10,000—\$19,999	497	513	12	17	5,368	6,208	1,258	3,452	6,626	9,660	19	36
\$20,000—\$39,999	227	374	6	13	8,652	9,962	1,678	3,503	10,330	13,465	16	26
\$40,000 and over	113	223	3	8	18,995	25,664	2,177	5,803	21,132	31,467	10	18

SOURCE: U. S. Department of Agriculture.

¹Measured in terms of annual farm product sales.

²Realized net income excludes inventory change and includes government payments.

cial-size" group had average family incomes of \$9,660 in 1970, and off-farm earnings accounted for over one-third of the total. The next larger-sized farmers had family incomes of \$13,465 in 1970, and off-farm earnings equaled more than one-fourth of their total incomes.

Although the relative importance of off-farm income decreases as the size of the farming operation increases, such earnings still comprise a significant portion of the total income of the very largest operators. About one-fifth of the 1.1 million large, commercial farmers in the United States averaged nearly \$125,000 in farm product sales in 1970. They had average family incomes of more than \$31,400, with almost one-fifth derived from off-farm sources. Undoubtedly, these very large farmers receive most of their off-farm earnings from nonfarm business enterprises or investments, such as stocks and bonds, rather than from wages and salaries. It should be pointed out, too, that an increasing proportion of farmers reach retirement age each year, and as a result an ever increasing proportion of "off-farm" income is accounted

for by monthly Social Security payments.

An Illinois study

An insight into the role off-farm income plays in the Corn Belt region of the Seventh District is provided by a recent University of Illinois study. The study included about 300 commercial farm operators in central Illinois, a highly productive farming region. Off-farm income accounted for nearly half the earnings of farmers with total annual incomes of \$6,000 or less. Those with just over \$9,000 in family earnings, which included two-thirds of the families studied, obtained about one-fourth of their annual incomes from off-farm sources. Those with over \$18,000 in family income earned only 4 percent of the total from off-farm sources.

Wages and salaries were by far the most important source of off-farm income, accounting for over 60 percent of the total. The farmer's wife, holding a job outside the home, was a major contributor to earnings, accounting, on the average, for 44 percent of the family's off-farm income. One-fourth of the farm wives surveyed in the Illinois study

worked off the farm. These women usually were employed full-time at jobs requiring special skills (secretarial work) or advanced education (teaching and nursing).

Some implications

The importance of off-farm income to farm families has implications for farm management, for farm lenders, and for farm policymakers. It is important to farm managers because it affects the way farm enterprises are organized. For the small farmer—the one who lacks the financial resources, the managerial ability, or the inclination to adapt to modern, large-scale farming—off-farm employment for himself and his family provides the means of maintaining a satisfactory standard of living while he continues to farm. In most instances, this means labor-intensive enterprises, such as livestock raising, will be eliminated from the operation of small farms. Moreover, machinery larger than might otherwise be necessary may be required to enable the operator to complete his farm work on schedule while maintaining off-farm employment.

The implication of off-farm income for farm lenders is that the repayment capacity of farm borrowers is increased by off-farm earnings. Medium-sized farms (\$10,000 to \$20,000 in farm sales) are significant both in numbers and in the amount of farm credit used. Operators in this size group make up more than one-third of the farm borrowers at Seventh District banks, and they account for

over one-third of the farm production credit outstanding. Since off-farm earnings are a major source of income to farmers in this size category, information concerning the education and nonfarm employment status of the farmer and his wife—and local off-farm job opportunities—is as important as knowledge about the prospective borrower's farm operation in assessing credit worthiness.

Farm policymakers may infer from the importance of off-farm earnings that increasing the availability of jobs in rural areas is more pertinent to aiding the majority of farm families than boosting the level of farm income through price supports or direct subsidies. Since present agricultural support programs are based on acres controlled and bushels or pounds produced, the few very large farmers receive the greatest benefits.

For example, in 1970, farms with less than \$10,000 in cash receipts comprised over three-fifths of the Census-enumerated farms but collected just slightly over one-fifth of the total direct government payments. On the other hand, farms with \$20,000 or more in cash receipts comprised only one-fifth of all farms but received three-fifths of the total payments.

It would appear that the "farm policy" that would bear the richest harvest for the majority of farmers is not one based on commodities or acres of land, but a national policy designed to foster overall economic growth and provide educational and job opportunities for low income rural families.

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