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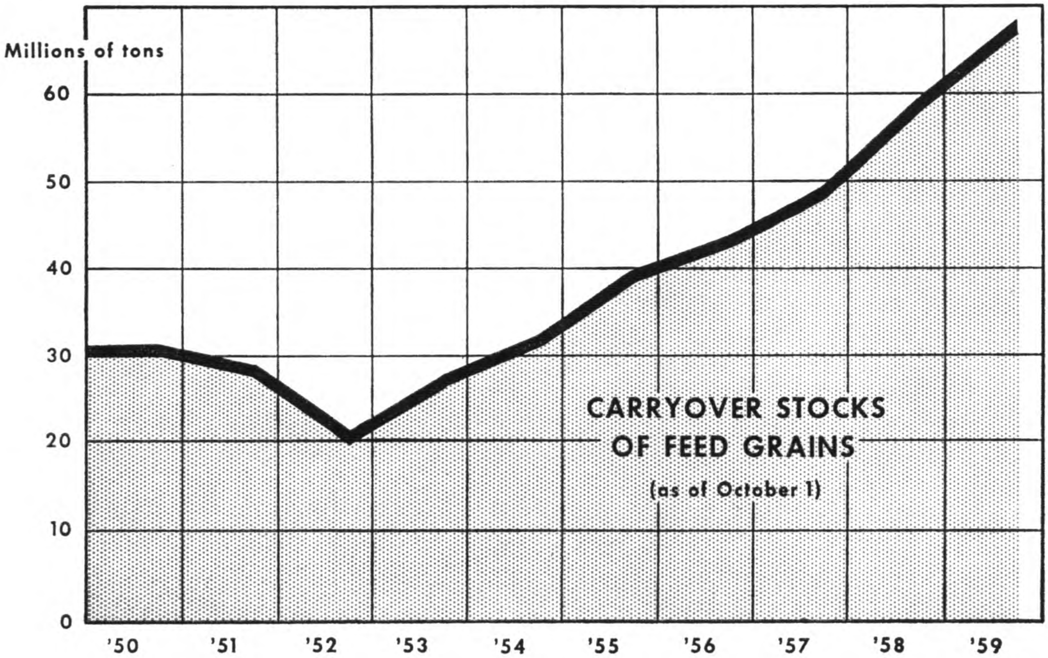
FEDERAL RESERVE BANK of CLEVELAND

March, 1960

IN THIS ISSUE

The rapid expansion of feed grain carryover has added materially to the surplus problems of agriculture and has been an important factor behind the government's rising investment in price supports.



Source of data: U.S. Department of Agriculture

Background of Bulging Farm Surplus

THE MOUNTING SURPLUS of farm commodities being accumulated under the existing price-support program has been recognized as an outstanding national problem.

During recent years the problem has become more acute, despite the fact that surplus commodities have been sold into the domestic market when it was possible to do so without depressing farm prices, despite the fact that farm commodities have been sold overseas for dollars whenever possible and for foreign currencies when dollars were not available, and despite the fact that farm commodities have been bartered for strategic materials or have been donated to foreign countries whenever such steps could be taken constructively. For each bushel equivalent sold or otherwise disposed of, more than one bushel has replaced it in the stockpile.(1) The result is that government investment in price-support programs at the turn of the year totaled $9.2 billion.

The current abundance of farm products cannot be attributed to a low level of consumer purchasing power, for consumer incomes in postwar years have advanced at an average annual rate of about 6 percent and part of that increase has been spent for food, as evidenced by the substantial increase in both the per-capita consumption of food and the total food bill.

Nor can the current abundance be attributed to declining exports, for both the total dollar volume and the total quantity of agricultural products shipped to foreign countries are now running at a pace equal to, or slightly greater than, that of ten years ago. Thus, the value of agricultural products exported during the past five years has averaged about $3.8 billion per year compared with an average value of $3.3 billion between 1945 and 1955, while in terms of physical quantities exports have been larger in the past five years than in any previous five-year period in history.

