

THE FARMER AND MONETARY POLICY

Address by
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While this day is Livestock Day and thus devoted to agriculture, I am going to talk to you primarily about money and banking. I certainly cannot tell you people much about farming or about livestock that you do not already know. I am supposed to know something about money and banking and perhaps can make some contribution to your knowledge in that field. I should point out, however, that I am aware of the importance of farming activity in Missouri. I was raised in a farm community in southeast Missouri and have spent practically all of my adult life in Kansas City. One can hardly grow up in southeastern Missouri and live in Kansas City for a long period of time without becoming aware of the great importance of agriculture, and particularly of livestock, to the economy of Missouri.

I am going to spend my time today telling you about some of the things I think it might be well for you as farmers to know about money and banking. But before doing that, let me emphasize the real point I wish to make. It is important for both bankers and farmers to know as much about each other's operations and problems as they can. The typical Missouri banker has to know something about agriculture and about livestock if he is to do a good job of banking. Since most Missouri bankers do a good job they obviously do know something about general farming and about livestock operations. Most Missouri banks depend at least to some extent upon agriculture for their business. When a banker is dealing with agricultural customers he necessarily has to learn something about the activities in which they engage.

Even the big city bankers - those in Kansas City and St. Louis - are concerned more or less directly with the livestock trade.

No country banker can serve his community as well as he should serve it unless he or someone in his bank has a thorough knowledge of the livestock industry. Missouri raises a lot of cotton and a considerable amount of wheat and corn. But of the more than one billion dollar cash farm income received in Missouri in 1950, about three-fourths (\$730 million) came directly from livestock and livestock products. To keep abreast of agricultural developments in Missouri, bankers have to be familiar with several different kinds of livestock production. One-fourth of total farm income in Missouri (\$266 million) came from the sale of cattle and calves. Just a little less than this came from the sale of hogs. About one-eighth came from dairy products, and another eighth from poultry and eggs.

Maintaining or increasing livestock numbers is important to the economy of Missouri and it is important to the economy of the nation. This state ranked fifth among all states in cash receipts from meat animals in 1950 and seventh in receipts from all livestock and livestock products. It ranked tenth in income from dairy products and income from poultry.

It is perfectly evident then that the banker, and particularly the country banker, should have some knowledge of agriculture and of the livestock end of agriculture. Now let me face about and try to tell you why I believe farmers should know something about money and banking.

There are really three major reasons why a farmer should know something about the money and banking system of this country. As a citizen in an economy of the type we have here the farmer should have some broad understanding of the functions of money and finance. As a producer of goods and services for sale the farmer needs specific understanding of the role of money and credit in the economy. And finally, as a user of credit the farmer should find it advantageous to understand something about the general characteristics of the financing institutions with which he may deal, and the rules under which they operate.

Let me for a moment get down to a few fundamentals. Most of these things you probably know, but I would like to state them for the record. In this nation we operate what is called a money economy. The great virtue of such an economy is that individuals in it can pursue activities of various kinds and can exchange the goods and services they produce for a common unit of exchange - for money. Thus, they can spend their time in the activities they like best and do best. They can specialize and economize their efforts so as to produce with greater efficiency. And when they produce with greater efficiency they can raise the total level of output available.

Money is the labor saving device which promotes efficiency. It also promotes individual freedom of choice, which is a keystone of our political system. The producer of a particular commodity or a particular service can sell that commodity or service and receive for it common units of money. He can then use those funds for whatever purpose he wishes subject, of course, to certain laws.

The very fact that there is freedom of choice in what the individual spends his money for aids in promoting efficiency and in raising living standards. For when there is this free choice, producers work to turn out more attractive and more desirable goods.

We have a financial system in this country mainly because we have a money type economy. That financial system consists of a number of different kinds of financial institutions. All of them, however, have two basic functions in common. On the one hand they accumulate funds and on the other hand they make those funds available through credit extension. When they accumulate funds, financial institutions draw on two major sources: capital funds from the owners of the enterprise and funds from deposits of one kind or another or from other lenders. In the lending process financial institutions extend credit and thus enable those who are borrowing to buy goods and services which generally the borrowers could not control at that particular time by using their own funds. The flow of credit into the economy permits the smooth meshing of requirements for payments and receipt of future income and thus tends to smooth the production-distribution process and promotes increased output.

Now, basically, there is no great difference in the accumulation and lending functions as exercised by any of the various kinds of financial institutions. All of them gather funds and all of them make credit available. But among financial institutions the commercial banking system is unique in that it can create new funds through its lending operations.

It is right at this point that the story gets pretty complicated. I have said that the commercial banking system can create new funds. It is able to do this because it can create check book money which is the kind of money most people use in this country. About 90 per cent of all transactions are paid for by check in this country and only about 10 per cent are paid for in currency and coin.

