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THE IMPORTANCE OF AGRICULTURE TO THE U.S. ECONOMY

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TUESDAY, DECEMBER 1, 1981

THE IMPORTANCE OF AGRICULTURE TO THE U.S. ECONOMY

TUESDAY, DECEMBER 1, 1981

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON AGRICULTURE AND TRANSPORTATION
OF THE JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10 a.m., in room 5110, Dirksen Senate Office Building, Hon. James Abdnor (chairman of the subcommittee) presiding.

Present: Senators Abdnor and Jepsen.

Also present: Bruce R. Bartlett, deputy director; and Douglas N. Ross, professional staff member.

OPENING STATEMENT OF SENATOR ABDNOR, CHAIRMAN

Senator ABDNOR. The Subcommittee on Agriculture and Transportation will come to order.

Today we are holding a hearing on the importance of agriculture to the U.S. economy and we are happy to have with us Vice Chairman Jepsen of our Joint Economic Committee, who heads up the leadership on the Senate side.

I do want to welcome you, Mr. Schultz, to the third in a series of Joint Economic Committee hearings examining the importance of agriculture to the U.S. economy.

At the first session of these hearings, both Secretary Block and Council of Economic Advisers Chairman Murray Weidenbaum, stressed the fundamentally new challenges facing agriculture today. In Mr. Block's words:

> Not only is domestic agriculture increasingly dependent on the sectors of the economy and events elsewhere in the world, but the general economy and many other countries are dependent on American agriculture.

Our country takes agriculture for granted and considers improvements in agriculture almost as a matter of course. Through productivity gains in technology and efficiency, we have been afforded abundant and very inexpensive food supplies for years. The cost of food, although rising, is a bargain here compared to other countries around the world. The average family in the United States spends only 13 to 18 percent of its income on food. Italians and Yugoslavians, for example, spend about 30 and 40 percent respectively.

Agriculture exports contribute substantially to the positive side of the balance of trade, yet the economic conditions facing the farm sectors today are dismal. The cash flow squeeze is serious. Prices are depressed. Costs are skyrocketing. Rates of return on investment are plummeting. Competent farm operators are going out of business and farm income is currently comparable to what we saw during the Great Depression.

The outlook for the near future is not encouraging. Today's hearing examines the impact of the financial sector on the agriculture sector. Thus, we have asked Mr. Schultz to spell out the implications of the current recession on the agricultural industry and on the future productivity of agriculture.

During the past several decades agriculture has become a heavily capital-intensive industry and has required substantial debt financing to establish its investment goals. During the sixties and until the late seventies, credit was available at reasonable rates of interest in the market. In addition, the Government programs offered alternative financing opportunities with generous payback arrangements. As we all know, credit conditions today are very, very different. Government programs are being trimmed back. Interest rates during the past few years have been at historically high level. Because of inflation and other disincentives to save, the pool of loanable funds has not kept pace with the demand for those funds.

Much of the increase in productivity can be attributed to investment commitments made by the industry. But today the typical farmer cannot afford to borrow even for operating capital, let alone expansion capital. Farming cannot be profitable when interest expenses exceed the proceeds remaining after other costs of production are paid for. The implications for the future productivity and income increases are not good if we do not maintain an adequate level of investment.

Mr. Schultz, I do welcome you to the subcommittee and we are looking forward to hearing from you, but first I want to call on Vice Chairman Jepsen of our Joint Economic Committee.

Opening Statement of Senator Jepsen

Senator Jepsen. Thank you, Mr. Chairman. I wish to echo your concern over the grave condition of the Nation's agricultural economy. The farm producers are having to pay the same exorbitant interest rates that every other person in this country is paying and they are having to patch up old, wornout equipment or pay outrageous prices for new equipment. Implement dealers are in no better shape. My guess is that many farmers and equipment dealers are on or very near the brink of bankruptcy. Other individuals and organizations in the agricultural community are faced with similar circumstances.

Tractor and combine sales nationally have dropped from 126,750 units in 1979 to 93,180 units in 1980. Trends are continuing downward in 1981. Many dealers face the frightening prospect of losing their business and their livelihood and, to lure buyers, many dealers have had to cut profit margins to the bone. The prosperity of dealers and their parent companies are tied directly to farm prices. Few farmers today are willing to commit themselves to big financial outlays. They will remain steadfast with that decision until farm income improves.

Another problem working against any improvement in the agricultural economy is that it has become too expensive for newcomers, young farmers, to buy land and equipment to start farming. A farm big enough to support a family today would cost $1.5 million or more.

In addition, it would take another $250,000 to buy machinery, implements, trucks, wagons, and storage bins needed to farm the land. This is the estimate provided by Donald Colglazier, owner of the International Harvester dealership in Adel, Iowa, during a discussion with the Des Moines Register business writers, Gene Erb and Kent Parker.

Corn today is bringing $2.25 per bushel, while at the same time last year it was $2.80 per bushel. Production has increased to a record 8.2 billion bushels, nearly a 20-percent increase over 1980. The 1981 harvest is winding down so the predictions are fast becoming facts, economically unpleasant ones for the agricultural community. Soybeans were selling for $9 per bushel last year at this time compared to the current market of about $6.50 per bushel. The cost of production—fertilizer, fuel, equipment maintenance costs, interest rates, chemicals—all have risen. Quite likely in many cases the cost of production exceeds the market price for grains. Cattle and hog production costs fall in the same category.

According to "Agricultural Outlook," published by the USDA Economics and Statistics Service, there is a profound effect on aggregate demand for food during a sluggish economy or a recession. A review of recessions over the past 30 years indicates that personal consumption expenditures for food tend to decline during a recession. This, of course, has a direct effect on livestock producers and an indirect effect on feed grain producers.

According to "Agricultural Outlook," prices for inputs and debt servicing continue to climb with the general rate of inflation, causing a squeeze on the producer's cash flow. Tight cash flow is expected to continue in the fourth quarter and into the first quarter of 1982, as crop prices keep falling, livestock prices remain flat, and prices paid by farmers move higher.

With increases in production expenses outstripping gains in cash receipts, farmer's 1981 net cash income will probably fall below last year's. Net income before inventory adjustment is now projected at $17 billion to $21 billion this year compared to $21.9 billion in 1980. Mr. Chairman, the agricultural economy is in real trouble.

