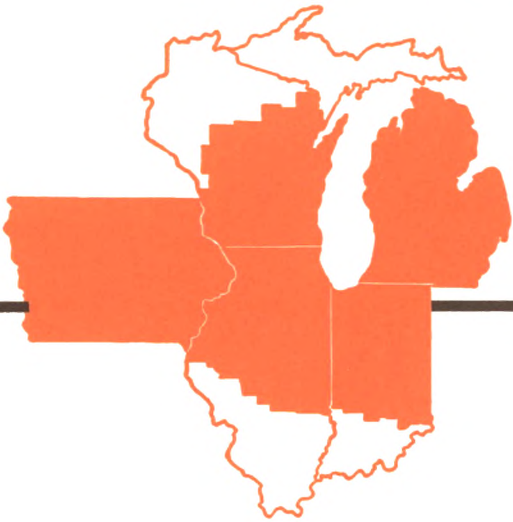
A review by the **Federal Reserve Bank of Chicago**

Business Conditions



December 1972

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THE Trend OF BUSINESS

Employment gains widespread

The upturn in employment that began early in 1971 continued and gathered strength throughout 1972. In November 1972, 85 million Americans, including members of the armed forces, held full or part-time jobs—up 2.2 million from November 1971. Nationally, unemployment was reduced to 5.2 percent of the labor force from 6 percent in November 1971.

While employment has increased in almost all sectors and areas, the strength of the uptrend has varied, especially when recent levels of employment are compared with the levels prior to the recession. For example, manufacturing employment, although up 4 percent nationally from a year ago, is still 5 percent below its 1969 peak. Output of manufacturing industries is achieving all-time highs month by month, but employment has not increased proportionately because workweeks have lengthened and output per man-hour, productivity, has increased substantially.

Midwest employment gains

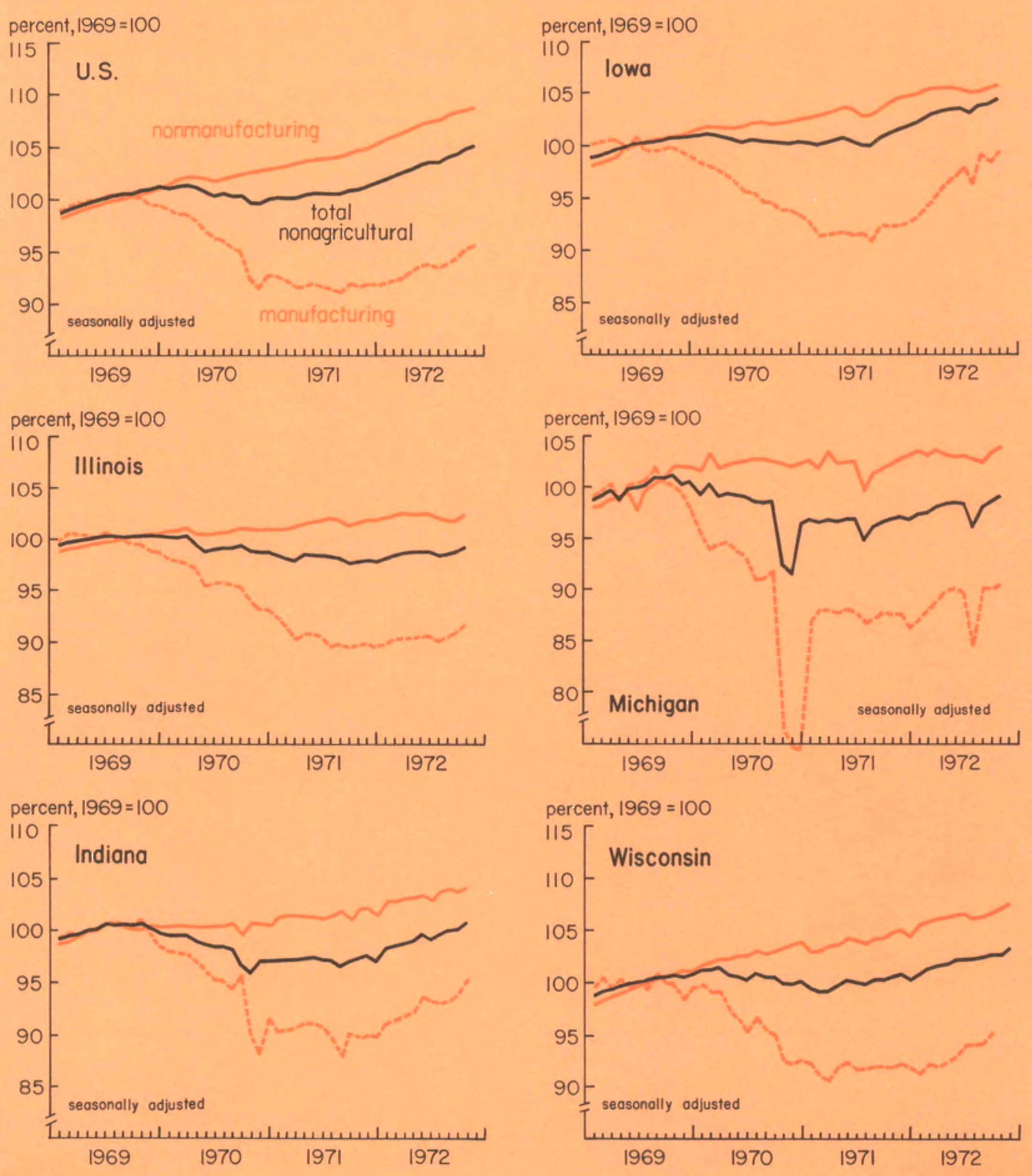
In October, the most recent month for comparable state data, total nonfarm wage and salary employment in the nation was up 3.8 percent from the October 1969 level, with all of the gain coming in the past year. Iowa was the only Seventh District state to approximate the national employment performance, reflecting vigorous prosperity in farm-related activities, especially in farm machinery output.