When a bank extends credit - when it makes a loan or invests in a security - it creates a deposit equal to the amount of credit extended. When you borrow to buy some cattle or some feed, the banker takes your note (which is his asset) and usually gives you a deposit credit (which is his liability). You, of course, can draw out that deposit if you wish. Most people write checks against the deposit. Those checks are paid to other people who deposit them in the same bank or in other banks. Thus, the deposits built up from your loan continue in being - unless they are drawn out in currency and kept out of banks, or unless you pay off your loan. Now I know that you have to pay off your loan, but other people are borrowing as you pay off and the same kind of process goes on as a result of their borrowing.

Just one more point needs to be made on this subject. The banks as a group not only can create new funds, they can create about six times as much in new funds as they have in free reserves. In the United States most banks are required legally to keep only a fraction of their deposits as reserves. That fraction averages about one-sixth for all banks in the nation. When one of you borrows \$600 your banker gets a \$600 note and creates a \$600 deposit liability.

He has to hold about \$100 in reserves for this new deposit (and he has to have this before he can lend you anything). But as you draw out the funds and pay them to others who deposit them in other banks they become new deposits. Say you pay out \$500 and all of it goes to one other bank. That bank has to keep only \$90 of this sum as a reserve; it can lend out the other \$410. As that process goes on and on you find that the end result may be a total credit and deposit expansion of six times the original reserve.

I want to stress that point because it leads to this next point. When financial institutions extend credit they are fulfilling a primary economic function which promotes development. The extension of credit is one of the two major reasons for the existence of a financial institution. But the responsibility of the financial institution is not merely to extend credit; it is to extend credit to the best and most efficient borrowers. The responsibility is to select the worthy borrowers. And I want to emphasize that I am not talking merely about credit worthiness in the sense of the borrower being able to repay the loan. I am talking about credit worth in the broad economic sense - the sense that the credit demand has economic merit, that it is essential.

Now note this point. All financial institutions, except banks, can lend only the funds they can accumulate in the form of capital or primary deposits. These lenders are definitely limited in the funds they have. Thus, they tend to be forced to exercise carefully their responsibility for extending credit to the most efficient users of credit.

The banks (as a system), however, are not limited to funds they gather. They can create new funds. So as long as the loan is safe the banker is not so pressed to choose between essential and non-essential credits. He may well be able to meet demand for both kinds of credits.

Thus, we have in this country decided that some sort of check is needed on the total volume of credit which the banking system can extend. In the United States such a check exists in the Federal Reserve System. I do not propose today to go into the technical manner in which the Federal Reserve System operates to attempt to regulate the supply, the cost, and availability of credit. I merely want to point out that the Federal Reserve System is charged in large part with taking over the extra responsibility of the commercial banks which arises from the power of the commercial banks to create new money.

It seems to me that broad understanding of this general picture is important to the farmer in all of his capacities. It is important to him as a citizen, and as a producer, and as a borrower. With this understanding should come clear recognition of the economic functions of the financial system, the responsibilities of financial institutions for selection of credit risks, and the role of the Federal Reserve System in keeping the supply of money roughly in balance with the supply of goods.

In a period such as the present that understanding is of particular importance. The supply of money presently is out of balance with the available supply of goods and services. We have all of the

potential factors which make for further inflation even though at the moment there seems to be some lull in actual inflationary forces. But as long as the underlying forces seem more likely in the future to promote inflation rather than deflation, the responsibility of the monetary authorities and the financial institutions is to attempt to restrain growth in the money supply, to restrain credit, and to channel credit which is extended into the most essential purposes. If the farmers of Missouri and of the nation as a whole recognize and understand the reasons for such action it makes that job easier with respect to agricultural financing.

I want to make perfectly clear that I am not saying at all that too much credit has been extended to farmers. I am not saying that farmers should receive less credit than they have. Agriculture, as I pointed out earlier, is extremely important to the economy of this state, and it is also tremendously important to the economy of the nation. We would wish to do nothing which would hamper full-scale agricultural production.

The point that I am trying to make is that when credit is granted to farmers it should flow to the most essential uses, particularly to farm resource development and to greater and more efficient production. Credit for less desirable purposes, for example, for speculation in land or in commodities, should be curtailed to make room for further expansion of credit for production and development. The problem which financial institutions face at

present is to use their available credit most wisely, to grant credit for essential purposes and to the most efficient users, and to withhold credit from nonessential purposes and nonefficient users. Recognition of this fact on the part of farmers generally would make the job of the financial institutions easier.

Both of these reasons I have cited might be classed as a combination of broad citizenship and selfish-interest reasons for the farmer to understand something about money and credit. Understanding as a citizen and as a producer leads to support of sound monetary policy, to a more stable economy, and to general benefits to the farmer as a citizen and as a seller of goods and services.