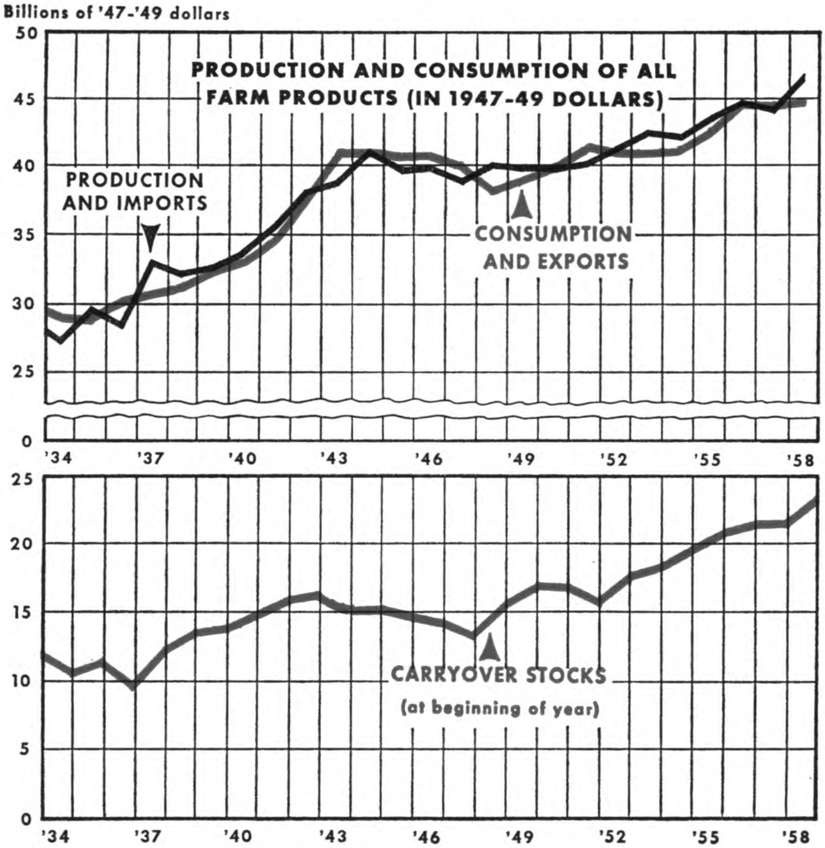
(1) Secretary of Agriculture Benson, in testifying before the Senate Committee on Agriculture and Forestry on January 12, 1956, estimated that for each bushel equivalent sold between fiscal 1953 and fiscal 1955, about one and a half bushels replaced it in the stockpile.

Chief Cause of Overabundance

What then is the major factor behind the growing abundance of agricultural products? The chief reason is the very great expansion in production in recent years relative to the increases in available market outlets. Total consumption has just not kept pace with increases in production, as shown in an accompanying chart.

In any given year, the total consumption of agricultural products of the United States is the combined total of domestic consumption plus exports to foreign countries, as shown by the colored line of the chart. Similarly, the supply of agricultural products available during a given period is the aggregate of production plus imports from foreign countries, as shown by the black line. Any discrepancy between the level of consumption and the level of new supply causes a change in the level of stocks of agricultural commodities carried over from one year to the next. If consumption and exports are less than production plus imports, there is a surplus and stocks are increased. If consumption and exports exceed production plus imports, stocks are reduced.

It will be noted that the chart deals with aggregate dollar values of agricultural products in 1947-1949 farm prices. The reason for



The production of agricultural products plus imports has exceeded our domestic consumption plus our exports in sixteen of the past twenty-five years. (Measurement is in constant dollars to approximate physical quantities.)

The result of production exceeding consumption has been an accumulation of stocks on farms, in the hands of processors, and in government warehouses.

