

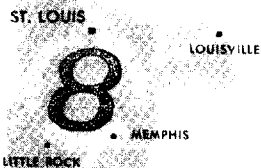
June 1965

FEDERAL RESERVE BANK OF ST. LOUIS

# Review

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FEDERAL RESERVE BANK  
OF ST. LOUIS

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## *Implementation of Federal Reserve Open Market Policy in 1964*

THE FEDERAL RESERVE SYSTEM has responsibility for influencing the nation's monetary affairs with a view to fostering national economic goals of high employment, relatively stable prices, and a viable balance of payments. Monetary actions of the Federal Reserve are largely implemented through its purchases and sales of U. S. Government securities. The *Fifty-first Annual Report of the Board of Governors of the Federal Reserve System* summarizes System actions during 1964 and forms the basis for this resume.

The national economic goals are not achieved directly by System actions. The Federal Reserve through its open market transactions affects intermediate (or proximate) measures, such as bank credit, money, and interest rates, in a way consistent with theories on how changes in these variables are related to changes in the demand for goods and services.<sup>1</sup> Much research has been devoted to these relationships, as evidenced by Harry G. Johnson's article in the June 1962 *American Economic Review* entitled "Monetary Theory and Policy," pp. 335-384.

<sup>1</sup>The link between intermediate objectives and the ultimate national economic goals has been subject to many diverse interpretations. Some economists stress the money supply as the main avenue by which the Federal Reserve helps the economy reach its economic goals; others stress bank credit as the link; and still others may stress the role of interest rates, total liquidity, total credit, or money market conditions, or they may embrace all financial variables in various combinations.

Because of data limitations and large seasonal and irregular movements, the intermediate guides cannot be controlled precisely in the very short run. Hence, the System has adopted more immediate money market guides for operations from day to day. The relationship between the immediate guides and the intermediate and ultimate objectives of policy has

been given little attention by economists generally.

The first part of this article describes briefly some immediate guides and intermediate objectives used by the System and presents sources of reference to more complete discussions. The article then traces the behavior of these guides during 1964. No attempt is made to evaluate the use of the guides.

## Policy Guides and Objectives

### *Dynamic and Defensive Actions*

The Federal Open Market Committee (FOMC) formulates policy regarding what have been called the "dynamic" operations of the System.<sup>2</sup> These operations are undertaken to influence the money and credit generating processes of the banking system for stimulating economic growth and for resisting inflationary or deflationary trends. The Manager of the System Open Market Account at the Federal Reserve Bank of New York is responsible for implementing these dynamic operations of the Federal Reserve System. He makes the decisions regarding daily purchases or sales of Government securities by the System after consulting with representatives of the FOMC.

In addition, the Account Manager has the task of smoothing money market pressures. Moves made in the performance of this task are called "defensive" actions. These operations are performed primarily to stabilize money market conditions from day to day. A major task is to assuage reserve deficiencies of the banking system or to remove superfluous reserves resulting from such factors as seasonal and irregular movements of currency in or out of circulation, shifts of reserves between banks in different reserve categories, and seasonal movements in the demand for bank credit.<sup>3</sup>

### *The Policy Directive*

The Federal Open Market Committee issues a policy directive to the Account Manager, usually at three-week intervals. The directive during 1964 consisted of two paragraphs.<sup>4</sup> The first paragraph stated the System's broad economic goals, gave its intermediate objectives for the following three weeks, and outlined

some of the important economic conditions that the Committee considered in deciding upon the content of its instructions. The System's broad economic goals were usually stated in terms of desired movements in aggregate demand, employment, prices, and balance of payments. Its intermediate objectives usually referred to desired movements in total member bank reserves, bank credit, money, and interest rates.

The second paragraph gave specific operating instructions to the Account Manager; they were given with respect to a desired set of money market conditions. These operating instructions embodied the dynamic policy of the Federal Reserve regarding economic goals and proximate objectives and were the guidelines which the Account Manager followed for the next three weeks in making day-to-day decisions.<sup>5</sup>

### *Measures of Money Market Conditions*

The FOMC and the Trading Desk examine various time series to interpret money market conditions and have constructed a terminology for discussing these conditions. Money market conditions are described by the Federal Reserve in terms of a degree of pressure or ease existing within the money market. The Trading Desk performs ". . . the dynamic job of creating the intended degree of pressure in the money market as a whole."<sup>6</sup> Increased pressure implies "tighter" money market conditions, and decreased pressure implies "easier" conditions.

In discussing guides for implementing policy, Mr. Frederick Deming, Under Secretary of the Treasury for Monetary Affairs and former president of the Federal Reserve Bank of Minneapolis, states, "They include the 'tone' of the money market which expresses itself in such phenomena as the rate on and the volume of trading in Federal Funds, dealer loan

<sup>2</sup> Robert V. Roosa, *Federal Reserve Operations in the Money and Securities Markets* (Federal Reserve Bank of New York, 1956), pp. 9, 96.

<sup>3</sup> Roosa, pp. 7-10.

<sup>4</sup> See *Fifty-first Annual Report of the Board of Governors of the Federal Reserve System, Covering Operations for the Year 1964*, pp. 63-128.

<sup>5</sup> *The Federal Reserve System: Purposes and Functions* (5th ed., Washington, D. C.: Board of Governors of the Federal Reserve System, 1963), p. 244.

<sup>6</sup> Roosa, p. 52.

rates, dealer borrowings and inventories of securities, and the distribution of reserves between money market and other banks.

“The guides include the amount of borrowings from the Reserve banks and the number of such banks doing the borrowing, the amount of excess reserves and the composite of excess reserves and borrowings or free reserves, which is, of course, also a proximate objective. At times other proximate objectives may serve as guides, especially total reserves and short-term Treasury bill rates.”<sup>7</sup>

There are many other factors the Manager of the Account considers in evaluating market tone. One important factor, which cannot be quantified, is the attitude of money market bankers, security dealers, and other major market participants.

### The Significance of Individual Money Market Guides

The following paragraphs discuss some frequently used, relatively concrete money market guides. The guides considered are the net reserve position of member banks, member bank borrowings at Federal Reserve Banks, the volume of and rate on Federal funds, the basic reserve position of money market banks, interest rates on loans to dealers in U. S. Government securities, dealer inventories, and the three-month Treasury bill rate.

#### Net Reserve Position

The net reserve position of member banks (free reserves when positive and net borrowed reserves when negative) is computed by subtracting from excess reserves member bank borrowings from Federal Reserve Banks. Pressure on the banking system is considered to be reduced when free reserves rise, since this indicates that banks have less borrowings or more idle funds. When free reserves fall, credit expansion is considered to be restrained as bank indebtedness rises or excess reserve funds fall. Because of the volatility of factors affecting bank reserve positions, a shift in free reserves for a single week means little, but a continuing

<sup>7</sup>John Gerrity, “The New U. S. Monetary Ace—Frederick Lewis Deming,” *The Weekly Bond Buyer*, January 11, 1965, p. 5.

trend in free reserves implies that more or less ease is being effected.<sup>8</sup>