As chairman of the Senate Agriculture Subcommittee for Soil and Water Conservation, I have been alarmed at how this Nation is allowing its precious topsoil to wash away. Producers care about their land and do not want it abused. However, they simply do not have the financial resources to take losses at the marketplace and spend the necessary funds for installation of permanent conservation practices. Many are adopting some form of conservation tillage to help reduce erosion, labor, and energy costs. That is a worthy endeavor especially during these difficult economic times for our agricultural producers. We cannot overlook the need, however, for permanent solutions for erosion control. Such practices and measures cost money but are wise investments when considered over a 5- or 10-year period. They might mean the difference between having a productive resource base and not by the turn of the century.

Thank you for inviting me to participate in this important and timely hearing. Mr. Chairman, I have been painting a very bleak picture for our farm economy, and indeed, it is in grim shape. But I would not be telling the whole story if I did not inject a ray of hope—and that ray is President Reagan's economic recovery program.

The entire plan is not even in effect yet, but we are already seeing signs that our economy has started to turn around. Interest rates are headed downward, and that's a welcome sign. From a high just over a year ago of over 21 percent, the prime rate has dropped over 6 points. The 90-day Treasury bill rate has shown an even greater change, dropping by over a third.

Inflation may drop into single digits this year for the first time since 1978.

Secretary Block has opened the feed grain reserve program, and already some 90 million bushels of corn have been placed into the reserve, lessening the downward pressure of our record harvest.

Soil conservation is starting to get the attention it deserves. For the first time in history, conservation has been addressed in a farm bill, and I am confident the awareness that is spreading across the country will continue to grow and we will get the job done.

Mr. Chairman, it is true that things are grim for the farmer today, but tomorrow bodes well, if we can stick to our path of recovery. It won't happen overnight, but I am confident that it certainly will happen.

I welcome Mr. Schultz and I publicly thank him for coming to Iowa a few months ago. We visited with the financial community there at a time when interest rates were just about at their peak and I appreciated not only your actions on the Federal Reserve Board but your deep and very perceptive and I think commonsense insight into our economic problems. I welcome you also, Mr. Schultz, and look forward to your remarks.

Senator ABDNOR. Thank you, Senator Jepsen, and we are indeed very pleased to have the Vice Chairman of the Board of Governors of the Federal Reserve System, Frederick Schultz, with us and we have asked Mr. Schultz to spell out particularly the implications of the current recession on the agricultural industry and on the future productivity of agriculture. We are certainly anxious to hear from you.

STATEMENT OF HON. FREDERICK H. SCHULTZ, VICE CHAIRMAN, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, ACCOMPANIED BY EMANUEL MELICHAR, SENIOR ECONOMIST, WAGES, PRICES, AND PRODUCTIVITY SECTION

Mr. SCHULTZ. Thank you, Mr. Chairman. Senator Jepsen, I appreciate your kind remarks. In the last couple of years, we in the Federal Reserve, have not been used to receiving too many of those.

I am pleased to have the opportunity to participate this morning in your hearings on the importance of agriculture to the U.S. economy. You asked me to discuss the impact on agriculture of developments in the general economy and financial markets. Although conditions in the agricultural sector depend very importantly on circumstances unique to that sector, over recent years its performance has in some respects become increasingly tied to events in the rest of the economy. During the past decade, in the absence of large surplus stocks of farm commodities, crop production problems, and changes in demand for farm output, whether in the United States or abroad, have been transmitted more rapidly to changes in the price and availability of farm products.

In similar fashion, cyclical changes in the general level of interest rates have recently been reflected more quickly and completely in the cost of funds borrowed by farmers.

Agriculture, like many other sectors of the U.S. economy, has been affected by the related ailments of high inflation, high interest rates, and sluggish economic activity that have plagued us for the last few years. The failure of consumer incomes to grow, after taking account of inflation, has limited demand for many farm products, particularly meat. With favorable weather in many areas of the country spurring production at the same time, retail food prices this year seem certain to register their smallest increase since 1976. Prices for meats and livestock have actually fallen this year, reflecting a shift in consumers' preferences that may have been accentuated by the uncertain economic environment. The softness in agricultural prices has helped to slow the overall rate of inflation this year, which, of course, is what we are all trying to achieve.

For the farmer, however, relatively stable prices have meant little growth in gross farm income. Other prices, unfortunately, have not stopped rising, including those paid by farmers for the goods necessary to produce their output. Prices of production goods and services purchased from the nonfarm sector rose by 11 percent in 1981, following a 16-percent increase in 1980. The result has been a marked decline in net farm income. Moreover, not only has inflation reduced farm earnings, it has also eroded the purchasing power of this net income. In response, farmers have pared their purchases of new equipment sharply, placing great stress on the manufacturers in this sector. Thus, inflation has played a major and direct role in causing difficulties for farmers and in related industries.

Inflation also has affected the agricultural sector through its influence on interest rates. When prices are expected to rise, lenders seek to be compensated for being repaid in funds of reduced purchasing power by receiving a higher return on their loans. Many borrowers often are willing to pay these higher rates, because they expect the goods they are purchasing on credit will be more expensive if they wait. As a result, the rapid inflation we have experienced in recent years has been associated with historically high interest rates.

Prior to 1979, farmers borrowing from rural banks were largely insulated from fluctuations in interest rates in national markets, because these changes had little effect on the cost of funds at such banks. The introduction of smaller time deposits with ceiling rates tied to money market rates has changed that situation, however. By September 30 of this year, 6 month money market certificates of deposit represented 30 percent of total resources at agricultural banks and large-denomination certificates accounted for another 7 percent; thus, well over a third of the footings of these banks were in the form of short-term deposits carrying market-related rates. In addition, most rural banks have been offering long-term "small saver" certificates, which, beginning this summer, have been issued at market-related rates. Consequently, when market interest rates increased sharply during the past spring and summer, the rising cost of funds at rural banks led to higher rates on farm loans. Even so, at their peaks, these rates remained below the prime rate at large banks The average effective rate on farm loans at the smaller banks had reached 19.1 percent at the time of our quarterly survey conducted during the first week of August, when the prime rate at large banks was 20.5 percent.

Although the shift to market-related yields on the liabilities of smaller and rural banks has caused loan rates at these institutions to fluctuate with changes in market rates, there have been offsetting benefits to rural communities. Rural residents, including farmers, have been able to obtain market-related yields on their deposits in local institutions. The capacity of rural banks to compete more successfully for savings has allowed them to maintain or increase their lending ability during a period in which it would probably otherwise have been impaired. The ample liquidity and lending capacity of rural banks is illustrated by the relatively low level of their average loan-to-deposit ratios recently. Currently this measure is around 61 percent, down from 68 percent 2 years ago, despite growth in loans over this period. Credit has remained available to farmers, albeit at very high rates.