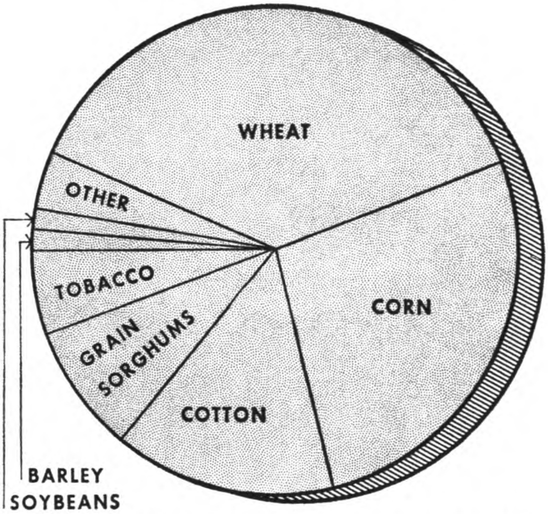
Source of data: *Measuring the Supply and Utilization of Farm Commodities*, Agriculture Handbook No. 91, U. S. Department of Agriculture, 1959.

such a device is that an approximation of total physical quantities is desired, in the face of the divergent units of the different commodities, such as tons, bushels, gallons, boxes, etc. The use of 1947-1949 unit prices for each commodity, applied as a multiplier to the physical quantities of each of the commodities for each of the years in question, yields an approximate measure of the over-all physical level.

To have a surplus supply of agricultural commodities is not a new phenomenon in American agriculture. In fact, supply has exceeded consumption rather consistently. Surpluses have occurred seven times in the last ten years and sixteen times during the past quarter-century. In earlier periods of the country's economic and political history, the "surplus problem" was not entirely unknown.

The only span of years within the past quarter-century in which consumption exceeded supply regularly was during the war and postwar years of 1943 through 1947. Also, consumption was temporarily greater than supply in 1951, at the time of the Korean War, and again in 1957. It is significant to note, however, that a surplus in any one year has been relatively small when compared with total supply or total consump-

COMMODITY CREDIT CORPORATION'S INVESTMENT IN PRICE SUPPORTS (as of Dec. 31, 1959)



Four commodities—wheat, corn, cotton, and grain sorghums—account for 88 percent of the CCC's investment in price supports. Adding tobacco, barley, and soybeans raises the proportion to more than 96 percent of the total.

Source of data: "Status of CCC Price-Support Programs", U. S. Department of Agriculture, February 10, 1960.

tion and that the currently large stockpile of agricultural commodities, therefore, has been a long time in the making.

Few Commodities Are In Surplus

Although an aggregate measure of production and consumption provides a good indication of the over-all dimension of the surplus problem of agriculture, it obscures the fact that surpluses are far more prevalent for some commodities than for others. A study of the investment of the Commodity Credit Corporation in the price-support program gives a better indication(2) of the size of the surplus for specific commodities.

The value of commodities held in inventory by the CCC and the value of items under loan and purchase agreement totaled $9.2 billion on December 31, 1959. Of that $9.2-billion total, over $8 billion can be accounted for by four commodities—wheat, corn, cotton, and grain sorghums. Adding barley, soybeans, and tobacco to the list raises the $8-billion fiigure to $8.8 billion, or to nearly 96 percent of the total. The remaining 14 of the 21 commodities eligible to receive price support account for only $329 million, or about 4 percent of the total investment.

Feed Grains Push Up Investment

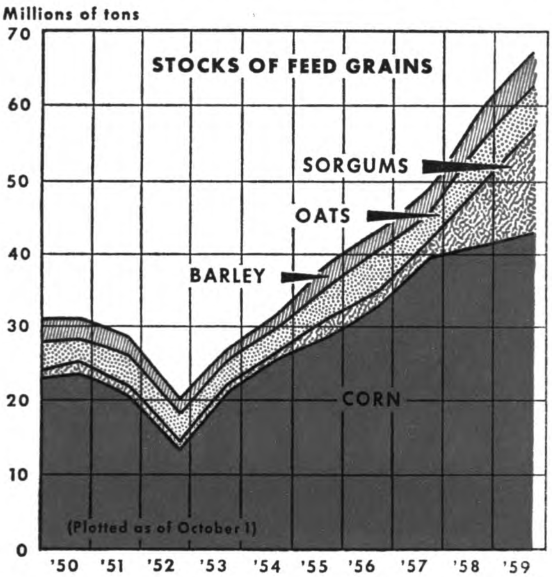
Increased production of feed grains resulting from higher yields, from incentives offered by price supports in general, and from acreage restrictions on such commodities as wheat and cotton, has been a major cause of the rapidity with which the CCC's investment has increased in recent years. Carryover stocks of the four feed grains — corn, grain sorghums, oats, and barley—are presented in an accompanying chart. As shown in the chart, total stocks of feed grains carried over from 1958 to 1959 totaled 67.4 million tons, or more than three times the 20 million tons carried over in 1952.