#### Member Bank Borrowings

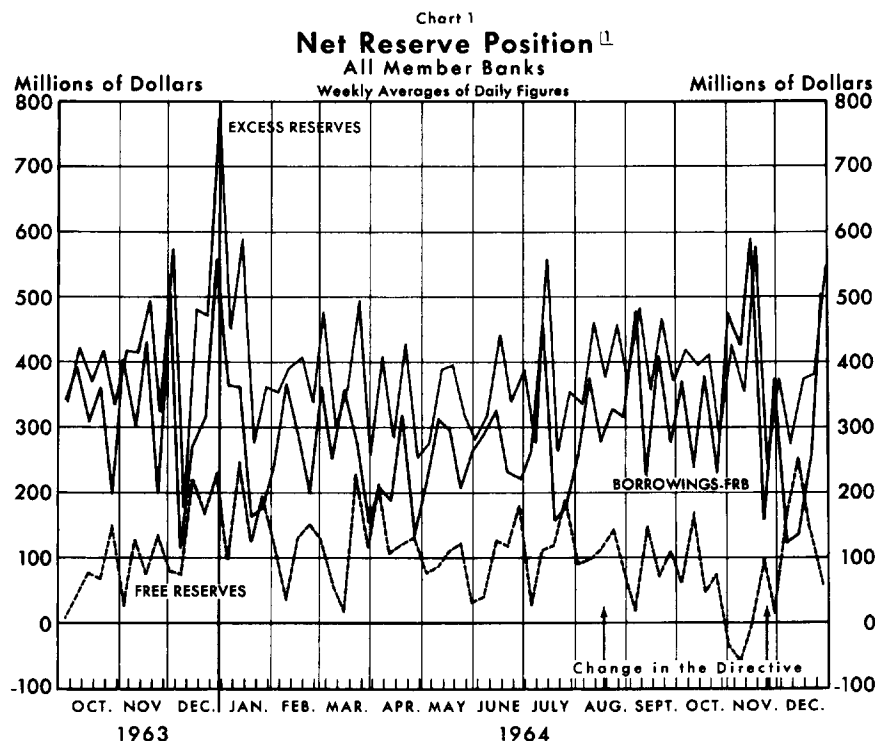
Member bank borrowing from the System is considered an important money market indicator, independent of its being a component of free reserves. There is a view that “. . . banks manage their affairs so that they do not need to resort to Reserve Bank borrowing except for necessary contingencies. And once in debt, they seek to repay such debt promptly.”<sup>9</sup> Tightness in the availability of bank credit and high interest rates have generally been associated with a large volume of borrowings, whereas ready credit availability and low interest rates have usually been associated with a small volume of borrowings.

#### Federal Funds

Federal funds, reserve balances loaned by one bank (or other money market institution) to another, are a means by which banks, particularly large banks, make short-run adjustments of their reserve positions at the Federal Reserve Banks. The Federal funds rate is very sensitive to day-to-day demands and supplies of funds in the money market and, thus, is an important indicator of daily pressure in the money market. If, at

<sup>8</sup>*Purposes and Functions*, pp. 223-224.

<sup>9</sup>*Purposes and Functions*, p. 44.



<sup>1</sup> The net reserve position is excess reserves less borrowings from Reserve Banks. It is called free reserves when positive and net borrowed reserves when negative.

a given Federal funds rate, the amount of unwanted excess reserves at some banks is larger than the amount of reserves demanded at banks having reserve deficiencies, the Federal funds rate will be driven down. On the other hand, when demand exceeds supply the rate rises to the discount rate or above.

Daily money market conditions are usually considered easy or comfortable when the Federal funds rate is below the discount rate. When the Federal funds rate is equal to or slightly above the discount rate, the money market is considered firm or tight.<sup>10</sup>

### Basic Reserve Position

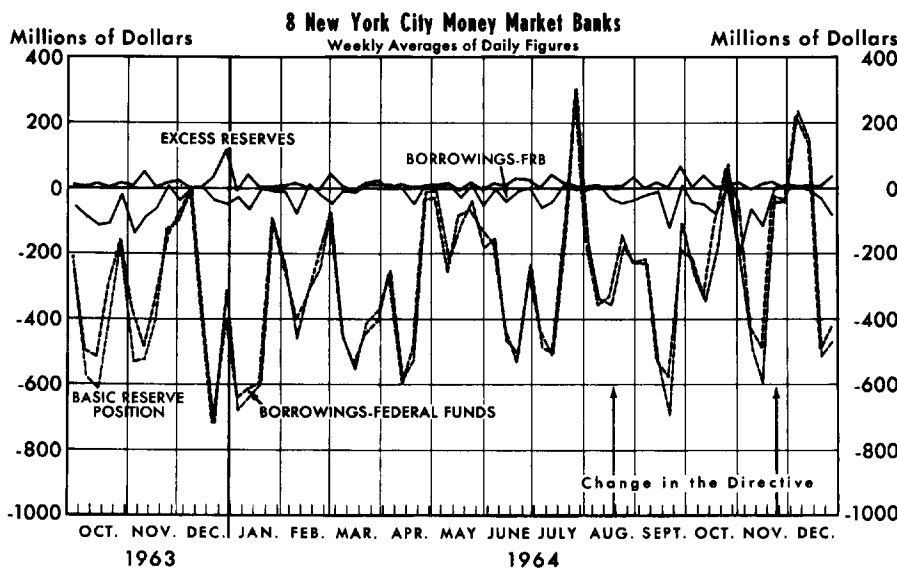
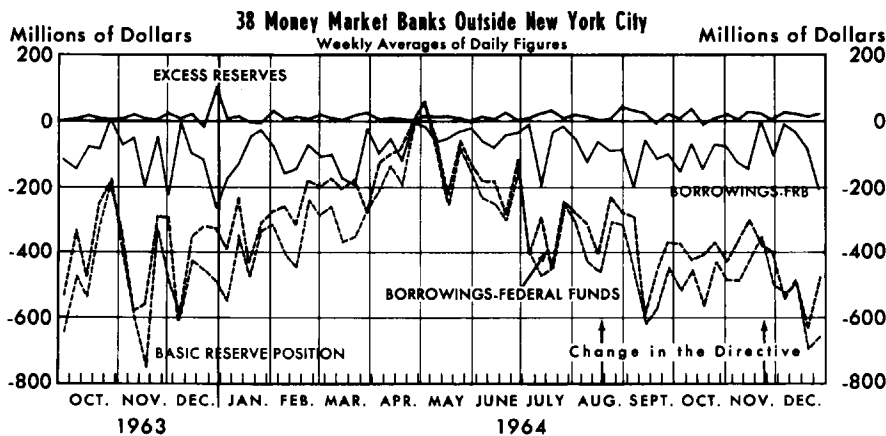
In analyzing money market conditions it is also useful to observe the so-called "basic reserve position" of banks—that is, their surplus or deficiency in total reserves over requirements before the banks have ta-

ken certain actions to adjust. A bank's basic reserve position (a surplus when positive and a deficiency when negative) is computed by subtracting net purchases or adding net sales of Federal funds to the bank's free reserves. If a bank's basic reserve position is negative, its borrowings of Federal funds plus borrowings from the Federal Reserve System are larger than its excess reserves.

"A bank that covers part of its reserve needs with large temporary borrowings, in the Federal funds market or elsewhere, is in a less comfortable position than if it held the same quantity of reserve balances with smaller borrowings."<sup>11</sup> The basic reserve position of money market banks is thus an important measure of pressure in the money market. The smaller the basic reserve surplus (or the larger the basic reserve deficiency) of the large money market banks, the greater the pressure.

<sup>10</sup> *Purposes and Functions*, pp. 49-50, 255.

Chart 2  
Basic Reserve Position<sup>1</sup>



<sup>1</sup> The basic reserve position is excess reserves less borrowings from Reserve Banks and borrowings of Federal funds.

### Dealer Positions and Borrowings

Expansions in dealer inventories of Government securities, growth in the volume of dealer borrowings, and increases in the interest rate on loans to dealers denote increased tightness in the money market. Other things equal, a rise in dealer inventories indicates some future upward pressure on interest rates as dealers adjust to normal levels. If loans to carry these inventories are relatively large and if interest rates on advances to dealers from banks, other financial intermediaries, and corporations are relatively high, the pressure is stronger.<sup>12</sup>

### Treasury Bill Yields

Banks often meet reserve deficiencies by selling Treasury bills, thereby tending to drive the bill rate up. When reserves are plentiful, however, banks are anxious to expand their portfolios of earning assets and may place some of their funds in Treasury bills, tending to cause the bill rate to fall. In a similar manner,

<sup>11</sup> "New Series on Federal Funds," Federal Reserve *Bulletin*, August 1964, p. 945.

<sup>12</sup> Louise Freeman, "The Financing of Government Security Dealers," *Monthly Review of the Federal Reserve Bank of New York*, Vol. 46, No. 6 (June 1964), pp. 115-116.

the Treasury bill rate reflects the relationship between the desired and actual cash position of such participants in the money market as nonbanking financial intermediaries, other businesses, local governments, and foreigners. If desired cash balances of these groups are higher than their actual cash balances, Treasury bills may be sold to acquire the difference, tending to drive the bill rate up. The opposite occurs when surplus cash exists. Thus, the bill rate is sensitive to the current cash position of money market participants and the expectation of these participants of future needs.<sup>13</sup>

An increase in the Treasury bill rate may imply a move toward tightness in the money market; a decline in the bill rate may imply a move toward ease. If the bill rate is stable over a length of time, it implies that the System is producing sufficient reserves to meet increases in demand for credit in this key market or is removing reserves when the demand for this type of credit falls.