Wisconsin reported wage and salary employment in October 2.4 percent higher than the level of three years ago, aided by the revival of output of capital goods and recreational vehicles. Indiana had only just regained the 1969 employment level in October. Despite gains in the past year, Michigan employment was still down 1 percent from the 1969 level, and Illinois employment was still short by 2 percent. Employment in Illinois is dominated by the Chicago metropolitan area, which accounts for almost 70 percent of the state's employment and was 3 percent less in October 1972 than in October 1969.

Manufacturing employment in Iowa had returned to the 1969 level in October. Wisconsin manufacturing employment was still short of the 1969 level by 5 percent, the same as in the nation. Indiana was down 6 percent. The most important industrial states of the Midwest, Illinois and Michigan, report the slowest comeback in manufacturing employment with October payrolls 8 percent and 7 percent, respectively, below the 1969 peaks.

In virtually all areas of the nation, increases in employment in nonmanufacturing activities—especially trade, services, and state and local government—continued to rise throughout the 1970-71 period of sup-

Wage and salary employment surged in 1972; but most Midwest states lagged the national pace



pressed growth. The general lag in employment in the Seventh District reflects, in large part, the greater relative importance of manufacturing in this five-state area—32 percent of total payroll employment, compared to 26 percent for the nation.

The supply of civilian workers is no longer being augmented by reductions in the number of men in the armed forces. From September 1969 to last June, the armed forces were reduced steadily from 3.5 million to 2.4 million and have remained at about that level since then. The sharp drop in Defense Department procurement, starting in 1969, gave way to a moderate rise starting in early 1972 and some defense contractors are hiring workers again.

Unemployment in the Midwest

The only Seventh District state reporting unemployment above the national average is Michigan, with 8 percent unemployed in October, seasonally adjusted, compared to 5.5 percent for the nation. The unemployment problem has been chronic in Michigan in recent years and continues despite some alleviation provided by the boom in motor vehicle output. Other district states estimate lower unemployment ratios than the nation, with October figures ranging from 2.2 percent in Iowa to 4.4 percent in Illinois.