The rate at which feed grain stocks have accumulated over the seven-year span between 1952 and 1959 is nearly 7 million tons per year. But that figure does not truly represent the rate of increase during the past two or three years, for stocks are being accumulated at an accelerated rate. Between 1953 and 1957 the average rate of growth was about 5 million tons per year, while the rate of advance between 1957 and 1959 averaged more than 9 million tons per year, or nearly twice the growth rate of the earlier period.

Corn and grain sorghums are the chief contributors to the CCC's increasing investment in feed grains, as well as to the increase in the over-all investment of the CCC in the price-support program. In fact, if surplus stocks of corn and grain sorghums had re-

(2) The investment of the CCC in price-support programs may be considered as a rough monetary measure of the maladjustment between production and consumption. A more accurate (and larger) measure would include value added to agricultural incomes by acreage restrictions, by income payments under the Conservation Reserve Program, and by subsidies paid in an attempt to push total utilization above commercially profitable levels.

Carryover stocks of feed grains rose to 67.4 million tons on October 1, 1959, a volume that represents the production of 60 million acres of cropland.



Source of data: *Grain and Feed Statistics*, Statistical Bulletin No. 159, U. S. Department of Agriculture, 1959.

mained at 1952 levels, the investment of the CCC in the price-support program would be only around $6.5 billion compared with $9.2 billion at the turn of the year. Additions to surplus holdings of corn and grain sorghums have thus added about $2.7 billion to the CCC's investment since 1952, or about $1.3 billion more than was added to the total investment by wheat.

The carryover of corn is expected to be even larger in 1960 than the 43-million-ton carryover in 1959. Fifty-nine million tons of corn are expected to be carried over on October 1 this year. That is practically half of the record production in 1959 and about three times the carryover in 1953. The 59 million tons of corn expected to be carried over into the 1960-1961 feeding year would represent the production of 39 million acres of corn, using 1959 average yields per acre.

Grain sorghum carryover is expected to total around 15.4 million tons next October, a volume that is nearly equal to the 1959 output and nearly ten times the carryover in 1953. The 15.4 million tons of carryover grain sorghums that is anticipated would represent the output of 15 million acres of cropland used to grow grain sorghums in 1959.

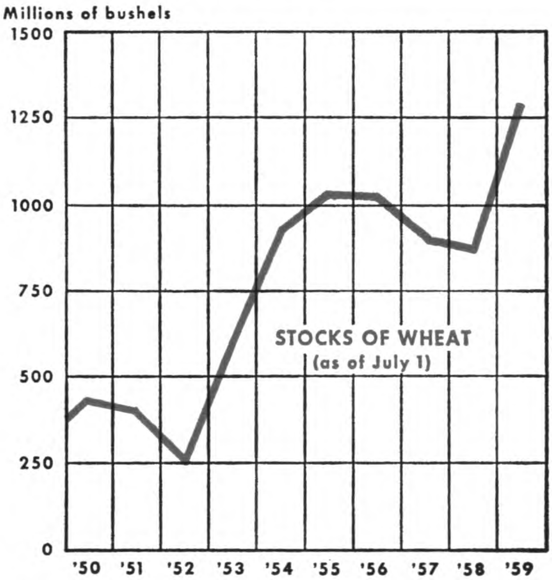
Livestock producers are expressing considerable concern over the build-up of feed grain stocks. Since livestock feed is the major outlet for feed grains, increasing stocks carry the constant threat of surplus livestock production. It can no longer be assumed that acreages producing surplus commodities such as wheat and cotton can be diverted to the production of feed crops without creating new problems equal to or greater than those which now exist. In fact, improvements in feeding methods are likely to reduce grain requirements per animal 3 percent to 4 percent by 1965.[3] A technical achievement such as this would reduce the amount of feed grains needed by 4½ million tons, and would result in a reduction of the land needed to produce feed grains by another 5 million acres.