### *Intermediate Objectives of Monetary Policy*

Intermediate objectives (e.g., total reserves, money, bank credit, and capital market interest rates) link the System's money market operations to its ultimate economic goals. Trends in intermediate objectives may also be useful for measuring the System's actions. Reserves are the base upon which the banking system generates credit and money.<sup>14</sup> An expansion of total reserves is required for increases in bank credit and money necessary for growth of the economy.<sup>15</sup> An easier monetary policy, other things being equal, generally implies increases in the rates of growth of total reserves, bank credit, and money and a decline in in-

terest rates. A firmer monetary policy usually implies movements of these objectives in the opposite direction.

### *Summary*

To recapitulate, the FOMC's directive to the Account Manager instructs him to perform operations to produce and maintain a desired degree of pressure in the money market. It would be expected that if the FOMC changed its instructions, a weighted average of the time series measuring market pressure listed above would reflect the change. For example, if the FOMC instructed the Account Manager to obtain firmer conditions in the money market, it would be expected that soon afterward most of the following events would happen: increases in borrowings from the Federal Reserve, greater dealer borrowings and inventories of securities, higher rates on dealer borrowings, increases in Treasury bill rates, Federal funds rates higher or near the maximum more frequently, decreases in free reserves, and lower basic reserve positions of money market banks.

Moreover, it would be expected that, because the instruction concerning the tone of the money market is a channel through which dynamic operations are effected, the measures of the intermediate objectives would reflect, after a brief lag, the change in the instruction. The rates of increase of reserves, bank credit, and money would fall, and certain interest rates would rise.<sup>16</sup>

It should be noted that certain measures of money market conditions, such as the Federal funds rate, are more useful for day-to-day analysis. Other measures, such as the basic reserve position, free reserves, and short-term interest rates, may be useful for analyzing money market conditions over longer periods.

## **Guides and Objectives During 1964**

An examination of the *Annual Report of the Board of Governors* indicates that 1964 may be divided into three periods of monetary policy: the beginning of the year to August 18, August 18 to November 23, and November 23 to the end of the year.

From the beginning of the year to August 18 the FOMC instructed the Account Manager to conduct

open market operations so as to maintain conditions in the money market at about the same degree of pressure as had prevailed in late 1963. On August 18 the Account Manager was instructed to maintain slightly firmer conditions in the money market.

The discount rate was changed on November 23, and on December 1 the Account Manager was instructed to moderate the adjustment of the money market to the increase in the discount rate and the rise in the maximum rate permitted for time deposits. An increase in the discount rate, taken by itself, is

<sup>13</sup> *Purposes and Functions*, p. 114.

<sup>14</sup> *Purposes and Functions*, pp. 63-81.

<sup>15</sup> Some increases in bank credit and money can be obtained by greater utilization of excess reserves but this is limited. Also, there may be changes in reserve expansion factors. See Leonall C. Andersen, "Federal Reserve Open Market Transactions and the Money Supply," *Review of the Federal Reserve Bank of St. Louis*, Vol. 47, No. 4 (April 1965), pp. 10-16.

<sup>16</sup> An exception might be when the changed market conditions were sought to offset some other force on the intermediate guides.

usually thought to signify a policy of growing restraint. The FOMC's observation that ". . . a larger-than-usual degree of flexibility in operations will be needed in this period when financial markets, while under strong seasonal pressures, are still adjusting to official rate actions here and abroad,"<sup>17</sup> indicated that, other things being equal, the shift toward restraint was to have been moderate.

The intermediate objectives throughout 1964 were to accommodate moderate increases in reserves, bank credit, and money. Also, it was generally understood that short-term rates were to remain stable or rise slightly, and long-term interest rates were not to rise much.

A crude method of evaluating the effect of the changes in the Federal Open Market Committee's instructions upon money market conditions and intermediate objectives is to compare their behavior in the three periods in which instructions for a desired degree of firmness were in effect. Table I presents averages of weekly figures of money market guides for the three periods and Table II presents data on intermediate objectives.

### Money Market Guides

The average level of free reserves for all member banks was significantly lower in the second period than the first, in accordance with the move to increase firmness. However, in December free reserves averaged higher than in the preceding two periods (Chart 1). Most of the interperiod variation in free reserves resulted from changes in borrowings from Federal Reserve Banks. Borrowings rose from an average level of \$274 million in the first period to \$352 million in the second and then fell to \$254 million in the third period.

The decline in borrowings from the second to the third period and the resulting rise in free reserves might not be inconsistent with a tighter money market. The rise in the discount rate was greater than the rise in the Treasury bill rate, increasing the relative cost of borrowing from Reserve Banks as a method of avoiding reserve deficiencies. Hence, at

<sup>17</sup> *Annual Report of the Board of Governors, 1964*, p. 121. The directive of December 15 instructed the Desk to maintain ". . . about the same conditions in the money market as currently prevail."

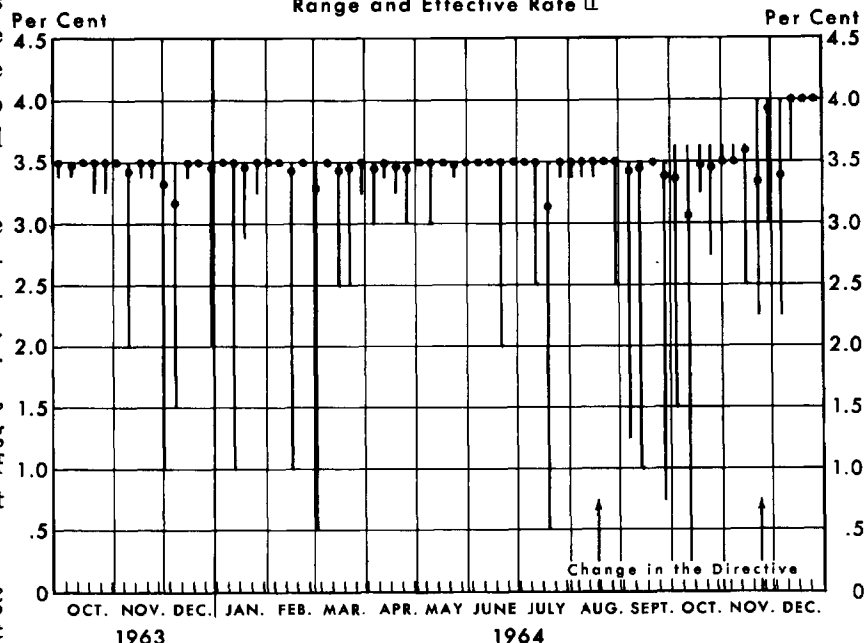
a higher discount rate more firmness may have resulted even though free reserves rose and borrowings fell.

Additional insight into money market conditions last year may be obtained by observing data from institutions very active in the market. The basic reserve deficiency of eight New York money market banks (Chart 2) declined progressively over the three policy periods. It is not clear whether this aspect of the market eased, as the figures suggest, or whether this movement resulted from special circumstances, such as the higher interest rates in December. The decline in basic reserves was reflected primarily in a reduction in net borrowings of Federal funds.

At the 38 reporting money market banks outside New York, the average basic reserve deficiency fell from the beginning of the year through the week ending May 6, when they became in net surplus (Chart 2). But from May 6 to the end of August the basic reserve deficiency of the 38 banks rose. At these 38 money market banks the average reserve deficiency was greater in the August to November period than in the January to August period, and it was still larger in December, thus moving in line with the actions toward firmer money market conditions.

The effective Federal funds rate was equal to the Federal Reserve discount rate on most days of 1964 (Chart 3). Thus, prior to the increase in the discount rate, the Federal funds rate was usually at 3.50 per cent and after the increase was generally at 4.00 per cent.

Chart 3  
Rates on Federal Funds  
Range and Effective Rate  $\perp$



$\perp$  The effective rate (•) is the weekly average of daily rates at which most transactions were conducted. The range extends between the highest and the lowest bid rates in the week.