The rise in interest rates has greatly aggravated cash flow difficulties for those farmers who are both highly leveraged—operating at high debt-to-asset ratios—and relying on short-term financing. When one looks at the agricultural sector as a whole, however, it appears that farmers in this particularly vulnerable credit position are a small proportion of all farmers.

The average debt-to-asset ratio in agriculture is only 18 percent—less than half the average ratio found in nonfinancial corporate business. Furthermore, the average interest rate being paid on all outstanding farm debt has risen relatively slowly, and for 1981 is estimated at about 10¼ percent, up less than 2 percentage points from 1979. Much outstanding debt was incurred in earlier years at lower fixed rates and for long periods from sellers of farms, life insurance companies, and other mortgage lenders, or from Federal Land Banks whose variable rates have risen relatively slowly; also, a significant proportion of recent new debt consisted of drought-related Farmers Home Administration loans made at below-market rates. The increase in interest costs that has resulted from the rise in rates accounts for a relatively small part—less than one-fifth—of the drop in real net earnings of the farm sector since 1979.

By the same token, the reduction in interest rates that has occurred in the last few months is unlikely to produce dramatic improvement in the financial situation of the farming sector as a whole. The increase in total interest costs will be slowed, but average rates on new loans would have to fall below 11 percent in order to reverse the upward climb in the average rate on all debt. However, the ongoing drop in market and farm loan rates will greatly aid those highly-leveraged users of short-term loans who were hardest hit as rates rose.

The recent declines in interest rates appear to stem primarily from reductions in private demands for money and credit associated with a weakening economy—a combination that implies costs as well as benefits to farmers. Longer term relief will not come until we see a pronounced and continuing moderation in the inflation that has gripped this country for more than a decade. Reduced inflation will bring with it permanently lower interest rates and will set the stage for a resumption of sustained economic growth.

The Federal Reserve is following a strategy designed to bring this about. We have announced our intention to reduce gradually growth in money and credit to rates consistent with stable noninflationary economic growth. The course will not be smooth. In a world of volatile expectations and rapid changes in financial practices, we cannot guarantee the achievement of our objectives for monetary expansion over short periods, nor perhaps should we attempt to do so. Moreover, even a stable growth path for money and credit may be associated with considerable volatility in the level and pattern of spending as the economy adapts to slowing inflation rates.

The current downturn in economic activity is an unfortunate example of this. I believe that the decline will be limited, partly because the recent downward movement in interest rates will buoy demands in credit-sensitive sectors. It would be a grave mistake, in my view, for the Federal Reserve to attempt to turn the economy around by greatly accelerating money growth. Such a policy might result initially in lower interest rates and a faster rebound in activity, but it would also signal once again a lack of resolve in combating inflation. The ultimate outcome would be higher inflation and interest rates and additional strains on our economy and financial system. This outcome can be prevented if the Federal Reserve sticks to its longer run policy, and we are determined to do so.

The transition to an economy of noninflationary growth will not be easy. The problems we are facing have been building up for many years, and we cannot expect quick or painless solutions to them. Moreover, heavy reliance on monetary policy to accomplish this goal puts particular stress on those sectors of the economy that are sensitive to changes in the cost and availability of credit—and agriculture falls increasingly into this category. The adjustment would be swifter and more equitable, were the Federal Government's budget policy working to reinforce the thrust of monetary policy. This does not appear to be in prospect, given the very large gaps now expected between receipts and expenditures in coming years. High budget deficits put additional strain on private borrowers, because in effect the Government has first call on the Nation's pool of savings. Reducing Government competition for these funds would lower interest rates and encourage private spending initiatives. As important as the direct effect of lower deficits on financial markets, in my view, would be the perception fostered by a better outlook for budget balance that policy throughout the Government was being formulated to accomplish the same goal. One reason that inflation has persisted at such a high level in the face of generally weak economic activity is that the public is not yet convinced that Government will follow a sustained and consistent policy to end it. We must convince businessmen, farmers, consumers, and wage earners that they can no longer plan on continuing price increases—that all elements of Government policy are dedicated to stopping inflation and will persist until they succeed.

Mr. Chairman, that concludes my testimony. I would be happy to answer any questions that you have.

Senator ABDNOR. Thank you, Mr. Schultz. We certainly appreciate your words here because you know of what you speak and you have experience in your field.

We are greatly concerned about the well-being of the farmer, for good reason. Some of the statistics you gave us today would imply that they are in better shape than business as a whole on the basis of a lower debt-to-asset ratio, but I find quite a difference between the farm and a Main Street business or a corporation. This is due to many factors over which farmers have no control and which businesses sometimes do. I was a little surprised, frankly. Is that a pretty accurate statement when you say that the debt ratio on the average farm is only half of what it is in the corporate business? That's pretty well established through records, is it?

Mr. SCHULTZ. Yes. I brought Mr. Melichar with me. He is responsible for our work in agricultural finance at the Federal Reserve Board.

Senator ABDNOR. We would be happy to have you come forward. Why don't you just come up to the table.

Mr. MELICHAR. For all corporate nonfinancial business, the average debt-to-asset ratio is 41 percent. However, such business is different from farming in that it involves more short-term assets and short-term financing. For instance, accounts receivable financing is a large proportion, as is inventory financing, whereas in farming much more of the assets and debt are of a longer-term nature.

Mr. SCHULTZ. I would add that I think you have to recognize that small business in this country is also under great pressure as a result of inflation and as a result of these high interest rates. So you have a lot of pressures in other sectors of the economy that are very similar to the kinds of pressures that you get in agriculture. Also, I think that you have a lot of people in agriculture who have been in there for a very long time and have built up a good deal of equity, whereas that is not necessarily the case in private nonagricultural industry where you have so many new businesses being formed all the time.

Senator ABDNOR. Don't you suppose that could be a result of losing so many farmers and those who are well established from years gone back have been able to take over some of these other farms? For instance, 2.6 percent of the population are in agriculture. When I first came here 7 years ago it was 4 percent. That's losing them pretty fast. You can't tell me that all of the 1.4 percent that dropped out were bad operators. What disturbs us here is how rapidly we are losing farmers—we used to say we have to weed out the poor operators, the inefficient operators, but don't you think we have pretty well weeded those out by this time?

Mr. SCHULTZ. I don't really think that's the main cause of the drop that you point out, Senator. I was looking at some of those statistics not too long ago and my recollection is that 40 years ago in this country some 22 percent of the population was engaged in agriculture.

Senator ABDNOR. Right.