Wheat—Another Contributor

The surplus of wheat held by the Commodity Credit Corporation is now receiving considerable public attention. In fact, considerably more attention has been given to the $1.4-billion increase in the CCC's investment in the price-support program for wheat that has occurred since 1953 than to the cumulative gain and the current rate of increase in investment in surplus feed grains, which has been of a larger order of magnitude. Since 1955, for example, the annual rate of increase in investment in feed grains has been $381 million per year, while the investment in wheat has been $121 million. Apparently the major reason for concern over wheat stems from the fact that rigid acreage restrictions, together with subsidized exports and domestic wheat disposal programs, have failed to halt the relentless growth in surplus stocks of this commodity.

(3) Orlin J. Scoville, "Technological Changes That Affect Livestock and Feeds," Agricultural Research Service, U. S. Department of Agriculture, November 1959.

Carryover stocks of wheat have risen intermittently despite rigid acreage restrictions and special government disposal programs.



Source of data: "The Wheat Situation", U. S. Department of Agriculture.

Carryover stocks of wheat rose from 605 million bushels in 1953 to 1.3 billion bushels in 1959, and by July 1, 1960, it is expected that carryover will total 1.4 billion bushels. Total consumption of wheat by both domestic and foreign markets is slightly more than one billion bushels annually. Thus, carryover stocks would be sufficient to meet total consumption, including the current level of utilization under subsidized disposal programs, for one and one-half years without a head of wheat being harvested.

Other Commodities

Surplus stocks also prevail for a number of other commodities. The most important of these are cotton, tobacco, and soybeans. Carryover stocks of cotton totaled 8.9 million bales in 1959, but are expected to be reduced to 8.5 million bales in 1960 as a result of a sharp increase in exports and a significant gain in domestic mill consumption.[4]

The stock of flue-cured tobacco in storage on July 1, 1959, totaled 2.2 billion pounds, half again as much as the figure for ten years ago, despite a sizeable expansion of domestic consumption. Little change from last year, however, is expected in the level of tobacco stocks that will be carried over on July 1, 1960.

Stocks of surplus soybeans tripled between 1958 and 1959, rising from 21.1 million bushels to 62.4 million bushels over the one-year interval. The 1959 crop of soybeans, however, was about 5 percent below the record outturn of 1958 and export demand is strong. Consequently, stocks are expected to be reduced to about 40 million bushels by October 1, 1960.

Some of the other surplus commodities owned by the Commodity Credit Corporation include barley, oats, rye, rice, peanuts, dry beans, flaxseed, cottonseed, honey, tung oil, and rosin.

Relief via Price Supports

A persistent tendency to decline is perhaps the most outstanding impression gained from observing any measure of farm income over the past decade. But the decline would probably have been more apparent without the price-supporting activities of the Federal government.

The effect that price supports have had on farm incomes is extremely difficult to measure precisely. But a rough approximation indicates that in the absence of price-support programs, realized net farm income, on a year-by-year basis, would have averaged about 33 percent below the average level actually realized between 1951 and 1956.[5] The measure does not take into consideration, however, the income effects of acreage allotments, and shifts of resources from the

[4] Some cotton merchants estimate that exports will reach 7 million bales, although the Department of Agriculture's prediction is 6 million bales. Should exports total 7 million bales, carryover on August 1, 1960, would drop to 7.5 million bales.

[5] Walter W. Wilcox, "The Farm Policy Dilemma," *Journal of Farm Economics*, August 1958.

production of such commodities as wheat and tobacco to the production of feed grains.

A report prepared by the U. S. Department of Agriculture and a statement from the Land Grant College Advisory Committee,[6] which was submitted to Congress, give further evidence of the effect of price supports on farm incomes. The committee reports that if all acreage controls (except for tobacco) were removed and price supports were at levels which would permit an orderly reduction of currently excessive stocks of storable agricultural commodities over a seven- to ten-year period, average farm prices would drop to 90 cents for a bushel of wheat, 80 cents for a bushel of corn, 25 cents a pound for cotton, $15 per 100 pounds for beef cattle, $11.20 per 100 pounds for hogs, 29 cents a dozen for eggs, and 15 cents a pound for broilers. At these price levels, net realized farm income would total $7 billion in 1965, or about 46 percent below the 1958 level and about 36 percent below that of 1959.