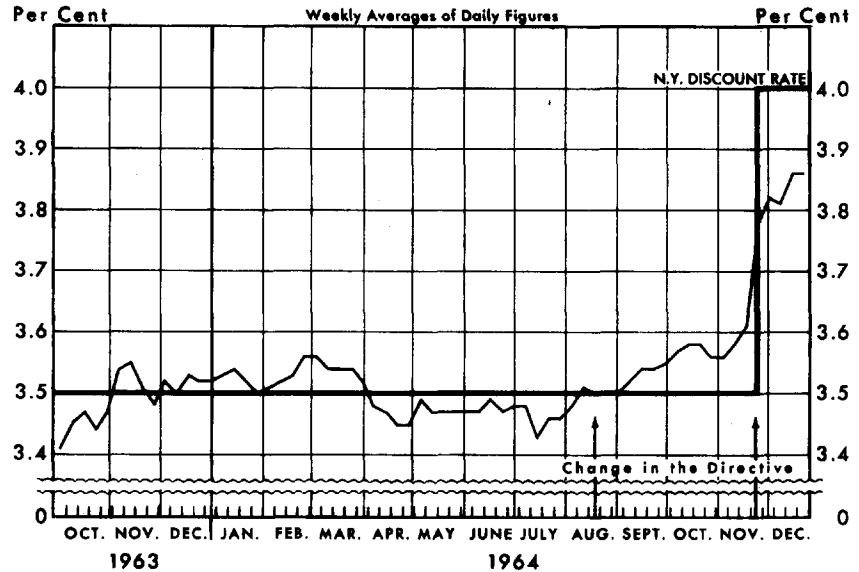
There were instances, however, when the rate on most Federal funds transactions was below the discount rate.<sup>18</sup> In the first policy period the effective rate on Federal funds was below the discount rate on 7 per cent of the days; in the second period it was lower on 11 per cent of the days; and in the third period it was lower on 23 per cent of the days. The increased frequency of the lower rates is not necessarily an indication of greater money market ease from period to period but may have resulted because pressures from day to day were more uneven.

Short-term interest rates changed little in 1964 until November, when they rose about  $\frac{1}{4}$  to  $\frac{1}{2}$  of 1 percentage point. Although short-term rates may have risen in response to the change in the discount rate and the increased maximum rate permitted on time deposits, the demand for funds usually rises relative to saving in the fall, and interest rates have frequently increased this much or more at about this time of year. The average three-month Treasury bill rate was slightly higher in the period August to November than in the first policy period (Table I and Chart 4), but the rise was less than seasonal. Rates on other short-term securities, 6- and 9- to 12-month Treasury bills and 4- to 6-month prime commercial paper behaved similarly to the rate on 3-month Treasury bills.

Rates on new dealer borrowings in the first eight months of 1964 averaged 3.84 per cent, and the rates on renewal loans averaged 3.79 per cent. The average rates for both types of dealer borrowings were essentially unchanged in the next policy period (Table I); the FOMC's instruction for greater firmness produced little shift upward in average rates. After the increase in the discount rate, dealer loan rates rose in response. Average dealer borrowings (primarily from banks and corporations) and dealer inventories rose from the first to the second Federal Reserve

<sup>18</sup>The Federal funds rate did not usually rise above the discount rate; in early November 1964, however, Federal funds were traded predominantly at rates above the discount rate on a number of days.

Chart 4  
Yields on Three-Month Treasury Bills



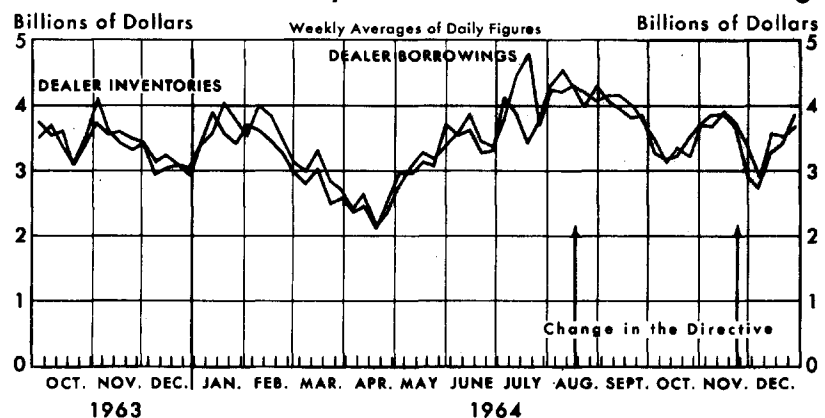
policy period but then declined in December (Table I, Chart 5).

### Intermediate Objectives

Money, total reserves, and bank credit grew more rapidly from August to November than over the preceding eight months. In December and the first quarter of 1965 the growth rate of total reserves and bank credit increased, but the rate of increase of money declined. Table II and Chart 6 show the patterns of growth in 1964 and early 1965 for total reserves, bank credit, and money.

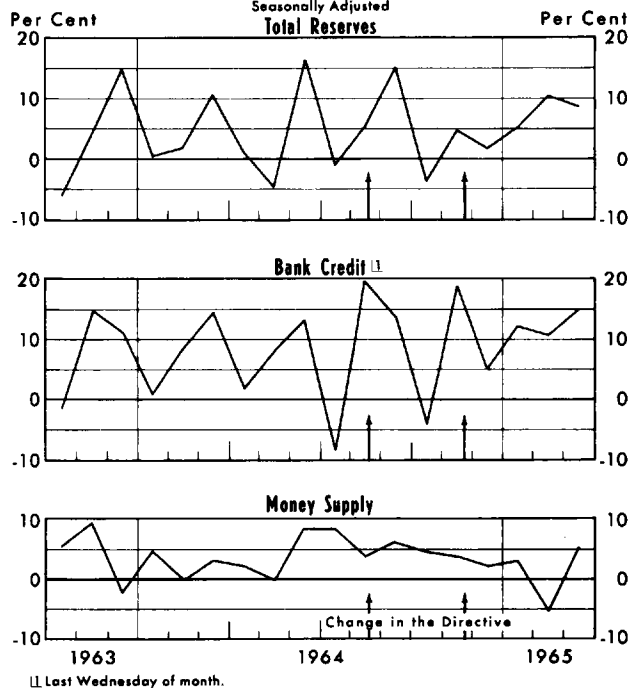
The money supply, seasonally adjusted, advanced at a 3.9 per cent annual rate from December 1963 to August 1964, continuing the trend which began in September 1962. The rate of expansion for the next three months rose to 4.8 per cent. In December and early 1965 money increased at a 1.3 per cent annual

Chart 5  
U.S. Government Security Dealer Inventories and Borrowings

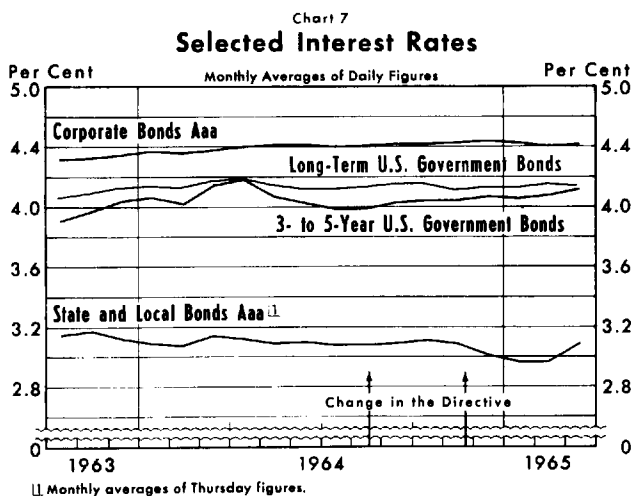


rate. The rates of growth of both total reserves and bank credit were higher in the period August to November than the period December 1963 to August. In December and early 1965 rates of growth of total reserves and bank credit again increased. The growth rate in the final period for total reserves was 6.8 per cent and for bank credit was 10.9 per cent.

Chart 6  
**Total Reserves, Bank Credit, and Money Supply**  
 Annual Rates of Change  
 Monthly Averages of Daily Figures  
 Seasonally Adjusted



Long-term interest rates changed little during the year (Chart 7). The yield on long-term Government bonds for December 1964, 4.14 per cent, was unchanged from the average rate for December of the preceding year. The rate on 3- to 5-year Government issues for December was only three basis points above the rate at the end of 1963. Yields on these issues rose



in March and April but afterward fell back to their December level. The yields on highest-grade corporate bonds rose gradually during the year, but the yields on high-grade municipals and medium-grade corporate and municipal bonds declined slightly. Mortgage rates were virtually unchanged.