Mr. SCHULTZ. And now, as you say, 2.6 percent are involved in agriculture. But the primary reason for that has been the enormous increase in productivity in the farm sector. It has not been that the farm sector has been less profitable or that people have been driven out of the farm sector, but a result of this enormous increase in productivity. People have in effect been moving from the rural areas into the urban areas because of this ability of fewer people to produce so much more.

Senator ABDNOR. Let me assure you, Mr. Schultz, that I have been in a farming operation for many years and I have a difficult time believing that anybody in agriculture would receive anywhere near the return on their investment that they do from a business. It's always been that way, I guess, but I think a lot of these people that went out of business in farming only went out because they were broke. I don't think it was for any other reason—the ones I know out my way. Now, the depressed agricultural economy doesn't always follow the business cycle. A lot of times the farm sector goes into recession long before business ever gets there. They were hurting before business ever heard of this recent recession.

Let me give you an example. When I first came down here I sold some wheat for $5 a bushel. Do you know what it's worth today out in the market out in rural America? $3.60 or $3.65 a bushel. That was 7 years ago. A lot has happened in 7 years. I'm concerned. I see land values keep going up and those who hold large acres of holdings of land are in a position to continue to buy. What about the young person—would you loan a young man money to go into farming today even if he had a little money to put into it? Do you think it would be a good investment?

Mr. SCHULTZ. Well, that's a little difficult for me to answer, Senator, because clearly that's going to vary depending upon where he is and what kind of farming he's going to go into. Obviously, the fortunes of farming are going to vary a good deal depending upon what the economists like to call exogenous forces, like the weather. So you're going to have these cycles that are not dependent upon the economy.

For example, in addition to the present business cycle that we're in, we had a remarkable harvest this year. As I recall the figures, the combination of the corn and wheat crop was some 900 million bushels bigger than any previous harvest that we have ever had in this country—an enormous harvest—that clearly is having a downward effect on prices.

In addition to that, I think it is quite clear that people have changed their eating patterns. My recollection on beef is that at one time beef consumption in this country was almost 100 pounds per person. Now the figure is something like 76 pounds. So there's been an enormous drop in the consumption of beef.

Add to that the fact that costs for the farmer clearly have continued to go up in an inflationary environment. There just is no question that they are getting squeezed. But I would tell you that most people in small business in this country would argue that the farmer is not getting hurt worse than the small businessman; there are a great many screams of pain out there.

What we are seeing is an economy that doesn't work very well when you have high inflation. Until we get inflation down and interest rates down—and that's the only way interest rates are ever going to come down on a permanent basis—we are going to have a lot of sectors of this economy that are hurting.

Senator ABDNOR. I couldn't agree with you more, Mr. Schultz, and if I suggested that small business wasn't hurting I apologize. But I will say this—at least in the State I'm in, most of those small businesses are hurting because the farmers haven't been able to buy anything. The implement dealers and the car dealers are among those businesses readily affected. I don't suppose that's true all over. Now we have unemployment in the cities, which certainly affects urban economics, but this has been going on for a long period of time. For instance, I just said that the farm population represents about 2.6 percent of the total population and my figures show that they receive less than 1 percent of the national income. That's an interesting figure. Do you disagree with that?

Mr. SCHULTZ. I don't know.

Mr. MELICHAR. I think the current farm operators' income, as you pointed out, is a low percentage of the asset value.

Senator ABDNOR. Only 2.6 percent of the total population and for the investment for that person out there farming, it's way higher than it is in industry on a per capita basis, and yet he's getting 1 percent of the income. That tells us it's disproportionate and something is wrong.

I don't expect you to have the answers immediately, but I would like to get an admission, if I get nothing else out of this subcommittee—to get the economists in this country to admit that farmers are in trouble and need some attention and help, or at least to get economists thinking that way—we would have accomplished something. This disturbs me: I listen to economists who come before this committee and they talk about the problems all through the economy, but I never hear them mention the agricultural economy. It just doesn't exist to them. Agriculture gives a mighty important contribution to our balance of trade due to selling grain overseas. This also disturbs me: Today most consumers think it's the farmers that are the cause of the high price of food. As I just mentioned, one item alone—I sold wheat for $5 a bushel in 1973 and today you get $3.60. If my memory serves me right, I believe I could buy a loaf of bread for 30 cents and what do you pay today—close to a dollar. How do we tell that story? Maybe the news people will write more about it because I think it needs to be brought out that the farmers are really hurting. The price of beef went up. Let me tell you something. Two years ago the people out my way got $20 a hundred more for their cattle than they're selling those calves for today. They received that much more. And yet beef keeps going up and people think that farmers must be getting rich.

I just hope that some day we can make people realize the importance of the agricultural economy. Don't you think, Mr. Schultz, that we make a great contribution in agriculture when the people in this country can buy their food for 13 to 18 percent of their takehome pay versus what other countries pay—30 to 40 percent? How many more dollars does that put into the economy for other purposes and uses? But I never hear anybody think of agriculture in terms of the great contribution it makes. This is the thing that disturbs us. I think you've got to agree that farm income is too low. Wouldn't you, sir? Wouldn't you think that income is pretty low for the farmer?

Mr. MELICHAR. Certainly relative to their asset values and so on, it is low, and lower than the level that would sustain those asset values. Now I believe the Department of Agriculture estimates are showing that the return to farm assets this year is going to be less than 2 percent, somewhere between 1 and 2 percent, and with interest rates at the current levels the return on farmers' equity will be around 1 percent this year. Those are one-half to one-third of the average returns of the past two to two and a half decades. And compared with 1979, which was a year of fairly satisfactory farm income that seemed to be about in line with the prices of land, income today in terms of purchasing power is only slightly more than half of the 1979 level.

So there's no doubt that there has been a large reduction in farm income. For instance, to have today an income equivalent to that of 1979's farm income purchasing power, the total income of farm operators and landlords would have to be about $47 billion. Instead of that, it is about $27 billion. So that's a tremendous reduction in their buying power, and this is the cash flow problem that you're pointing out.

Senator ABDNOR. Well, I appreciate that. I really do, because that pretty well tells the story right there, and that's the point I'm trying to make. My time is running out. One last question.

From your vantage point, either one of you two gentlemen, do you see anything other than the inflation that can be done to help agriculture and to improve the situation? Do you have any suggestions or thoughts as to what could be done? More Government programs? What do you feel the answer is?