Unemployment in all areas has declined in the past year and especially in recent months. A further improvement is expected for 1973. Nevertheless, unemployment rates remain above the very low levels of 1968 and 1969 (3.5 percent for the nation), and there is scant hope that the pre-recession levels will be matched, or closely approached, in 1973, even with continued rapid expansion of the general economy.

The unemployment problem is partly a matter of matching people and jobs. Some employers already are facing problems in recruiting workers. Accountants, engineers, machinists, welders, and other skilled workers are in short supply in many areas. Other firms report shortages of suitable trainees, recruits for second and third shifts, and people who will accept hard, dirty, or "menial" jobs.

Unemployment is a relatively greater problem in the large metropolitan areas and especially in the older sections of central cities. Various factors have encouraged business firms to transfer their activities to suburbs, smaller towns, and rural areas.

Outlook is favorable

Real output of goods and services is expected to rise 6 to 6.5 percent in 1973, about the same as in 1972, and well above the average long-term increase of less than 4.5 percent annually.

Output per man-hour in the nonfarm private economy was up more than 5 percent from a year earlier in the third quarter of 1972, and a similar rise for the year as a whole is probable. The unusually large increase in productivity can be expected to moderate in the period ahead, as less experienced workers are hired, second shifts are added, and less efficient facilities and sources of supply are utilized. The long-term average annual rise in productivity has been about 3 percent.

These prospects suggest that the recent rate of gain in employment will be maintained or accelerated, and that unemployment will moderate further. With especially favorable sales gains anticipated for the motor vehicle and capital goods industries in the Seventh District, this region should participate, at least proportionately, in the national economic improvement.

District farmers and the expanding cattle-feeding industry

Beef production will reach 22.4 billion pounds in 1972, up more than 700 million pounds from 1971, and marking the tenth consecutive year of expanded output. Since the mid-1960s, ever-larger supplies of beef have been consumed at ever-higher prices, attesting to the rapid growth in demand for beef in recent years. The nation's growing appetite for beef has resulted in a rapid expansion of the cattle-feeding industry. Prior to 1950, most cattle were marketed directly from pasture. Now, over three-fourths of all cattle slaughtered are fattened on grain rations in feedlots.

Although farmers in Seventh District states—principally Iowa, Illinois, and Indiana—have expanded their cattle-feeding operations, their competitors in the Plains and Western states[1] have expanded far more rapidly. Cattle marketed from feedlots in the 23 major feeding states totaled 12.6 million head in 1960, and 35 percent of these cattle came from feedlots in the Seventh District states. Total marketings from feedlots have grown to an estimated 26.7 million head in 1972, but the Seventh District states share of marketings has declined to less than 22 percent of the total. By contrast, fed cattle marketings in the Plains and Western states increased from 52 percent of the total in 1960 to 70 percent in 1972.

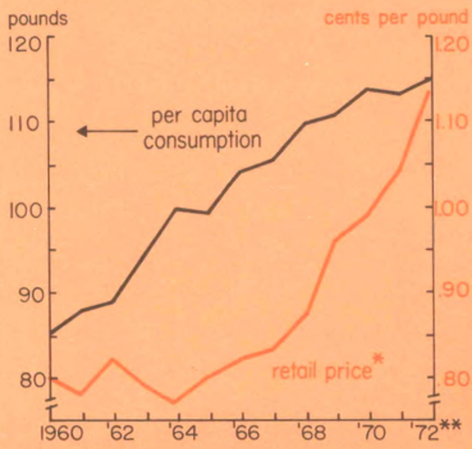
[1]The Plains states are Nebraska, Kansas, and South Dakota. The Western states are Texas, Oklahoma, Colorado, Idaho, New Mexico, Arizona, California, Washington, Oregon, and Montana.

What's behind the shift?

The advent of the large, commercial feedlot is the most obvious and most important factor contributing to the geographical shift in beef production. For purposes of definition, a feedlot with a 1,000-head, one-time capacity is usually considered "commercial." In recent years, the lots showing the most rapid expansion have been those with a capacity of 8,000 head and over.

