

THE IMPACT OF MONETARY ACTIONS ON AGRICULTURE

Speech by
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It is good to have this opportunity to discuss with participants in the "Twelfth Agricultural Industries Forum" some implications of Central Bank actions for agriculture. One of the unique features of our central banking system, namely, twelve separate Federal Reserve Banks, was largely determined by the agricultural spokesmen of the nation. All other nations have one central bank, which is generally located in the capital city. Farmers in the United States, however, had long been skeptical of the gold standard, which appeared to them to be biased toward over restrictiveness and against the economic interests of the smaller cities and towns and rural communities. Farm and rural groups accordingly insisted upon separate regional banks, in contrast to one central bank, when discussions relative to the Federal Reserve Act were in progress prior to 1914.

In order to further insure the protection of agricultural interests, the Act designated the Secretary of Agriculture as one of three members of the Organization Committee which laid out the Federal Reserve Districts and decided on the location of the Reserve Banks. The Act also required that the President, in selecting members of the Board of Governors, give "due regard to a fair representation of financial, agricultural, industrial and commercial interests," ^{1/} and that three directors of each Reserve Bank "shall be actively engaged in their district in commerce, agriculture, or some other industrial pursuit." ^{2/}

The functions of the Federal Reserve System were also tailored to meet agricultural demands. Farmers throughout the late 1800's and early 1900's espoused greater flexibility in the banking system, currency, and in the stock of money. The Federal Reserve System introduced flexibility into currency and the stock of money, permitting the issuance and withdrawal of currency and creation of money according to the demands of agriculture and business. This design for flexible money and currency creation was in contrast to the provision for money in the superceded

^{1/} Federal Reserve Act. p. 28.

^{2/} Federal Reserve Act. p. 10

National Banking Act. This Act provided for an automatic ceiling to money creation and at times, especially during crop marketing seasons, totally failed to meet demands for currency.

The Federal Reserve Act was especially favorable to agriculture in its provisions for Federal Reserve lending to member banks. Farm credit with maturities up to six months was eligible for discount by Reserve Banks. In contrast, the discounting of credit for other purposes was limited to ninety-day maturities.

Early Hopes for Reserve Banks Unrealistic

After a decade of favorable experience, many people in the 1920's believed that the nation's money and credit problems had been solved. We had a system of issuing money against the security of sound, self-liquidating commercial paper. Money created in this manner was thought to always meet the demands for a medium of exchange when production and trade were expanding, when crops were moving, and when demand for goods and services was strong. The farm sector was well provided for in the Act. It need not further depend on the so-called "money trust" for credit and currency demands or be crowded out by lending for so-called speculative purposes. Each region had its own semi-autonomous Federal Reserve

Bank with power to create money and credit as the region's demands warranted.

Despite this generally favorable view, in the 1920's some leaders in the Federal Reserve System, including the president of the New York Bank, began to question a monetary policy based on passive accommodation of commercial and agricultural credit.^{3/} It was not until the Great Depression of the 1930's, however, that the weakness of the automatic accommodation system became apparent to most students of money and banking. The monetary system based on a flexibility doctrine was unable to cope with a major business fluctuation. One could take the historians' point of view that this great catastrophe was the inevitable result of a prolonged buildup of causal factors and little could be done to alter its course once a sequence of events was set in motion. However, I do not believe that most major catastrophies are caused in this manner. It seems to me that many wars are caused by foolish acts of heads of state, and that many domestic problems are the result of inappropriate action by public officials.

Over the past six months many have said that an

3/ Lester V. Chandler, Benjamin Strong, Central Banker (Washington: Brookings, 1958), p. 200.

essentially unchanged quantity of money was quite restrictive. It has been sufficiently restrictive to brake the excessive rate of economic expansion that had been with us for a number of years. If we were so foolish as to permit the money supply to decline again by one-third as in the 1929-33 period, I suggest that the results would probably be quite similar.

Farm Problem Caused by Instability in Nonfarm Sector

From late 1929 to mid-1931 total Federal Reserve credit declined more than 40 per cent, and by July 1933 the stock of money had declined about 30 per cent. Gross National Product declined about 50 per cent and unemployment rose to 25 per cent of the labor force. You will also recall that gross farm incomes dropped about 50 per cent and net farm incomes dropped more than 60 per cent.

During that period of disastrous contraction in both national and farm income, the number of farm workers, which had begun to decline in the 1920's, held steady. With major unemployment prevailing in the nonfarm sector, no nonfarm opportunities for employment were available for farm workers. This excess of farm workers, coupled with a major decline in demand for farm products, resulted in the very sharp decline in net farm income, income per farm,

and income per farm worker.