Mr. SCHULTZ. Senator, I really believe that inflation is the key because I think if you want to stimulate this economy the best way to do it is to get interest rates down, not to spend more money at the Government level but to get interest rates down. And you can get interest rates down more quickly by spending less at the Government level. So we are in one of those unusual situations. People have always felt that in a recession you needed to increase Government spending to stimulate the economy. I think the opposite is true this time. What you need to do to get this economy stimulated is to get interest rates down, and to do that, you need to attack the inflationary expectations. But I really think that getting inflation down would be by far the best thing you could do for the farmer. It would be the best thing you could do for lots of other people, too, but it clearly is going to help the farmer a lot.

And let me just make a final comment to you. You talk about how important agriculture is to the country. I don't think anybody that spends any time thinking about this economy can fail to recognize the tremendous natural resource that we have in this country in our land and the people who work that land, and I think that over time it will become increasingly a greater resource. As populations continue to grow around the world and with the problems that they're having with weather changes and what is happening to land in other places around the world, our land is going to become increasingly valuable. I share Senator Jepsen's concern about the topsoil question because it is an enormous natural resource, but I don't think anybody that thinks about this economy fails to recognize how important it is that in the United States we spend 18 percent or less of personal income on food, whereas in a country like Russia it's twice that much.

Senator ABDNOR. Thank you.

Senator Jepsen.

Senator JEPSEN. Thank you, Senator Abdnor.

Mr. Schultz, in my opinion and that of some of my colleagues, the interest rates are indeed the item that has been immediately politically and otherwise irritating the entire climate. It has caused a change of projections and predictions that is somewhat directly related to the number of chapter XI's that are being filed in the United States daily and in my State daily.

I would like to talk just about interest rates and examine some of the opinions that have been voiced over the past several months from different circles about them.

First of all, in the interest rates, do you believe there is a built-in inflation expectancy?

Mr. SCHULTZ. Yes, I think a very large one at this point in time, and that's generally historically been true. When inflation was on the rise, real interest rates have tended to be negative and when you started to begin to get inflation under control and began to bring it down, as we are right now, real interest rates tend to be high. There tends to be a lag there and that is in part due to inflationary expectations.

I don't think there's any question that inflation expectations are higher than they have been in this country for a long, long time.

Senator JEPSEN. And the inflation expectancy, whatever those points are—and I have heard anywhere from 4 to 6 percent—that's usually what we talk about with the expectancy—is that a ballpark figure that you hear bantered around or what is the inflation expectancy?

Mr. SCHULTZ. Well, I think that's a fairly good ballpark figure for real interest rates. You have to break that down into the components of what you would term to be a normal rate of return. Real interest rates generally are though to be in the 2- to 3-percent range, not the 4- to 6-percent range. So that difference is due to something. We think most of it is due to the lag in adjusting inflationary expectations. There is also some uncertainty premium in there because of the volatility of rates. In our judgment that is not anywhere near as great as the other factor, which is inflationary expectations.

Senator JEPSEN. Then this may seem to be an oversimplification, but let's walk through it. Then there is a great deal of psychology in those inflationary expectancy rates?

Mr. SCHULTZ. There is indeed, an enormous psychological factor that is really critical at this point in time. Up until the summer of 1979, people in this country believed that we were going to get inflation under control and they acted in that way. In the summer of 1979, they suddenly began to act very differently. You saw a tremendous amount of borrowing and spending. You saw consumer borrowing go up. You saw real estate speculation rise. You saw speculation in commodities of all kinds—precious metal markets—you saw a flight from currency into tangibles, everything from comic books to diamonds or art. So, the change in expectations made an enormous amount of difference. People began to do things differently. They stopped saving and began borrowing and investing and doing things to protect themselves against inflation. And until we break those expectations and begin to get them started back the other way—to get people of saving so that we can have the money for investment—then I think we're going to have a very difficult time with the economy.

Senator JEPSEN. I agree, and I think the psychology that's alluded to in your last sentence is really the key to bringing interest rates down to a point where I think we're going to have a real boom in the economy. I'll read your last sentence again:

We must convince businessmen, farmers, consumers, and wage earners that they can no longer plan on continuing price increases—that all elements of government policy are dedicated to stopping inflation and will persist until they succeed.

That last one would have the biggest effect on this inflationary expectancy in 4 to 6 months, whenever it may be, when at some time the people again believe that the Government policy is dedicated to stopping inflation and that they are going to follow through and they are going to mean what they say and they are going to do what they say.

Mr. SCHULTZ. Indeed, I think it's absolutely critical. What we've got to do in this country is to get long-term interest rates down and keep them down. Now the Federal Reserve policy could, by pumping in a lot of reserves, get short-term interest rates down; but we think that action could have the effect of making long-term interest rates go up rather than down. And if we can't get long-term interest rates down, we can't get mortgages made in this country, so we can't do the kinds of things we need to do in housing and in agriculture. And unless we get long-term rates down, we can't get the long-term capital markets working so that business can sell bonds and pay off their loans at banks, which then makes more loans available to small business and farmers.

Now long-term interest rates are basically dependent on what a lender thinks he's going to get back in real terms over time. He's worried about whether he's going to get paid back in inflated dollars. So it's not what happens this year that's crucial to him but what happens down the line.

Now the only way that he's going to see his way clear to accept lower rates is if he becomes convinced that we are going to get inflation down in this country. And I believe that a critical factor in doing that is to do something about the Federal deficit because, however you want to argue theoretically, the fact is that 99 percent of the people in this country believe that Government deficit is causing inflation. I don't think it's 1982 that makes the difference, but I think it's critical that these people see some movement in 1983, 1984, and 1985, whatever it is. And again, it's not critical that the budget be balanced in 1984, but you've got to see the movement in that direction.

If you do that, I believe inflationary expectations change and change quite radically and you will begin to get this economy moving again. But until we do that, I think we've got a problem.

Senator JEPSEN. So we're talking about credibility, believability, what the people perceive in this country as far as the Government's commitment and the resolve to follow through on it, the way that we finance our deficit. As you have alluded—and I think it's an accurate statement—that over a period of years up until just recently we financed the deficit by pumping new money into existence, like 67 percent of all of our deficit financing has been pretty much new money that's been cranked out due to the Federal Reserve Board direction.

Mr. SCHULTZ. I don't know the figure, but I think it is clear that in the past the debt has been heavily monetized, Senator.

Senator JEPSEN. I'm not saying that to be critical. I'm just making an observation.