Overabundance Problem Not Solved

Thus, despite several attempts to control the acreage of cropland used in production in an effort to bring supplies in balance with consumption, the problem of overproduction in agriculture remains to be solved. Excess productive capacity (in terms of the market) is especially acute for feed grains and wheat, which, together with forage and pasture for livestock, make up the present use of the bulk of our farmland. Moreover, the forces back of the increases in output in recent years appear to have unexpended power. Significant productivity gains, for example, can still be made through the use of fertilizers and improved seeds, insecticides, and weed killers.

There is no attempt here to choose among the welter of prescriptions which have been, and are currently, offered as "solutions" of the agricultural surplus problem. Nonetheless, a modest attempt to suggest a broad and objective classification of the alternative roads of policy may be in order.

(6) Senate Document No. 77, 86th Congress, 2d Session.

Probably most, if not all, of the possible approaches to the problem may be subsumed under one or another of the three paths which are described below in as objective a manner as possible.

(1) Policies centered on price supports coupled with limited forms of inducements to production curtailment could be continued without drastic modification. The cost of such policies would be the continuation of surpluses, with corresponding financial burdens upon the nation, and probably adverse effects on the nation's position in the balance of international payments.

(2) Price supports and agricultural subsidies could be abandoned, production limitations could be lifted and a return to laissez-faire could be effected. The cost would be the violent displacement from occupation of a large number of farmers. Social dislocation on a considerable scale would be the cost to be applied against the benefits accruing from a return to a market economy.

(3) Price supports could be abandoned, or sharply reduced, while strict production controls are instituted by forthright government steps. Advocates of this course suggest that there are precedents to be found in certain patterns of business behavior. The cost would be the drawback attached to any "regimentation" process, as recognized or conceived by a people generally attached to a free economy. An additional cost might be an underscoring of the paradox (already observable) whereby physical needs of people in various parts of the world cannot be matched up with existing production possibilities in technically advanced areas.

The possibility may be granted that the three alternatives suggested above do not cover all the possible variants of policy. However, in view of the dimensions of the problem as suggested above, it seems safe to assert that there is not likely to be any alternative that is free from a large measure of cost of some sort—a cost to be borne either by the nation as a whole or by some important groups or interests within the nation.

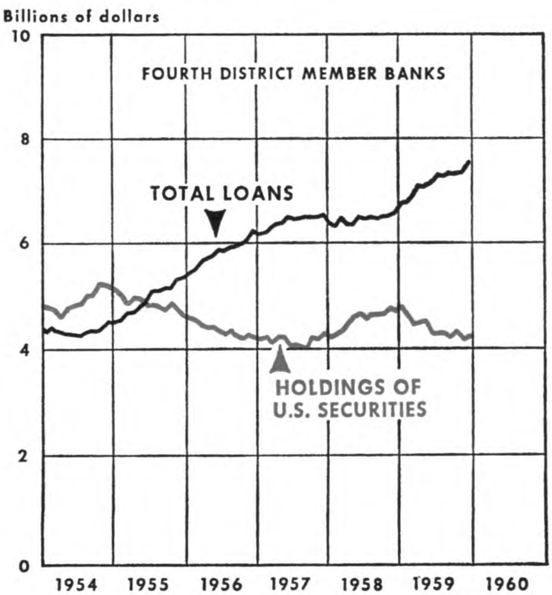
Bank Earnings

(Fourth District Member Banks)

PRELIMINARY FIGURES on earnings of Fourth District banks which are members of the Federal Reserve System are now available for the year 1959. This information indicates that in some respects the year was a favorable one for banking; however, not all phases of the returns can be viewed in this light.