The yield on short-term securities—which is also a money market guide and discussed above—changed little during most of 1964. After the discount rate was raised on November 23, most short-term rates rose between  $\frac{1}{4}$  and  $\frac{1}{2}$  of 1 percentage point.

### Summary

Many money market guides, on balance, moved in a direction consonant with changes in the FOMC's directives during 1964, although a few individual measures had only small net changes or actually moved in a contrary fashion. This emphasizes the need to examine various aspects of the money market—including market psychology—before making judgments about its ease or tightness. Also, changes in the set of economic variables impinging on the money market must be taken into account in interpreting movements in the money market guides. For example, with a higher discount rate, the same money market pressure may be maintained even though free reserves and the basic reserve surplus rise.

The movement in the intermediate objectives during 1964 showed little relation to the changes in the money market conditions, and these intermediate measures did not always move in a mutually consistent manner. The rates of change of money, bank credit, and reserves were all greater during the second policy period, when firmer conditions developed in the money market, than during the first period. In the first few months after the changes in market conditions in November, bank reserves and bank credit continued to grow rapidly—even accelerated. However, money moved up at a slower pace. Most interest rates showed little change during the year; an exception was the rise in short-term rates after November 23.

The year 1964 illustrates well the problems of monetary management. Throughout the year the FOMC felt that the domestic economic situation called for a moderate growth in bank reserves, bank credit, and money, while the international situation would be best served by stable or slightly higher short-term interest rates. During the first eight months it directed the Manager to keep money market conditions unchanged at December 1963 levels. Interest rates changed little, and both reserves and money rose moderately while bank credit increased rapidly.



Table I  
**MONEY MARKET GUIDES—1964**  
 Averages for period, not seasonally adjusted

	Policy Periods <sup>1</sup>		
	1	2	3
	Millions of dollars		
Free reserves .....	\$ 121	\$ 62	\$ 156
Excess reserves .....	395	414	410
Borrowings .....	274	352	254
Net purchases of Federal funds			
8 N. Y. banks .....	307	233	139
38 other banks .....	223	377	533
Basic reserve deficiency			
8 N. Y. banks .....	318	277	159
38 other banks .....	304	473	604
Dealer inventories .....	3,323	3,684	3,322
Total dealer borrowings .....	3,411	3,705	3,398
Short-term interest rates	Per cent		
Dealer loans			
New loans .....	3.84	3.86	4.16
Renewal loans .....	3.79	3.82	4.12
Treasury bills			
3-month .....	3.50	3.59	3.84
6-month .....	3.63	3.74	3.94
9- to 12-month .....	3.71	3.78	3.96
4- to 6-month commercial paper ....	3.94	3.96	4.17
Certificates of deposit (secondary market rate) .....	3.83	3.90	4.16

<sup>1</sup> The first policy period extended from January 1, 1964 to August 18; the second policy period began on August 18 and terminated at the end of November; the third period covers the month of December.

In August the Committee decided that developments were such that their proximate objectives could better be attained by permitting a slight firming in the money market. The Manager, using numerous guides—many more than discussed here—brought these conditions about in a smooth manner. Interest rates changed only slightly, but bank reserves, bank credit, and money each rose more rapidly in the following three months.

Table II  
**INTERMEDIATE OBJECTIVES OF THE  
 FEDERAL RESERVE SYSTEM  
 1964**

	December 1963 through August	August through November	November through March 1965
	Annual rates of change, seasonally adjusted		
Money supply .....	3.9 %	4.8 %	1.3 %
Bank credit .....	7.4	9.6	10.9
Total reserves .....	3.8	5.4	6.8
	Averages for period, not seasonally adjusted <sup>1</sup>		
Interest rates			
U. S. Government—			
long-term .....	4.15%	4.15%	4.15%
U. S. Government—			
3- to 5-year issues ...	4.07	4.04	4.08
Corporate bonds			
Aaa .....	4.39	4.43	4.43
Baa .....	4.84	4.81	4.79
Mortgage rates (conventional first mortgages) .....	5.79	5.76	5.78
Municipal rates			
Aaa .....	3.10	3.09	3.01
Baa .....	3.54	3.56	3.47

<sup>1</sup> Average interest rates for January through August, September through November, and December through March 1965.

In late November the Federal Reserve System decided that some further tightening in the money market would be more consistent with their intermediate guides. On November 23, after the Bank of England raised its bank rate, the Federal Reserve raised its discount rate from 3½ per cent to a level of 4 per cent. Most short-term market interest rates rose. Following the change, bank reserves and bank credit expansion accelerated, but money growth moderated.

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 JULES M. LEVINE



# Economic Expansion Continues

**T**HE NATION'S PRODUCTION of goods and services increased slightly in April, after advancing markedly from the fourth quarter last year to the first quarter this year. From a short-run viewpoint, most indicators suggest that the pace of activity quickened in the first quarter and has since slowed. From a somewhat longer viewpoint, gains from September to April represent a continuation of the rapid pace of activity which has prevailed since mid-1963.

Since late last summer, there has been substantial fluctuation in the rate of economic gain. This pattern of uneven increase in recent months can be ascribed to two distorting factors: strikes in the automobile industry last fall and steel stockpiling in anticipation of a strike in the steel industry in the spring of this year. These factors have made difficult an interpretation of the course of the economy from month to month.

## Prices, Wages, and Productivity

Since World War II, prices and wages have tended to increase in the later stages of periods of economic expansion. During the expansion since 1961 little increase in the average level of prices has appeared, compared with experience in previous periods of business expansion.

Labor cost-productivity relationships in the strategic manufacturing sector of the economy are sometimes measured by labor cost per unit of manufacturing output.<sup>1</sup> By this measure, productivity in manufacturing has exceeded increases in money wage costs during most of the recent expansion, i.e., average unit labor costs have been declining since 1961. In April this index was 94 per cent of its value in February 1961. These estimates suggest a lack of pressure on businesses to increase prices of products they sell.

Comparable measures are not available for nonmanufacturing, but conclusions may be inferred by examining labor cost per dollar of corporate gross product.<sup>2</sup>

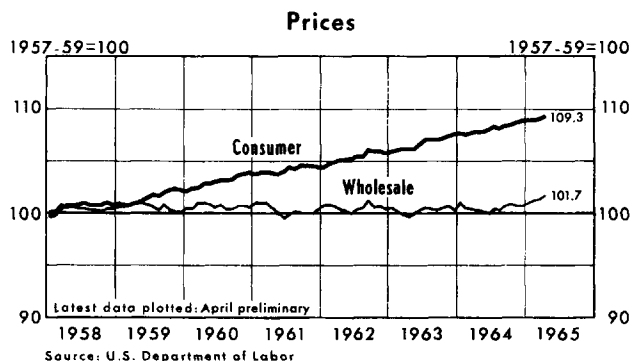
<sup>1</sup>As computed by the Bureau of the Census of the Department of Commerce, this is the ratio of the index of compensation of employees in manufacturing to the Federal Reserve's index of industrial production. See the Bureau of the Census' publication, *Business Cycle Developments*.

<sup>2</sup>Ratio of compensation of employees in corporate enterprises to value of corporate product in 1954 dollars. See *Business Cycle Developments*.

In addition to corporate manufacturing concerns, the following industries are included: construction, finance, trade, and transportation. By this measure, wage costs have been increasing about as rapidly as productivity. In the first quarter of 1965 labor cost per dollar of corporate product was 100.2 per cent of its value in the first quarter of 1961. To the extent that these two series are comparable, when viewed together they suggest that wage costs have been increasing more rapidly than productivity among non-manufacturing concerns.

Prices reflect recent developments in wage costs, productivity, and total demand. Wholesale prices, particularly of industrial materials, were virtually unchanged from 1961 to mid-1964. From September 1964 to April 1965 wholesale industrial prices rose at a 1.7 per cent annual rate. This recent increase may reflect the special circumstances related to the uneven advance in production activity since September. Some bottlenecks appeared as firms attempted to accumulate inventories. It seems that such price increases as have resulted were caused by abrupt increases in demand rather than by increasing costs. Wholesale prices during the past year, for the first time in several years, have risen as rapidly as consumer prices.

The consumer price index has continued to rise at a steady rate. In view of the limitations of the index, it is not clear that prices have risen during the 1961-65 expansion. Especially difficult is the measurement of changes in the quality of services, which have been a major factor in the upward drift of the index.