Mr. SCHULTZ. But I think it's an important point to be made because of the fact that the Federal Reserve is an independent agency. It is independent within the Government, but it's not independent of the

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Government. And if there are enormous deficits which go on over a long period of time, if the Fed does not to some degree monetize those, then the effect on the economy becomes enormous. Government is taking all the money and the interest rates go up extremely high. You get this terrible pain in certain parts of the economy.

The fact is, in my opinion, we have been unfair in this country to farmers and small businessmen and people in the housing and automobile industry and the thrift industry and others who have carried too much of the burden because there's been too much of the burden placed on monetary policy, and when that makes interest rates go higher, the interest-sensitive sectors of the economy are hurt, whereas energy and defense are just flying high. That's not fair, in my opinion.

Senator JEPSEN. In the interest of bringing about this credibility, many of us have been working in a number of ways in a number of areas to try to do everything we can—everything from resolutions to public comments and so on—to bring about this faith, credibility, that we have in both the Government and the Federal Reserve Board. There will be within the next 72 hours in this Congress proposed legislation that the Federal Reserve Board in its appointees appoint a representative from the small business and agriculture community to the Reserve Board. In the last 23 years there's been one appointment that's had some very remote relationship to small business. Since 1959 there has hardly been any that has been related to agriculture, whereas we have had I think—and I don't mean this disrespectfully—9 or 11 Harvard graduates and economists and so on, and some of us believe—and I think it's very key to the establishment of the fact that the farmers and the small businessmen and so on don't feel they're being represented or being heard, and certainly not on the Federal Reserve Board.

As a member of the Board, just as an observation, do you think that's an accurate analysis of some of the feeling outside of Washington?

Mr. SCHULTZ. Yes, indeed I do, Senator, and I think that it is important, particularly at this point in time, that my successor be someone with a broad business background, someone who has dealt with day-to-day business problems, whether it's in the area of agriculture or whether it's in the area of housing or whatever. I think it is important that the Federal Reserve Board have a balance, that not all of the members of the Board be professional economists. I do think there should be some professional economists on the Board, but I think that we do need a broader mix than we have had in the past. I think not only in terms of credibility, which you talked about, but in terms of the kinds of decisions we make, because there's an enormous amount of pressure on the Federal Reserve Board these days in so many different areas, and the broader experience will be helpful, in my opinion.

I would not like to see us—parden me—not like to see you pass legislation which would specifically designate that a certain group has to have a representative on the Board. I think that would be much too constraining if you happen to have each slot designated—that you may very well have someone who is really first-class that you want on there for a different reason that doesn't fit a mold. I do think it is important that we have breadth both in terms of the background of the members of the Board and in terms of geographical representation. I think it would be good for the Board and it would be good for the country if the next appointee was a person of a broad business background from the West or Southwest.

Senator JEPSEN. Well, thank you for that. There will be three amendments offered. One will be an amendment in the form of legislation by Senator Byrd which is specified as small business. Senator Weicker has one that's similar to that and I have a resolution which is now cosponsored by some 37 Senators that is a resolution that calls attention to essentially the way you just stated it—that the statute does say that consideration must be or should be given to commerce and geography, the agriculture and so on, and somewhere between those parameters of those three amendments there will be something. I would predict some action taken by the Senate in the next 72 hours.

Mr. SCHULTZ. I would just make two comments, if I may, Senator. I would say that the resolution which you have coauthored is one that I think is the right way to go at this point in time. I think it has great validity. I would also point out that this legislation is directed at the President. We don't pick our own members. But I think that what you have put forth represents a feeling on the part of a great many people in this country that the Federal Reserve does need to have better balance and that it does need to have better representation geographically, and I happen to think that's correct.

Senator JEPSEN. Thank you. Thank you, Mr. Chairman.

Senator ABDNOR. Thank you.

Mr. Schultz, one of my colleagues, a colleague from Iowa and my good friend, Senator Charles Grassley, asked me to submit a question on his behalf.

He asked this question. What consideration, if any, does the Federal Reserve Board give to the unique seasonal borrowing needs of our Nation's farmers during the Board's development of its fiscal strategies and policies?

Mr. SCHULTZ. Well, we have a seasonal borrowing program, Senator, which allows for borrowing from the discount window for longer periods of time by banks in farming communities. That's been a part of our general discount window policy pretty much since the Federal Reserve was started, and there has been a formal program to do this since April 1973.

One of the reasons that the Federal Reserve was begun was to act as lender of last resort, particularly in those areas that had seasonal requirements. So that has been part of our policy.

Senator ABDNOR. Thank you. Let me ask one last question. Mr. Schultz, in your testimony you said that the average debt-to-asset ratio in agriculture is only 18 percent, less than half the average ratio found in nonfinancial corporate business. The ratio is not the burden—it is the magnitude of the debt. Managing the debt is my concern. The big problem of the farmer has been cash flow. You know, farmers die rich and live poor because they simply don't have any cash flow coming in. As a matter of fact, I think you just said it—the return on his investment of a farmer is 1 or 2 percent. I have 1.6 percent. I've heard that used, which tells us something. It's hard to have much of a cash flow on that kind of return when you have to keep your family around and do a few other things besides putting it all back into agriculture.

Do you have any thoughts on what we could do about this? Is it a hopeless case to say that the only thing that's going to save us is we've got to get inflation down and interest rates down and that's the only way to correct it? Do you think there's a place for Government to have a part in this or is the best way to keep it out? How do you feel about that?

Mr. SCHULTZ. This is always a very difficult question to answer, Senator, because clearly farm income is very volatile, primarily because of the weather, not because of developments in the economy. And so I guess for a very long time in this country we have been working on the theory that Government ought to do something to try to even this out a little bit. I'm not an expert in this area and I can't tell you where the answer to that kind of judgmental question should fall. It's clear if you take it too far in one direction you have a tendency to harm the economy in terms of the prospects throughout the population and if you don't do anything about it you get very wide swings in farm income. I can't tell you where the right balance is.

Senator ABDNOR. Well, you have the same concern that I have. Pointing out that the percentage of people in agriculture drops from 4 to 2.6 in a matter of maybe 7 years or so tells us if we don't straighten this situation out we can soon forget about the family from. Don't you think that's a possibility?

Mr. SCHULTZ. But at the same time, Senator, these lesser number of people have been able to produce the biggest harvest in the history of the country.

Senator ABDNOR. Well, let me say we have encouraged that. Not long ago we were urging farmers to farm from fence to fence, and then we turned around and put obstacles in their path on foreign trade. Don't you think that exports are probably our greatest hope for the future, in getting rid of surplus grain?