Despite a $22-million addition to net operating income during the year, which represented an 11-percent gain from the previous year, net profits before taxes for Fourth District banks declined by nearly one-fourth from the year before, due to changes in nonoperating transactions which resulted in a substantial net reduction of profits in 1959. Nonoperating factors include changes in reserves set aside for losses as well as actual losses and recoveries on both loans and securities.

Loan portfolios expanded by nearly one billion dollars in 1959, whereas holdings of U. S. Government securities declined by about a half billion.



During 1959, banks were selling U. S. Government securities under unfavorable market conditions in order to meet the demand for loanable funds; thus, they were absorbing losses in order to meet their customers' demands, as well as in order to shift assets into a higher earning category. This was in marked contrast to the experience with security transactions in the previous year, when banks added about $43 million to their earnings from nonoperating factors. Smaller provisions for Federal and State income taxes in 1959, however, practically offset nonoperating losses, leaving after-tax profits at about the 1958 level.

Earning assets of Fourth District member banks rose by almost half a billion dollars during 1959 to a total of $13.2 billion at the end of the year. Loan portfolios expanded by nearly one billion dollars during the year, whereas holdings of U. S. Government securities declined by about one-half billion. (See chart.) Holdings of other than U. S. Government securities showed only a slight increase.

Operating Earnings

Gross operating earnings of the District member banks for 1959 totaled $628 million, up $63 million from 1958 and the highest on record. This represented an increase of 11 percent from a year ago, as compared with a 3 percent increase in 1958. All types of earnings registered gains, but earnings on loans accounted for almost 60 percent of the year's operating income. Earnings on loans rose by $44 million, as compared with only a $4-million increase reported in 1958. Both the larger volume of loans and the increase in the average rate of return contributed to the increased earnings.

In general, banks operated in a climate of monetary restraint during 1959; pressures on reserves were substantial during a considerable part of the year. At the same time, the upward movement of interest rates brought the average rate of return on loans to the highest level in nearly 30 years. A major factor in higher average return on loans was the expansion of consumer loan portfolios by commercial banks, chiefly in the field of instalment financing of consumer durables.

Earnings on U. S. Government securities were $14 million larger than in 1958. Although banks contracted their portfolios of U. S. Government securities substantially during 1959, an increase in average yields resulted in higher income. Earnings on other securities, principally securities of State and

MEMBER BANK EARNINGS, 1959

(FOURTH DISTRICT)

	Amount (Millions of Dollars)	Change from 1958	
		Amount (Millions of Dollars)	Percent
OPERATING EARNINGS	$628	+ $63	+ 11.1%
U. S. Government Securities	126	+ 14	+ 12.3
Other Securities	38	+ 2	+ 4.9
Loans	373	+ 44	+ 13.5
Other Earnings	91	+ 3	+ 3.4
OPERATING EXPENSES	402	+ 41	+ 11.3
CURRENT OPERATING EARNINGS	226	+ 22	+ 10.8
RECOVERIES, TRANSFERS FROM VALUATION RESERVES, AND PROFITS	26	— 67	— 72.0
LOSSES, CHARGE-OFFS, AND TRANSFERS TO VALUATION RESERVES	92	+ 7	+ 8.2
PROFITS BEFORE TAXES	160	— 52	— 24.6
TAXES ON NET INCOME	48	— 51	— 51.5
NET PROFITS	112	— 1	— 1.4
CASH DIVIDENDS	49	+ 2	+ 4.4

local governments, were up $2 million from a year ago, reflecting higher yields as well as larger average holdings.

Operating earnings from all other sources, which include mainly service charges on deposit accounts, commissions, and fees, increased by about $3 million in 1959 to a total of about $91 million. The gain in operating earnings was primarily due to the increased pace of banking activity. A steady rise in turnover of demand deposits continued in 1959. Thus, for example, the average rate of deposit turnover in the Fourth District increased from an average of 23.2 in 1958 to 25.5 in 1959.

There has been a significant change in the major sources of member bank earnings during the past decade. Thus, while earnings on loans increased from 43 percent of the total in 1949 to almost 60 percent in 1959, earnings on U. S. Government securities declined during the same decade from 32 percent of the total to 20 percent. The importance of operating earnings from all other sources declined slightly, whereas earnings on other securities held their own at about 7 percent of the total.