## Production, Employment, and Sales

Standard measures of economic activity have increased unevenly but, on the whole, quite rapidly since

September. When rates of change of various measures of activity for the period from September to April and for the year ending in April are examined, they indicate that the recent upswing in activity has been a continuation of the rapid rate of advance which began in mid-1963.

Industrial production increased at an 8.7 per cent annual rate from September to April, compared with 7.9 per cent in the year ending in April. Increases were largest among durable goods, particularly automobiles and steel.

Outlays for new construction in April were up at a 2.2 per cent annual rate from September and 1.2 per cent from a year earlier. Business construction has shown the largest increase over the past year, while private residential construction has changed little.

Payroll employment rose at a 4.3 per cent annual rate from September to April, above the rate of increase since April 1964. Employment gains were widespread among the major industries. Total employment is estimated to have increased at a 3.1 per cent annual rate from September to May. Population aged 18 to 64 is estimated to have been increasing at a 1.6 per cent rate during the past year. Thus the comparative rate of growth of employment is very strong. Unemployment has also declined; in May unemployment of married men was 2.5 per cent of their labor force, compared with about 2.8 per cent a year earlier.

Retail sales were up at a 4.3 per cent annual rate from September to April, significantly below the rate since April of last year. Sales have declined from the very high level attained in February.

Personal income in April was up at a 5.7 per cent annual rate from September, the same rate as from April 1964.

### **Monetary and Fiscal Developments**

Some variables strategic to the determination of total demand for goods and services have been less stimulative in recent months than in most of 1964. The rate of expansion of the money supply has slowed somewhat since late last fall, and Federal Government receipts have been increasing more rapidly than expenditures.

Preliminary data show that money was virtually unchanged from November to May, compared with a 4.2 per cent average annual rate of increase from September 1962 to November 1964. New seasonal adjustment factors currently are being computed for money, and it appears possible that when the new factors are applied to the period since November there will be some moderate expansion in money.

Member bank total reserves rose at an 8.2 per cent annual rate from November to the month ending May 15. Most of the addition to reserves was absorbed by increases in time deposits and Government demand deposits. Reserves available for private demand deposits increased at a 0.7 per cent annual rate from November to the month ending May 15.

Interest rates changed little from November to May, a period of rapid expansion in business activity. Associated with these conditions has been a very rapid growth of commercial bank loans. Business loans expanded at a 23 per cent annual rate from November to April. To expand their loans, banks have reduced their holdings of U. S. Government securities, borrowed funds (both from the Federal Reserve and from other banks), and attracted more time deposits.

Federal Government receipts (national income accounts basis) rose sharply in the first quarter, and expenditures increased only slightly. As a result, the national income accounts budget showed a deficit of \$0.1 billion (annual rate) in the first quarter, compared with about a \$5 billion deficit in the second half of 1964. The full employment budget surplus, which adjusts the national income accounts budget for cyclical variations in economic activity, is estimated to have increased to about \$5 billion from about \$2 billion in late 1964.

Current estimates indicate that the budget situation will be more stimulative in the second half of 1965 than in the first half. Reductions in excise tax rates are expected, along with increases in social security pensions retroactive to January 1, 1965. Beginning January 1, 1966, however, Government receipts are expected to rise because of proposed increases in social security tax rates.

### **Balance of Payments**

The recent trends in U. S. monetary-fiscal policy mix can be compared with those in other major foreign economies. Stabilization policies are implemented by relying on some combination of fiscal and monetary action. The relative weights attached to these can be described as the "policy mix." A given stimulus to aggregate demand can be attained by a variety of fiscal and monetary combinations, but the implications for credit availability and interest rates differ. "Liberal" fiscal measures tend to raise interest rates and "tight" fiscal measures to reduce them, while "easy" money tends to lower rates and "tight" money to raise them. Accordingly, in deciding on the policy mix to be followed, the question of appropriate interest rates *vis a vis* other countries cannot be overlooked.

(Continued on page 16)

# Recent Trends in Farm Credit

**F**ARMING HAS BEEN CHANGING rapidly in recent years. Because of efficiencies from new technology, there has been a strong incentive to increase the size of farms. Acreage per farm has risen more than 60 per cent since 1950, and the number of farms has declined about 40 per cent. Along with this consolidation into larger units and the use of more and larger machinery, credit in agriculture has increased rapidly.

Total farm debt on January 1, 1965 amounted to \$36.0 billion, up from \$23.6 billion in 1960 and \$10.7 billion in 1950. Since 1950, the increase in such debt has averaged about \$1.7 billion per year, an average annual increase of about 8.4 per cent compounded.

Farm credit has increased somewhat less rapidly than consumer credit and nonfarm mortgage credit but at about the same rate as business loans at commercial banks and more rapidly than total bank credit. Since 1950, total consumer debt has expanded at an average annual rate of 10.5 per cent, and other mortgage debt, at a rate of 12.4 per cent. Commercial and industrial bank loans have increased about 8.4 per cent per year, and total bank credit has risen at a 5.6 per cent rate. This article examines some recent trends in the composition and sources of farm credit and attempts to explain the reasons for these trends.

From 1950 to 1965 farm real estate debt and other farm debt increased at similar rates. Real estate debt rose from \$5.6 billion to \$18.9 billion, an average annual increase of 8.5 per cent. Other farm debt increased from \$5.1 billion to \$17.1 billion, an average rate of 8.3 per cent per year.

Part of the increase in farm real estate debt has reflected rising land prices. The average price of farm land rose from \$65 per acre in 1950 to \$140 in 1965. An abundance of mortgage credit has probably been a factor in permitting the bidding up of land prices as such prices have increased without a corresponding increase in farm income. Total net farm income declined about 5 per cent from 1950 to 1964, about the same per cent as the decline in land used for farming. Although net farm income per acre has shown little change during the period, marginal returns to real estate capital for the individual farmer may have been quite high. The incentive to enlarge existing farms

apparently was strong, tending to support rising farm land prices.

Relative to farm assets, farm debt nearly doubled during the period 1950-1965. Nonreal estate debt relative to nonreal estate assets, however, rose at a much greater rate than real estate debt relative to real estate assets. Nonreal estate debt increased from 9.3 per cent of total nonreal estate assets in 1950 to 24.5 per cent in 1965 (Table I). In comparison, real estate debt increased from 7.4 per cent to 11.9 per cent of real estate assets during the period.

Table I  
TOTAL FARM ASSETS AND LIABILITIES<sup>1</sup>  
(January 1)

	Assets	Liabilities	Liabilities as a Per Cent of Assets
	(Billions of dollars)		
	TOTAL		
1950	\$129.9	\$10.7	8.2%
1955	160.5	15.2	9.5
1960	198.2	23.6	12.0
1961	198.2	24.8	12.5
1962	206.2	26.8	13.0
1963	213.7	29.7	13.9
1964	221.1	33.0	14.9
1965	229.1	36.0	15.7
	REAL ESTATE		
1950	\$ 75.3	\$ 5.6	7.4%
1955	98.2	8.2	8.4
1960	129.9	12.1	9.3
1961	131.4	12.8	9.7
1962	137.4	13.9	10.1
1963	142.8	15.2	10.6
1964	150.8	16.8	11.1
1965	159.4	18.9	11.9
	NONREAL ESTATE		
1950	\$54.6	\$ 5.1	9.3%
1955	62.3	7.2	11.6
1960	68.3	11.5	17.0
1961	66.8	12.0	18.0
1962	68.8	12.9	18.8
1963	70.9	14.5	20.5
1964	70.3	16.2	23.0
1965	69.7	17.1	24.5

<sup>1</sup> Excluding CCC loans.

Source: USDA, *Agricultural Finance Review*, December 1964, except the data for 1965, which are estimates.

## Agencies Supplying Farm Credit

The amount of farm debt held by each of the major farm credit agencies has risen since 1950, but at somewhat different rates. As a result, the percentage of farm credit outstanding by agency changed slightly during the period.

### Farm Mortgage Debt

Of the lenders supplying farm real estate credit during 1950-1965, Federal Land Banks expanded their loans most rapidly. Such loans at Land Banks rose at an average annual rate of about 10 per cent per year (Table II). Farm mortgages held by life insurance companies rose at a 9.0 per cent rate, and Farmers Home Administration loans, at an 8.0 per cent rate. Farm mortgage loans held by commercial and mutual savings banks made the slowest gains of any of the reporting groups, averaging 7.2 per cent annually. Mortgage loans by other lenders (primarily individuals) increased about 8 per cent per year.