Mr. SCHULTZ. I don't think there's any question about that and I happen to know Senator Jepsen's very strong feelings on that issue because when I was traveling in Iowa with him that was his greatest concern at that point in time. When you talk about the fact that we have encouraged farmers to farm fence to fence, I think you put your finger on one of the great problems of Government involvement in the farming sector. I really can't give you a very good answer to that. There's a balance somewhere and I just don't know where it is.

Senator ABDNOR. Well, we appreciate your time with us. You have been very helpful and we appreciate having your remarks on the record. We would like to feel free to submit questions in writing if we might from other members who would have liked to be here today but couldn't.

Mr. SCHULTZ. At any time, Senator, and the Federal Reserve is a resource for you in that area and when you have questions we would be happy to try to help with them.

Senator ABDNOR. Thank you very much.

We've invited two prominent private sector bankers to share their insights and experiences with us today.

First is Nels Turnquist, representing First Bank System of Minneapolis. Mr. Turnquist is president of the National Bank of South Dakota, which is located in my home State. Also with us is Charles "Buck" Moore, representing Northwest Bancorporation of Minneapolis. He is president of that bank holding company's Northwestern National Bank of Sioux Falls. These men and their institutions are leaders in the field of agriculture lending in the Midwest region. Out of the over 4,000 banks in the country, Mr. Turnquist's bank ranks 17th in the dollar amount of agriculture loans, and Mr. Moore's ranks 15th.

Agriculture is of major importance to this region of our country and the contribution of the region is vital to the overall U.S. economy, so it's indeed a pleasure to have you share your expertise with us. I simply wanted you gentlemen to come because I know you're right in the farming country where nothing like experience can tell the story. So either one of you gentlemen may start. Mr. Turnquist, I see you're on the list first.

STATEMENT OF NELS E. TURNQUIST, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, NATIONAL BANK OF SOUTH DAKOTA, AFFILIATE OF THE FIRST BANK SYSTEM, INC., MINNEAPOLIS, MINN.

Mr. TURNQUIST. Thank you, Mr. Chairman. You have described the National Bank of South Dakota pretty well, which is an affiliate of the First Bank System. We have 18 statewide branches serving the State from Sioux Falls on the eastern border to Rapid City in the west. In addition to those two urban areas, we serve nine other communities in the State that are predominantly rural agricultural areas.

Our bank has a long history of services to agriculture and has ranked for the past 10 years in the top 25 banks in the Nation in terms of dollars loaned to agriculture for production loans. In addition, we are 1 of 92 banks and trust companies that are affiliated with First Bank System, Inc.

It's a real privilege for me to be here today and to have the opportunity to share with you some of our views on the current economic circumstances in agriculture in our State and region. Moreover, I wish to share with you some thoughts we have regarding the future direction in agriculture and where we see the most efficient and effective use of Government resources in that future. Many of the issues that I will be visiting with you about today have already been discussed in the previous presentation, but I'll continue on through with the statement.

Senator ABDNOR. Let me assure both you gentlemen that your prepared statements will be printed in the hearing record even though you may not repeat everything, but you go right ahead. We've got plenty of time.

Mr. TURNQUIST. Sales of agricultural products produced at the farm and ranch level historically have run as high as 50 percent of the State's gross sales. To date, farmers and ranchers have looked to livestock for efficient utilization of South Dakota's agricultural resources and for maximizing profits. Livestock sales have represented as high as 70 percent of the gross agricultural sales with the remainder being primarily in the sale of grain and dairy products.

The past decade began with unprecedented growth in terms of production, prices, and profits. In 1973, agricultural sales reached 44 percent of gross State sales. Most of us are aware of what followed. Cycle highs in livestock together with the drought experience in the Upper Midwest propelled the cattle industry into a major liquidation. Grain prices turned downward in a response to a sharp decline in demand. The cost of agricultural production escalated as transportation and energy-related problems were compounded. The management skills of farmers, ranchers, and lenders were put to the test in a world of changing fundamentals.

At this point Government became more involved as a lending partner with direct, guaranteed and disaster loans adding to the debt leverage and often substituted for or postponed sound decision processes. All of you have had sufficient input, I'm sure, from a variety of sources detailing our current situation with a continued depressed price environment coupled with further escalation of costs of production. In the aggregate, agriculture continues to have a reasonably healthy balance sheet, but with severe current problems centered on cash flow deficiencies.

The average capital structure of the farms and ranches seems to have a great deal of similarity nationwide despite wide differences in production of crops and livestock. The latest statistics indicate that the average equity in a farm or ranch is approximately $350,000. Despite this sizable equity position, farmers have invariably had liquidity problems. Our concern is not with the balance sheet but with the income statement.

High interest rates, increased operating expenses, low commodity prices, and the resulting lowered net income, will have an impact on the equity picture within agriculture. Historically, agriculture has enjoyed a strong equity position, but the return on equity or return on investment, if you will, has been very low over several years—approximately in the 5-percent range. With interest rates at near record highs in the past few years, a return on equity of 5 percent becomes very unattractive to anyone making an investment decision. Recent USDA figures indicated that for the overall agricultural sector the rate of return on equity on farm assets fell to 1.5 percent in 1980. This would be the lowest since the thirties and with the present depressed state of commodity prices, this could be lower in 1981. If this situation persists, the value of farms assets—three-fourths of which is real estate—may be subject to declines, at least temporarily. The implication of a faltering real estate market among farmers and ranchers is not encouraging. A loss of equity implies farmers have less borrowing power to cushion a period of lowered earnings and in some cases liquidations are the result.

Without sounding defensive, we think that investment alternatives are singularly much more significant than the impact of a 16- or 17-percent interest rate. Our bank's agricultural people have done an analysis which shows that even at lower borrowing rates our unprofitable farms and ranches would still be unprofitable in present pricing of commodities. Reinforcing this observation is the experience of governmental financing agencies. In fact, in many cases low interest rate loan programs have solved very few problems for farmers and ranchers and in most instances just delayed the day of reckoning. The Farmers Home Administration had no foreclosures in South Dakota from 1973 to 1978. Since then, the number has been increasing each year as the impact of emergency loan programs wears off.

There are problems of financing the capital structure of agriculture, particularly in passing on the farm operation to the next generation. Various alternatives for long-term financing will be developed, including the family farm corporation. The usual corporate structure is not well adapted to midwest farm operations. It has been tested and found wanting.