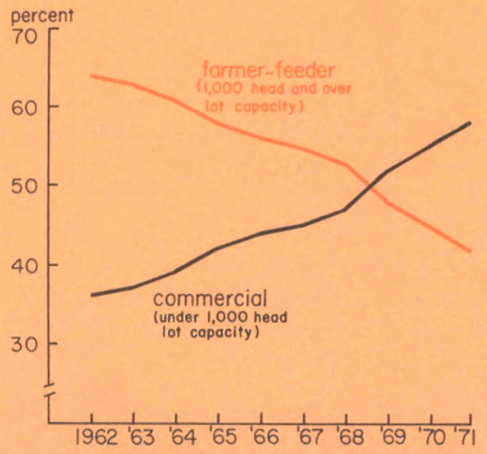
There were just over 2,200 commercial feedlots in the 23 major feeding states in 1971. Although they accounted for only 1 percent of all feedlots (commercial and non-

Americans consuming more beef at higher prices



*Weighted average price for all retail cuts.
**Estimate.

Large-scale commercial feedlots now market three-fifths of fed cattle



Note: Based on marketings for 23 major cattle-feeding states.

commercial), they marketed 58 percent of the fed cattle produced in these states.

Large-scale commercial feedlots were pioneered in California and Arizona where rapid postwar increases in population created a sizable deficit in local beef supplies relative to consumption. An added factor was that cattle feeding provided an outlet for by-products from the sugar beet and vegetable industries in these states. At the same time, large retail food chains were rapidly developing in the West. These stores maintained national policies of providing high-quality, USDA choice-graded grain-fed beef, rather than the lower-quality grass-fed beef that traditionally had been raised in the West.

Development of commercial cattle feeding in Texas, Oklahoma, and Kansas was retarded until the late 1950s by drought conditions and slow consumer acceptance of grain-fed beef. Two events appear to have been catalysts that triggered rapid expansion of large feedlots in these areas. One was a change in federal farm programs that curbed wheat and cotton acreage. The other was the development of a drought-resistant, high-yielding, hybrid grain sorghum (a feed grain). As acreage was shifted from cotton and wheat to grain sorghum, these areas changed from deficit to surplus feed producers, greatly enhancing the competitive position of western livestock feeders.

The advantages of being big

Numerous studies have demonstrated that large-scale feedlots have definite cost advantages over smaller lots. The major sources of these "economies of scale" arise from spreading labor costs and overhead expenses (taxes, depreciation, insurance, etc.) over more units of production, i.e., pounds of beef. Bigness also results in more subtle advantages that are not easily quantified but may be most significant. These include savings through large quantity purchases of feed and feeder cattle, and better knowledge of "the market" through the continuous buying and selling activities inherent in large-scale operations. Large lots also may be able to attract more buyers and obtain premium prices because of their established reputations and because they nearly always have cattle of varying weights and grades ready for immediate delivery. Being large also enables feedlot owners to successfully integrate into other related businesses—such as feed milling, slaughtering, and transportation.

Large feedlots also are able to attract outside investment capital by custom-feeding cattle for others, such as ranchers, packers, and outside investors. It is now estimated, for example, that 90 percent of the cattle in feedlots in the Texas Panhandle region are owned by someone other than the feedlot operator. Custom feeding allows feedlot owners to utilize their facilities more fully to achieve the cost savings of high volume. In recent years, "cattle-feeding clubs" and tax shelter plans have been developed to attract new investors. Often, the ability to defer tax liability on income from nonfarm sources is more important to investors than the profitability level of cattle feeding.

Why not the Corn Belt?

Probably one of the main reasons cattle feeding in the Midwest continues to be dominated by thousands of small operations with most farmer-feeders marketing from 50 to 300 cattle per year is that this well-established and reasonably efficient cattle-feeding system was already in place in these areas. As a result, expansion in cattle feeding in the central Corn Belt has come about, albeit more slowly, through enlarging existing operations rather than establishing entirely new facilities which may entail a complete reorganization of the farming business and large initial outlays of capital. Also a sort of "birds of a feather" phenomenon may be operative whereby similar business organizations tend to cluster together. Reasons for this include the availability of experienced labor, and the proximity of suppliers and markets geared to serve a particular type of business operation. In many cases, an entrepreneur seeking to establish a huge, western-type feedlot in the central Corn Belt might be considered a maverick by the local business and financial community—a factor making chances of success more risky because of lack of understanding and cooperation of local lenders and supply firms.