Table II

#### FARM DEBT HELD BY MAJOR LENDERS

Annual Rates of Change  
(January 1)

	1950-65	1950-55	1955-60	1960-65
<b>REAL ESTATE DEBT</b>				
Federal Land Banks .....	9.8%	6.9%	13.0%	9.6%
Farmers Home Administration..	8.0	8.3	8.8	7.1
Life insurance companies ....	9.0	11.9	6.6	8.8
Commercial and savings banks	7.2	5.3	6.1	10.4
Other .....	8.1	7.7	7.2	9.4
Total .....	8.5	8.1	7.9	9.4
<b>NONREAL ESTATE DEBT</b>				
Commercial and savings banks	8.5%	7.4%	10.4%	7.6%
Production credit associations..	12.5	8.1	18.7	10.9
Farmers Home Administration..	4.2	3.7	1.0	10.1
Other .....	7.7	6.6	8.7	7.9
Total .....	8.3	6.9	9.9	8.2

Although the growth of farm mortgage debt was most rapid over the entire 1950-1965 period at Federal Land Banks, such debt increased at a faster rate during the first 5 years, 1950-1955, at life insurance companies and during the last 5 years, 1960-1965, at banks (Table II). This recent higher rate of mortgage lending by banks reflects their attempts to meet credit demands by raising interest rates paid on time and savings deposits and acquiring larger supplies of loanable funds.

As a result of different rates of growth, the relative proportion of mortgage debt held by the various lenders changed over the period. Mortgages held by the Federal Land Banks increased from 16.2 per cent

of the total in 1950 to 19.5 per cent in 1965 (Table III). The proportion held by commercial and mutual savings banks declined from 16.8 per cent of the total to 14.1 per cent, while the share held by life insurance companies (about one-fifth of the total) and all other lenders (about two-fifths) showed little net change.

Table III

#### DISTRIBUTION OF OUTSTANDING FARM DEBT

	1950	1955	1960	1965
<b>REAL ESTATE DEBT HOLDERS</b>				
Federal Land Banks .....	16.2%	15.4%	19.3%	19.5%
Farmers Home Administration..	3.5	3.5	3.6	3.3
Life insurance companies ....	21.0	24.9	23.3	22.7
Commercial and savings banks	16.8	14.7	13.5	14.1
Other .....	42.5	41.6	40.2	40.3
Total .....	100.0%	100.0%	100.0%	100.0%
<b>NONREAL ESTATE DEBT HOLDERS</b>				
Commercial and savings banks	39.8%	40.8%	41.8%	40.6%
Production credit associations..	7.5	8.0	11.8	13.3
Farmers Home Administration..	6.7	5.8	3.4	3.8
Other .....	46.0	45.4	43.0	42.3
Total .....	100.0%	100.0%	100.0%	100.0%

Note: Detail may not add to totals due to rounding.

### Nonreal Estate Debt

Production credit associations have been the fastest growing source of nonreal estate farm credit since 1950 (Table II). Outstanding loans held by these associations increased at an average annual rate of 12.5 per cent from 1950 to 1965. Their share of all nonreal estate debt made sizable gains, rising from 7.5 per cent to 13.3 per cent of the total during the period (Table III).

Nonreal estate debt held by banks grew at about the same rate as total nonreal estate debt during the 15-year period, 8.5 per cent and 8.3 per cent, respectively. The proportion held by banks remained at about two-fifths of the total during the period.

Nonreal estate debt held by the Farmers Home Administration rose 4.2 per cent annually from 1950 to 1965, the lowest rate of increase for any of the major nonreal estate farm credit lenders. Relative to the total of such debt outstanding, FHA credit declined from 6.7 per cent to 3.8 per cent.

Nonreal estate debt held by other creditors (dealers, merchants, finance companies, individuals, and others) increased about 8 per cent per year, slightly less than the growth rate of total nonreal estate debt. The proportion of the total held by these creditors declined slightly, from 46.0 per cent to 42.3 per cent.

## **Forces Contributing to Rising Credit Demand in Agriculture**

The increased use of credit in agriculture is associated with: (1) an increase in farm capital, reflecting both new investment and rising prices, especially increases in land prices, (2) higher operating expenses, (3) a relative decline in liquid assets of farmers, and (4) rapid adjustments in agricultural resources, especially a decline in number of farms and an increase in their average size.

### **Increase in Farm Capital**

The rise in amount of farm investment has been an important factor in the increased use of credit in agriculture. In addition to the need for financing increments to capital on existing farms, the transfer of higher valued farm real estate from one owner to another generally involves the use of credit.

The value of farm production assets in the United States almost doubled from 1950 to 1965, rising from \$105.4 billion to \$201.7 billion (Table IV). This increase resulted primarily from the increase in market price of farm land rather than additional real capital investment. The average rate of increase for the period was 4.4 per cent per year. Although the up-trend continued throughout the 15 years, the rate of increase has been somewhat less since 1960 than previously. The value of farm assets rose at an annual rate of 4.8 per cent from 1950 to 1955, 5.1 per cent from 1955 to 1960, and 3.4 per cent from 1960 to 1965.

Table IV  
**FARM PRODUCTION ASSETS<sup>1</sup>**  
Billions of dollars  
(January 1)

	1950	1955	1960	1965
Real estate .....	\$ 75.3	\$ 98.2	\$129.9	\$159.4
Livestock .....	12.9	11.2	15.6	14.4
Machinery and motor vehicles	11.3	16.2	18.6	20.5
Stored crops <sup>2</sup> .....	5.9	7.4	6.6	7.4
<b>Total .....</b>	<b>\$105.4</b>	<b>\$133.0</b>	<b>\$170.7</b>	<b>\$201.7</b>

<sup>1</sup> Total farm assets less household furnishings, liquid financial assets, and investments in cooperatives.

<sup>2</sup> Excludes crops held as security for CCC loans.

Source: USDA, *Balance Sheet for Agriculture*, except 1965 data, which are estimates.

The rates of change for the various capital items used in agriculture have been diverse. Real estate made the greatest gains. Farm real estate more than doubled in value, reflecting primarily inflation in land prices. The value of farm land and buildings rose from \$75.3 billion in 1950 to \$159.4 billion in 1965. Increases in farm land prices have been very large in each period considered. Machinery and motor vehicle values increased far less in amount but at about the same

rate as real estate, rising from \$11.3 billion to \$20.5 billion, with the greatest gains coming during the 1950-1955 period. On the other hand, investments in livestock and stored crops made relatively small gains, with generally declining prices partially offsetting greater physical volume of such inventories.

### **Higher Operating Expenses**

A portion of the gain in nonreal estate farm credit reflects a rise in farm production expenses. Cash outlays relative to farm production are steadily increasing as a rising portion of "farming" is done off the farm. Among the major current expense items are seed, feed, fertilizer, fuel, machinery repairs, and hired labor. Feeder cattle and hogs are also major expense items on livestock feeding farms. Such expenditures must be financed by the operator either out of working capital or through the use of credit. The magnitude of such expenses is therefore a factor in determining the level of credit demand.

Total farm production expenses increased from \$19.3 billion in 1950 to \$29.4 billion in 1964. Relative to gross farm income, production expenses rose from 59 per cent to 70 per cent (Table V). During this period such expenses increased about \$700 million per year, or at an average annual rate of 3.1 per cent. The rate of increase tended upward toward the middle of the period, rising from an average annual increase of 2.6 per cent during 1950-1955 to 3.7 per cent during 1955-1960 and declining to an average increase of 2.9 per cent per year in the 1960-1964 period.

Table V  
**FARM PRODUCTION EXPENSES**

	Billions of Dollars	Per Cent of Gross Income
1950	\$19.3	59.4%
1955	21.9	65.8
1960	26.2	69.1
1964	29.4	70.0

Source: USDA, *Farm Income Situation*.

Nonreal estate debt at the beginning of 1950 was equal to about one-fourth of farm production expenses for the year. In comparison, such debt in 1965 was almost three-fifths of farm production expenses for the preceding year.