The third reason why it should be useful for the farmer to understand fully the role of money and credit and to know something about the characteristics of financial institutions and the rules under which they operate is that as a borrower such understanding should permit the farmer to approach the lender most intelligently. Knowledge of the characteristics of the various kinds of financing institutions and the rules under which they operate should enable him to shape his credit applications more carefully and should enable the lender to consider them more easily.

Let me illustrate this by a single example. The commercial bank receives its funds mainly from depositors. Most of its deposits can be withdrawn on demand. The commercial banker thus has to be concerned with his ability to meet these withdrawals. He has to be concerned with the safety of the deposits he keeps and with the liquidity of the assets in which he invests the deposits.

Consequently, the commercial bank has a tradition of lending funds for relatively short periods of time and for purposes which will provide for liquidation of the debts. While banking has departed somewhat from this pure tradition, essentially bank credit has been and is concentrated in relatively short-term self-liquidating form.

Banks also are subject to considerable supervision and regulation. They are regarded as semi-public institutions because they hold funds on deposit. Their operations are held within certain carefully formulated legal rules which cannot be violated.

Understanding of the rules of the game under which the banker has to operate either because of law or because of the kind of institution a bank is should be helpful to the farmer as a borrower. Recognition of the fact that the banker may not be in position to meet every kind of demand upon him for credit at any given time would make the joint dealings of the banker and farmer easier to handle. A banker may be prevented from extending a perfectly sound credit in the broad economic sense simply because he is legally prohibited from so doing in view of his position at that particular time.

A farmer also should find it useful to know that a bank can judge more easily the worthiness of a particular credit request if it is documented with accurate records and accompanied by a reasonable statement as to purpose and by a plan for liquidation. Now I don't mean to imply that the borrower has to work out all the details of the credit by himself. Rather what I am saying is that he should recognize that such details do have to be worked out and he should be in position to supply the needed information.

This example is drawn from the field of commercial banking. It could be duplicated by considering the various other types of financial institutions. The point is that if the farmer has some working knowledge of the kind of rules under which a particular type of financial institution has to operate it enables him to slant his credit demand toward the kind of institution that can most appropriately serve him in a particular instance.

I expect what I have been telling you has been pretty heavy going. I feel strongly, however, that it would be most helpful for farmers to have a better understanding of the nature of money and credit and of the kinds of institutions that deal with money and credit. At the risk of being repetitious, I again assert two fundamental principles: first, that the banker has to be well informed about agriculture if he is to do a good job in serving his agricultural customers; second, and of equal force, that the farmer is in better position to deal with his banker if the farmer knows something about banking. Better knowledge of each other's problems makes for better teamwork in solving those problems. I believe that all of you recognize the fact that as understanding grows, so does ability to do a better job.

I told you at the beginning of this talk that I was not going to discuss farming as such because I could not tell you much if anything you do not know about agriculture. However, I do want to say one thing that I suspect will be no news to you. All of you know that Missouri agriculture could be made to yield much higher production and much higher income if every farmer in the state put into practice

the good farming techniques already known to him. What you see and observe here on Livestock Day represents good livestock farming practices and the results of such practices. But while such techniques are known, and widely known, a lot of farmers do not employ them as fully as they might. The same story is true of farming in general.

Part, but only part, of the reason for not carrying out fully the best farming practices known is that instituting the base for many such practices requires more money. Quite often a farmer is perfectly aware that he would be a better producer and have more income if he changed his present land use pattern. Or he knows that additional machinery would increase his productivity substantially. These things cost money, however, and in many cases require credit.

Where sound farm plans are worked out by the farmer and the agricultural agent, needed credit usually is forthcoming. At the St. Louis Federal Reserve Bank our agricultural people have case record after case record which shows that with a proper investment in better land use plans, the capital required to raise farm productivity, when soundly planned, can and will yield many more dollars in income than the amount of investment. Cases such as these can be financed by credit - if the farmer has a good plan and the financing agent can be informed about the plan.

Many Missouri banks have added to their staffs agricultural specialists who can work with farmers and farm agents in developing such plans and in working out any needed financing for them. These bank agricultural specialists know farming problems at first hand,

and they know banking problems at first hand. They are doing an excellent job in every case I know about and are contributing to increased banker-farmer cooperation.

Now I have told you why I believe farmers should know more about money and banking. How are you going to learn more about it? Well one very good way is to talk to your local banker. He will be glad to explain as best he can the workings of the banking system and the rules under which he operates. Many Missouri bankers spend a considerable amount of time and effort to do just that for their customers. And the agricultural representatives of the banks can be most helpful to you in this respect.

You can help the banker help you learn more about money and credit if you are receptive to his attempts to explain. The banker may be most willing to tell about his business practices and rules but he has to have his customers willing to listen to him on this subject. If you are willing, and particularly if you definitely seek out the information, he can do a good job of explaining.

In conclusion, let me reiterate my central theme: It is important for both banker and farmer to understand each other's operations and problems. The more mutual understanding there is, the better job both can do.

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