FINANCING TOMORROW'S CAPITAL

Outline of Remarks Made

by

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to

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I. Does this country face a shortage of capital over next decade?

A. Two years ago, universal answer seemed to be "yes."

1. On <u>demand side</u>, saw tremendous demands for investment.

a. New energy resources (N.D.)

b. Electrical generating facilities

c. Pollution control - agri.: Reserve Mining

d. Public transportation

e. Rebuilding of cities

f. Raw material producing industries - "bottlenecks"

2. On <u>supply side</u>, pointed to "low" rate of savings in U.S. compared to many industrial countries, especially Germany and Japan.

a. Consumption oriented society

3. <u>Bleak outlook</u> spawned some "radical" <u>suggestions</u>.

a. New emphasis on national <u>planning</u> - setting of priorities and guidance by government of private investment. Government ownership of model firms.

b. <u>Credit allocation</u> - efforts to have Fed. induce or penalize bank credit for specified end users.

c. <u>Tax reform</u> (e.g., enhanced investment tax credit, accelerated depreciation, pro-rated capital gains tax, ending double tax of dividends, even inheritance tax deductions).

B. Today, much of the furor has subsided.

1. Magnitude of problem exaggerated by panic over energy crisis. For time being, we've weathered that.

2. Scaled down expectations: N. Y. City; housing.

3. Problem also greatly magnified by double-digit inflation - people - businesses.

   a. Nominal profits greatly overstated because of inventory gains.

   b. Depreciation schedules didn't reflect replacement costs.

   c. Capital base of industry and banking system eroded.

4. The threatened "crowding out" of private borrowers by needs to finance government deficits failed to materialize.

   a. Savings increased

   b. Private borrowed less - also govts.

C. A more sober assessment of the capital shortage issue today puts it in more manageable perspective: may need to increase savings rate in the U.S. economy by 1/2 to 1 percentage point over next decade.

   Not insignificant, but not terrifying.

1. Whether we can achieve depends in substantial measure on budget performance of federal govt.

   a. Optimistic: budget committees; gen'l public; candidates

II. What's the outlook for long-term int. rates over next year or so, and what role will Fed'l Reserve play in the outcome?

A. Obviously, depends very much on speed of recovery and ability to hold down inflation.

   1. Personally, optimistic on both counts.

B. Optimism based in part on better performance by Fed itself: contrast between '72 and '76.

   1. Reflects our own learning process, but also a different, more conservative, temperament in country.

C. Conclusion - long rates not likely to rise much over next year; could decline modestly.

   1. Partly reflection of extent to which economy - businesses, banks, consumers - have become more liquid over last 18-24 months.

III. What about trends in ag. credit?

#1 - no expert.

#2 - am concerned about some of the trends.

A. Increase in agri land values over last four years disturbing.
   Basic question: are crop prices likely to sustain the net income stream necessary to amortize the debt incurred to finance or refinance land acquisition purchased at today's prices.

   1. No prophet, but history does not offer much reassurance that booms of the kind we've recently experienced in agri land prices can be sustained.

B. Tied directly to the boom in land values has been the rapid rise in loans by land banks.

1. Loans outstanding for system rising at compound rate of 15-23% over last four years.

   End - 75 value double that of end - 71.

   a. One of surest signs of trouble in commercial banking is very rapid increase in balance sheet totals.

2. Also significant that land banks are carrying more of the risk today - in several ways:

   a. % of total credit extended to finance agri-real estate: land banks 12% in 1970; 33% in '75.

   b. owner equity has been dropping as debt/purchase price ratio rising somewhat. (75% in '75)

      1.) Presumably reflects in part the liberalization of law in 71 to allow loans up to 85% of current market value.

   c. Program to extend loans to young farmers consciously means lower equity positions.

   d. Ratio of net worth to loans outstanding 16% ('65) → 12% ('75).

C. Question: to what extent is agri financing repeating a few years later the excesses that plagued the commercial banks - and the rest of the econ. - a couple of years ago. i.e., agressive lending, over-leveraging, banking on inflation bailout.

   1. Capital for agriculture.

      Real problem - how accumulate equity; not how obtain more credit.