### **Relative Decline in Liquid Assets of Farmers**

The decline in liquid financial assets of farmers relative to total production expenses may also have contributed to the increased demand for farm credit. Total liquid financial assets of farmers (cash, demand and time deposits, and United States savings bonds) have

held relatively stable since 1950 (Table VI), while

Table VI  
SELECTED LIQUID ASSETS OWNED BY FARMERS

	Billions of dollars (January 1)			
	1950	1955	1960	1964
Currency .....	\$ 2.5	\$ 2.2	\$ 1.9	\$ 1.8
Deposits				
Demand .....	4.5	4.7	4.3	3.9
Time .....	2.1	2.5	2.9	3.5
U. S. savings bonds .....	4.7	5.0	4.7	4.2
<b>Total .....</b>	<b>\$13.8</b>	<b>\$14.4</b>	<b>\$13.8</b>	<b>\$13.4</b>

Source: USDA, *Balance Sheet for Agriculture*.

production expenses have risen substantially. Relative to production expenses, liquid assets declined sharply, dropping from 71.5 per cent in 1950 to 45.6 per cent in 1964 (Table VII).

Table VII  
SELECTED LIQUID ASSETS OF FARMERS  
AS PER CENT OF PRODUCTION EXPENSES

1950	71.5%
1955	65.8
1960	52.7
1964	45.6

### Adjustments in Agricultural Resources

Basic changes within the agricultural industry have had an important impact on credit demand. Technological changes have permitted a major expansion in farm output per worker and per farm while largely retaining the traditional family farm structure of the major portion of agriculture. This readjustment of labor, land, and other capital resources has tended to concentrate the use and ownership of farming assets into fewer and larger units. Such enlargement of units has occurred both by renting and by direct ownership of larger units by farm operators. It is enlargement through direct ownership by operators and landlords, however, that has had the greatest impact on credit demand. United States Department of Agriculture data indicate that about 46 per cent of all farm purchases in 1962 were for the purpose of enlarging existing farms. These consolidations have tended to increase credit use.

The number of farms in the United States has declined at a rapid rate during recent years, while size and total assets per farm have increased sharply. The number of farms in the nation declined 40 per cent from 1950 to 1965, an average annual rate of 3.4 per cent. The rate of decline, however, has been somewhat less in recent years than in the earlier part of the period. From 1950 to 1955 the number of farms declined one million, or at a rate of 3.8 per cent per year

(Table VIII). In comparison, the number declined 573,000 from 1960 to 1965, an annual rate of 3.1 per cent.

Table VIII  
NUMBER AND SIZE OF FARMS

	Number of Farms <sup>1</sup> (Thousands)	Land in Farms (Millions of acres)	Acres per Farm
1950	5,648	1,202	213
1955	4,654	1,202	258
1960	3,949	1,174	297
1965 <sup>2</sup>	3,376	1,151	341

<sup>1</sup> 48 states.

<sup>2</sup> Preliminary.

Source: USDA, *Number of Farms and Land in Farms*.

Coincident with the downtrend in number of farms has been a substantial increase in farm size. The average size of all farms rose from 213 acres in 1950 to 341 acres at the beginning of 1965, an increase of about 60 per cent, or an average annual rate of 3.2 per cent. Similar to the change in number of farms, the pace of growth in farm size has slackened in recent years. From 1950 to 1955 the average size of farms increased from 213 to 258 acres, a 3.9 per cent average annual rate of gain. The pace slackened, however, to an annual rate of 2.9 per cent in 1955-1960 and 2.8 per cent in 1960-1965.

Capital assets per farm more than tripled from 1950 to 1965, reflecting both an increase in total farm capital and a decline in the number of farms through combinations of existing farming units. Capital per farm rose from \$18,700 in 1950 to an estimated \$60,200 in 1965, an average rate of gain of 8.1 per cent per year (Table IX). The rate of increase was not quite so large in recent years as in the 1950's. For example, assets per farm rose at an annual rate of 8.9 per cent during the period 1950-1955, 8.6 per cent from 1955 to 1960, and 6.9 per cent from 1960 to 1965.

Table IX  
AVERAGE VALUE OF PRODUCTION ASSETS PER FARM

1950	\$18,700
1955	28,600
1960	43,200
1965 <sup>1</sup>	60,200

<sup>1</sup> Preliminary.

The incentive for larger farms has been great, according to a sample of typical commercial farms in the United States.<sup>1</sup> When averaged over a number of

<sup>1</sup> USDA, *Farm Costs and Returns: Commercial Farms by Type, Size, and Location*, Agricultural Information Bulletin No. 230. This selection of farms was not designed to provide data on returns to scale; nevertheless, the analysis is probably indicative of such returns.

years, the rate of return on capital was highest for the group with greatest assets per farm. For example, the eight largest farms in the sample, with assets averaging \$175,498 in 1963, had an average return on capital of 6.9 per cent in the four years 1960-1963 (Table X). This compares with an average return of 1.3 per cent for the seven smallest farms.

Table X  
**AVERAGE RATE OF RETURN ON FARM CAPITAL**  
Typical Commercial Farms in the United States  
Classified by Value of Assets

Group	Assets per Farm, 1963	Average Return on Capital			
		1947-49	1950-54	1955-59	1960-63
1	\$175,498	10.9%	7.3%	6.0%	6.9%
2	98,111	10.1	7.0	5.3	6.0
3	58,003	10.1	4.7	2.8	3.2
4	31,080	0.6	0.1	0.4	1.3

Note: The total number of farms in the array includes all the typical farms having consistent data throughout the period. Returns to capital are based on net farm income for owner-operated farms, less deduction for operator and family labor at average U. S. farm wage rates without board or room.

Source: USDA, *Farm Costs and Returns: Commercial Farms by Type, Size, and Location*, Agricultural Information Bulletin No. 230, June 1964 and preceding issues.

The data indicate that the spread in returns to capital between the large and small farms was not so great in recent years as in 1947-1949 and the early 1950's. The spread in returns to capital between the largest farms and the smallest farms in the three years 1947-1949 was 10.3 percentage points, whereas in the periods 1955-1959 and 1960-1963 it averaged only 5.6 percentage points.

## Summary

Since 1950, credit used by farmers has grown at about the same rate as credit used by other major sectors of the economy. Credit per farm and per farm worker has increased sharply. Relative to farm assets, farm debt has almost doubled, with the greatest increases in the nonreal estate portion.

Farm mortgage debt held by the Federal Land Banks expanded more rapidly than that held by any other class of institution. Production credit associations showed the greatest rate of gain in nonreal estate credit.

Major forces contributing to the growth of farm credit include the bidding up of land values, higher operating costs, reduced liquid assets of farmers, greater investment in the industry, and adjustments of farm resources into fewer and larger operating units.

The increase of farm credit has played an important part in the greater productivity of agriculture. It has aided readjustment of the nation's farm resources into more efficient and more highly capitalized units, thereby contributing to more efficient use of the nation's supply of labor. In turn, these trends have brought consumers lower food costs. Credit has thus aided in releasing labor from production of food and other agricultural products to the production of non-farm goods and services and contributed to a rapid increase of total real product in the nation.



### *Economic Expansion Continues—(Continued from page 11)*

Varying policy mixes have implications for capital movements among countries. For example, a mix of "tight" monetary policy and "easy" fiscal policy may reduce an outflow of funds and consequently reduce a deficit in the international accounts of a nation. "Easy" money and "tight" fiscal policy may help to slow inflows of capital to a country and reduce an inappropriate surplus in a country's international accounts.

It may be that a major correction of imbalance in the world pattern of international accounts could be achieved by appropriate change in the mix of monetary and fiscal policies in various countries. "Tighter" fiscal policies in surplus countries combined with "easier" fiscal policy and "tighter" monetary policy in deficit countries might facilitate a high rate of economic activity generally along with less discrepancy of

interest rates among leading industrial nations.

The U. S. balance of payments in the first quarter showed marked improvement over the fourth quarter, despite adverse effects stemming from the dock strike and heavy foreign lending prior to the announcement of the Voluntary Credit Restraint Program. The deficit of \$3.1 billion per annum was half that of the fourth quarter. The trade surplus fell from over \$7.1 billion per annum to around \$3.9 billion, chiefly because of the strike. However, U. S. private capital outflow fell sharply from over \$8.0 billion (annual rate) in the fourth quarter to around \$4.0 billion, with most of the gain reflecting reduced short-term flows abroad. Available data, highly tentative, indicate that the U. S. international payments accounts have been in surplus since the end of March.