By the mid-1930's two forces had begun to have an impact on the farm sector. First, the stock of money turned sharply upward, rising at an annual rate of 11 per cent from 1934 to 1940. The general economy began to pull out of its depressed condition and demand for labor in industry consequently rose. The number of farm workers resumed a downtrend with the attraction of higher earning opportunities in the nonfarm sector. From 1934 to 1940 the number of farm workers dropped from 10.1 million to 9.5 million.^{4/} The second force operating in the farm sector was the direct action of the Federal Government in providing for production controls and price supports for major farm commodities. These actions tend to raise farm incomes in the short-run, but provide incentive for an excessive number of workers operating inefficiently small farms to remain in agriculture.

During the World War II years from 1940 to 1945 farm incomes in the nation rose at the very high rate of 22 per cent per year. Nevertheless, the exodus of workers from agriculture continued at a rate of 2 per cent per year impelled by the great demand for workers in the private

4/ U. S. Department of Labor.

nonfarm sector and the military services. The decline in farm workers continued in the early postwar years of 1945-50 and 1950-55 despite the returning World War II and Korean War veterans to farm life. Nevertheless, the relatively high farm incomes prevailed as a result of large shipments of farm products to the war-torn nations, especially during the 1945-50 period.

After 1955 the reduction of the farm labor force accelerated. From 1955 to 1965 the nation's monetary policies were conducive to maintaining a relatively stable growth rate in the economy with relatively few excesses on either the restrictive or expansive side. From 1965 until 1969 overly expansive policies prevailed. During these periods growth in the nonfarm sector was sufficient to absorb enough labor from the farm sector to permit generally rising farm incomes. The farm work force declined about 4 per cent per year from 1955 to 1969. Thus, despite continued rapid technological developments in agriculture, which contributed to a growing volume of food production, the exit of labor from farms was sufficient to permit the remaining farm population to increase their disposable personal incomes. Such income per capita rose 8.8 per cent per year from 1960 to 1968, or more than 50 per

cent faster than the rate of gain in the nonfarm sector. ^{5/}

Rising Farm Incomes Result Primarily
from Derived Demand

It is my belief that the moving force in the rising per capita income in agriculture, given the growth of farm technology, has been the ability and willingness of farm workers to move to new occupations where demand for labor and other resources are greater than in the farm sector. The demand for farm products in the United States since the end of World War II has been relatively inelastic with respect to national income, i. e., national income declines during this period have not had a significant impact on demand for food. Furthermore, at our national level of food consumption, consumers spend a smaller proportion of their income gains on farm products. They apparently do spend more in eating out and on further processing and servicing of farm products as their incomes rise, but the farmer apparently gets little benefit from such increased expenditures. The overall demand for farm products in high income nations such as ours thus rises primarily as a result of nonfarm population gains, rather than through major gains in per capita food consumption. Since population in the United

5/ U. S. Department of Agriculture, Farm Income Situation, July 1969.

States grows only about one per cent per year, this source alone does not provide a sufficient increase in demand for farm products to offset technological advances in production.

Stable Growth Rate in Nonfarm Sector
Best for Agriculture

If my belief that demand for farm products is relatively inelastic to changes in national income is true, one might ask the question - why should the farm sector be interested in general economic stabilization policies and particularly monetary policy, when such policies are not likely to have an early impact on total farm income? The important factor to individual farmers is not the total returns to agriculture, but rather the returns per farm and per farm worker. Unless we have a growing economy, the lower income groups in agriculture cannot obtain jobs in the nonfarm sector, and their output from farms will continue to have a depressing effect on total farm income and income per farm. On the other hand, if a stable growth rate at relatively full employment is achieved in the nonfarm sector, marginal farmers and farm workers will be bid away from the farm sector and the remaining farmers as well as those who move will benefit. Although farm output will tend to be less, total farm income will be higher, and fewer

farmers will share in the larger total. Higher incomes per farm and per farm worker consequently will follow. It is thus highly important that farmers make the transition from the farm to the nonfarm sector of the economy as easily as possible.

Inflations no Windfall

The fact that a growing economy and relatively full employment is highly beneficial to the farm sector does not mean that agriculture benefits from inflationary policies. Evidence indicates that the first substantial impact on farmers from excess total dollar demand created by overly expansive monetary policies is on farm production costs. Monetary actions have a lagged effect on farm production costs over a period of 4 years or more. In contrast to this impact of monetary actions on agriculture, Government expenditures apparently have no significant impact on either farm income or farm expense.