Economic forces

There are good economic reasons why cattle feeding has largely remained a supplementary enterprise on midwestern farms—or in many cases been discontinued. Alternative uses for available resources (land, labor, capital, and management) are often more profitable. The central Corn Belt with its natural endowment of fertile soil and climatic conditions has always had a competitive advantage in the production of corn and soybeans. And in the decade of the 1950s and early 1960s, technological advances in hybrid seed corn, herbicides and pesticides, and farm tractors and machinery further enhanced profitability and encouraged specialization in crop production. This was manifested in the sharp rise in Midwest farms that derived most of their income from crops. While the total number of farms has trended downward, the proportion of "cash grain farms" has increased. Specialized crop farms, for example, accounted for over 54 percent of all commercial farms in Illinois in 1964—up from 48 percent in 1959. During this same period, the proportion of Illinois commercial farmers specializing in raising cattle and hogs declined from 34 percent to 29 percent. Similar trends occurred in Indiana and Iowa. In the latter half of the Sixties, however, high livestock prices relative to grain prices encouraged more livestock feeding, and data from the 1969 Census of Agriculture indicate the trend toward specialized crop farming has leveled off.

Another economic trend that favors cash grain farming over large livestock operations has been the increase in the proportion of farmers that hold off-farm jobs. The Midwest is a major industrial region as well as an important agricultural region, and the expanding economy of the 1960s resulted in increased availability of off-farm jobs. As more and more farmers have found off-farm employment, many undoubtedly curtailed livestock raising—an operation that requires year-round attention.

Financing

The substantial initial investment and high operating capital requirements of a major feedlot also may be barriers to entry into large-scale cattle feeding for many Corn Belt farmers. The initial capital outlay for land, equipment, and machinery for a 10,000-head capacity feedlot is estimated to total over $500,000 in the Southwest. Operating costs of a 10,000-head lot total more than $6 million annually. Assuming 70 percent of operating costs are financed, and with a turnover rate of just over two times per year, this would require about $500,000 of operating credit on a continuous basis. Obviously, financing a business of this size might require going outside the local area for funds. Moreover, it might necessitate a complete reorganization of the farm business, typically a sole proprietorship, into a corporate or partnership form more amendable to sophisticated financing techniques.

Climate

Climate conditions in the central Corn Belt are a natural obstacle to large-scale feedlot operations. Moisture conditions—conducive to high corn and soybean yields—require large overhead investments in paved feeding floors for large concentrations of livestock. Harsh midwestern winters require greater outlays for shelter. Environmental pollution problems may inhibit development of large-scale feedlots to a greater extent in the more densely populated Corn Belt states than in the more sparsely populated West. Livestock operations and their attendant waste disposal and odor problems, however, have come under public attack in both regions.

The future

The cattle-feeding economy has undergone substantial change in recent years. Whether the current westward shift in cattle feeding will continue in the future is uncertain. The economies of scale available to large, western-type feedlots, however, seem likely to remain a pervasive force. Changes in relative prices of grains and livestock, limited water and feed supplies in some areas of the West, and changes in government programs as well as many other factors could alter current trends. One thing seems certain though; the demand for fed beef will expand rapidly in the years ahead as a growing U. S. population becomes still more affluent. Corn Belt farmers that do not adopt the cost savings available through economies of scale, or develop other means to better utilize their resources and reduce costs, will continue to get a smaller share of the beef market.

BUSINESS CONDITIONS is published monthly by the Federal Reserve Bank of Chicago. George W. Cloos was primarily responsible for the article "The trend of business—employment gains widespread" and Dennis B. Sharpe for "District farmers and the expanding cattle-feeding industry.

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