Operating Expenses

An increase in operating expenses in 1959 was about in line with the increase in earnings. Total operating expenses, amounting to $402 million, absorbed 64 percent of the year's earnings, or about the same proportion as in 1958. In the postwar years, operating expenses have been consuming on an average about 62 percent of operating earnings, with the highest ratio (65 percent) in 1947 and the lowest (59 percent) in 1956.

As in the previous years, wages and interest payments were the largest items on the expense side of the ledger. Higher interest rates on time deposits, as well as an addition of about $400 million to time deposit liabilities during the year, partly accounted for the increased expenses.

Taxes on net income took only three-tenths of net income in 1959. The total tax bill of $48 million was less than one-half of that for 1958 and was the smallest in the past seven years. Tax liabilities declined in 1959 in response to a decline in taxable income, because of substantial losses on sales of securities. This left $112 million in net profits after taxes, which was $1 million below 1958.

Cash Dividends and Retained Earnings

Cash dividends declared by Fourth District member banks in 1959 totaled $49 million, or $2 million more than in 1958. This sum represented about 44 percent of net profits after taxes; the remaining $63 million was added to bank capital.

In summary, the year 1959 proved to be one of high activity for the Fourth District banks, despite a prolonged labor dispute in the steel industry which is very important to the District. Credit extended to business and other borrowers rose substantially, but this occurred at the expense of investments, which affected net earnings.

Around the Fourth District—

SAVINGS DEPOSITS OF INDIVIDUALS

(Outstanding at commercial banks, end of February 1960)

	% change from year ago
Columbus	+12%
Toledo	+11
Canton	+ 8
Erie	+ 6
Lexington	+ 6
Pittsburgh	+ 4
Cincinnati	+ 4
Akron	+ 2
Dayton	+ 1
Cleveland	+ 1
Youngstown	− 0
Wheeling	− 6
FOURTH DISTRICT TOTAL	+ 3%

* * *

Department store sales in the Fourth District during January were 5 percent larger than they were a year ago. Eight of the twelve reporting metropolitan areas registered year-to-year sales increases, ranging from 12 percent in Youngstown down to 4 percent in Canton.

* * *

During the first week of March, *steel output* in the Cleveland-Lorain district was estimated at 101 percent of capacity. The rate in this district continued to exceed the national steel operating rate, which was calculated at 93 percent in early March.

* * *

Total *commercial and industrial loans* outstanding at 26 weekly reporting banks in the Fourth District reached a new record high during the week ended March 2. At the same time, reporting banks reduced their security holdings for the sixth consecutive week.

* * *

The volume of *bank debits* at 33 Fourth District centers in January was nearly 9 percent above the year-ago month. All but four of the 152 reporting banks shared in the year-to-year increase.

* * *

In contrast to the national trend, 1959 *crop revenues* showed a year-to-year decline in Pennsylvania, Kentucky, and West Virginia.

(The above items are based on various series of District or local data, which are assembled by this bank and distributed upon request in the form of mimeographed releases.)

NOTES ON FEDERAL RESERVE PUBLICATIONS

Among the articles published in the February monthly business reviews of other Federal Reserve banks are:

"Who Are the Unemployed?", Federal Reserve Bank of Chicago.

"Growth and Price Stability: the German Experience", Federal Reserve Bank of New York.

Copies may be obtained without charge by writing to the Federal Reserve Bank named in each case.

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"Business Forecasts for 1960" is a convenient compilation of statements, previously published elsewhere, by various forecasters. The 22-page booklet is available without charge from the Federal Reserve Bank of Richmond.

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Recent statements of Federal Reserve policy and related matters include:

"Monetary Policy and Economic Growth", by William McC. Martin, Jr., Chairman of the Board of Governors of the Federal Reserve System. Statement before the Joint Economic Committee, Washington, D. C., February 2, 1960.

"The Controversy Over Interest Rates", by Woodlief Thomas, Adviser, Board of Governors of the Federal Reserve System. Address given at New York City, January 20, 1960.

Copies of these remarks are available without charge from the Board of Governors of the Federal Reserve System, Washington 25, D. C.