Prices that farmers pay for labor, other farm input items, and living costs tend to rise ahead of prices received for farm products. In other words, during the early stages of a peacetime inflation, total farm expenses tend to rise faster than farm incomes. For example, from 1965 to 1968 total farm expenses rose at an annual rate of 5 1/2 per cent

whereas realized gross farm income rose only at the rate of 4 per cent. Realized net farm income declined slightly in the first three years of the inflation and only began to rise substantially in 1969. It is true that the movement of labor out of agriculture was hastened as a result of the great demand for workers by other sectors, but much of the early gains to the remaining farmers from this adjustment was offset by rapid price increases for family living and farm production items.

I recognize that an individual farmer who purchases a farm and acquires a mortgage at low interest rates just prior to an inflation, like any other similar debtor, is the recipient of a windfall. On the other hand, if he purchases at high interest rates just before stabilization is achieved, the deal can be an excessive burden for a long period. Windfalls to some farmers as a result of poor monetary actions are thus likely to be offset by excessive burdens to other farmers.

Economic Stability Best Role for Monetary Policy

The maximum contribution that monetary actions can make to agriculture is to provide farmers with a stable demand for goods and services in general. If this is done and the gate is left open for farm labor to move freely into nonfarm occupations, agriculture can expect to benefit equally

with other sectors in generally higher incomes resulting from efficiency gains in all sectors.

Government Programs Not Conducive to
Necessary Resource Adjustments

I might add at this point that in my view most Government crop control and price support programs have a favorable impact on farm incomes only in the short-run. They tend to close the gate to resource adjustments by retaining an excess of workers on farms. In this manner they tend to slow the necessary adjustments that are beneficial to efficient farm producers.

In the long-run these programs which tend to maintain prices at higher levels than are warranted by supply and demand conditions are self-defeating. As indicated above, they tend to keep an excess of producers on farms to share in total farm incomes. Income per farmer or per farm worker is not likely to benefit from the larger total income achieved in this manner. I am convinced that the farm sector would have been just as well off today if we had not had a price support or production control program following the Second World War. These programs have denied both farmer and nonfarmer the gains from the larger nonfarm work force that would have resulted from the movement of the excess of workers from agriculture.

I do not deny that the Government can play an important role in improving welfare in agriculture. I believe, however, that the role played should be in the direction of a long-run solution to the problem, rather than stop-gap measures which impede the real solution until a hopefully more pleasant day arrives. Long-run programs should aid in the ultimate welfare of agriculture and ease the hardships of occupational shifts rather than retard the move from agriculture to other occupations. They would involve intensive vocational training projects to broaden job opportunities for farm youth. To the extent that direct payments are deemed necessary, they could be used to transfer farm workers to locations where nonfarm job opportunities are available and perhaps guarantee a minimum level of income to such workers for a limited time period.

Such a program as this could work hand in hand with appropriate monetary policy for the welfare of agriculture. I am reasonably sure that with appropriate monetary actions we can avoid major swings in the economy. I also believe that we can maintain a reasonably stable growth rate in the economy and that the nonfarm sector can hereafter absorb a sufficient number of farm workers to assure profitable farming opportunities for most producers. That is not so large a job as it once was, since the number of farm workers

is only two-thirds the number in 1960 and only about one-third of the pre-World War II total. Nevertheless we still have some relatively inefficient farm producers, who must eventually move to nonfarm occupations. This group will reap special benefits from stable economic growth which will follow from appropriate monetary actions.

Conclusion

In conclusion, the Federal Reserve System has not proved to be the panacea for agriculture envisioned by some of its early proponents. It cannot assure farmers unlimited quantities of credit under all conditions and at the same time meet its greater responsibilities relative to economic stabilization. Furthermore, I believe that central bank actions directed toward stabilization objectives is the most beneficial course that monetary authorities can take in the interest of agriculture over the longer run. Overly restrictive monetary actions tend to close the exit for farm workers to the nonfarm sector. A major contraction of money and economic activity could reduce total demand for farm products which would further restrict income per farmer.

On the other hand, overly expansive monetary policies tend to raise farm costs faster than farm receipts in the early stages of inflations, delaying agriculture's participation in the nominal monetary gains.

Most government programs tend to blunt farm adjustments, even under ideal monetary conditions. In addition to their undesirable economic effects, these programs impinge on individual freedom. I fully concur with President Nixon's comment in the economic report to Congress last week. He said "Personal freedom will be increased when there is more economy in Government and less Government in the economy." I would like to see Government programs in agriculture tailored toward solving farm problems, rather than retarding their solution.

The number of farm workers has now declined to 4 per cent of the nation's labor force, and the absorption into the nonfarm sector of excesses created by gains in farm technology is less of a job than formerly. Nevertheless, with monetary actions directed toward stabilization objectives, we can assure employment in the nonfarm sector for those not meeting the tough standards for survival in agriculture. In this manner our central banking system can play an important role in maintaining profitable opportunities for efficient producers in both the farm and the nonfarm sectors.