The history and significance of water development is well recorded. Given the current political climate, it's very obvious to those of us in the Midwest that if water development is to continue it is going to take much more initiative from both the public and the private sectors. In South Dakota we have doubled our irrigated acres in the last 4 or 5 years but still have only about 400,000 acres under irrigation. For the most part, those that have made investments in irrigation have found that despite the rather depressed prices we've experienced over that period of time, it still can be a profitable investment. In addition, South Dakota has taken an imaginative step in selling Missouri River water for a coal-slurry pipeline. If this sale is eventually completed, the revenue will be used to finance other water projects. Hopefully, this kind of initiative will continue, but the major incentives will have to come from outside our State, including the continuing development of external markets.

Expanded markets, improving demand for food and fiber, and improving farm commodity prices, will be a great assistance to the economics of future water development. I guess it's really not much different than any of our natural resources whether those be oil, coal, or water. With the appropriate price in the marketplace, it can become economically feasible to develop any one of these natural resources.

Whether you analyze our current agricultural economic circumstances in a manner similar to what I have done or pick some other approach, the bottom line still comes down to a very fundamental fact. We have a desperate need to refocus our attention from the production side of agriculture to that of the marketing side. This refocusing must include educational institutions, financial communities, and other entities in the public and private sector that have a significant impact on our agricultural economy. If you take a look at the 1981–82 curriculums of our agriculturally oriented land-grant colleges, you can quickly notice that at least 90 percent of the material available to students concentrates on the production side of agriculture. If you look at the bulk of the financial institutions active in agricultural lending, you don't see their agricultural departments staffed with marketing experts but with people who have expertise on the financial and production side, usually with a personal farm background. In essence, we have developed an industry of production experts while few have adequate knowledge of the national commodity markets and their function and the factors affecting price movements. This transition will not be an easy one, whether one is a farmer, educator, banker, or member of a government agency involved in agriculture.

The role of the Federal Government in this transition can assume several dimensions. Of primary importance is its role in the development of foreign markets. We concur with Secretary Block that cultivating existing foreign markets and breaking new ground to expand foreign demand for food and feed grains ought to be the Federal Government's No. 1 priority when establishing this Nation's agricultural policy. We believe this effort ought to include meat products as well. Because this Nation is rich in basic agricultural resources and because we are the world leader in developing and deploying technological production inputs into agriculture, we produce twice as much wheat and roughly one-third more feed grains than we consume. It follows that this Nation ought to be a primary, dependable supplier rather than a residual supplier of agricultural products to the world market. As many foreign purchasers of our agricultural products are governments themselves, it logically follows that our Government should be a key negotiator and developer of those markets. A strong and consistent foreign market demand for our products could spur the upgrading of our transportation and water systems and, most importantly, would improve the net prices received by the farmer.

It is the responsibility of Government to insure fairness in trade policies and tariffs. There's strong doubt in my mind whether the farm producer is being fairly treated in our trade agreements with some of our principal trading partners, such as the extraordinarily high tariff on imported beef in Japan. I'm not suggesting a trade war by imposing barriers in this country, although the threat of imposition of trade barriers may be necessary to obtain some form of reciprocity from them in the agricultural sector. Not only does the development of foreign markets assist in sustaining the health of our domestic agricultural economy, but agriculture also plays a key role in our balance of payments. In fiscal 1981, agricultural had a positive trade balance of $27 billion. We believe that our region of the country on a per capita basis, already contributes a higher amount to a favorable balance of trade than any other region.

Another key role of Government in market development is in the area of education. This is a role that should be shared by the private sector and our educational institutions. Agricultural banks must increase their knowledge of the market and then must take a more active role in educating and alerting producers to market opportunities and how to take advantage of them. The farmer needs more, better, and timely information if he is going to deal on an equal basis with large marketing firms that obviously have much greater bargaining strength and a much wider intelligence network. We recognize that technical production know-how through research and education has produced the most efficient food machine in the world. However, we need to place greater emphasis in marketing knowledge going ahead, knowledge that is available on a timely basis at the grass roots or farmer/rancher level.

A third area of Government involvement is not related to marketing and that, of course, is the emergency loan program. We believe that Federal Government should reevaluate its current role as a lender to the production agricultural community, and should limit its activities to those specific situations in which farm and ranch operations are dealing with natural disasters such as floods, hail, drought, and so forth, and the implementation of such programs should be strictly interpreted. The liberal programs of the past have only added to the debt leverage and were often substituted for sound decision processes. Whether the Government intervention is through a direct loan program, through a guaranteed program, through some type of Federal crop insurance program, is something that can be debated elsewhere. If we would direct just a small portion of the funds that have been disbursed to the farm community through various disaster programs of the Farmers Home and the SBA, to a productive use in export market development, I'm sure it would pay great dividends for the farmer/rancher in the long run.

Although of a lesser priority, going hand in hand with an aggressive foreign market development program is the need to maintain a quality control program. Price adjustments for inferior products are ultimately passed down to the producer which lowers his price and profit potential. Accordingly, we believe it is imperative that the Federal Government maintain inspection programs as foreign sales can only be maintained if we insure that quality products are delivered to our customers.

I've tried to focus my attention today on long-term fundamental issues. Current issues such as price support levels are already being determined by the Congress; and the issue of assistance for the beginning farmer is being explored at the Federal and State levels by both the public and private sectors. My basic theme is to reinforce that of the present administration—leave more of agriculture in the private sector and marketplace.

Thank you for the opportunity to share these thoughts with you.

Senator ABDNOR. Thank you, Mr. Turnquist.

[The prepared statement of Mr. Turnquist, together with attachments, follows:]

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PREPARED STATEMENT OF NELS E. TURNQUIST

Mr. Chairman, Members of the Committee -

My name is Nels Turnquist. I'm Chairman and Chief Executive Officer of the National Bank of South Dakota. National Bank of South Dakota has total assets of over $600 million which places us in the top 300 banks in the nation. We have 18 state-wide branches serving the State from Sioux Falls on the eastern border to Rapid City in the west. In addition to those two urban areas, we serve nine other communities in the State that are predominantly rural agricultural areas.

Our bank has a long history of service to agriculture and has ranked for the past 10 years in the top 25 banks in the nation in terms of dollars loaned to agriculture for production loans. In addition, we are one of 92 banks and trust companies that are affiliated with First Bank System, Inc., which serves the entire Upper Midwest from Wisconsin to Montana. First Bank System is a $14 billion banking corporation which places it in the top 20 banking organizations in the country.

It's a real privilege for me to be here today and to have the opportunity to share with you some of our views on the current economic circumstances in agriculture in our state and region. Moreover, I wish to share with you some thoughts we have regarding the future direction in agriculture and where we see the most efficient and effective use of government resources in that future. While

Senator Abdnor has a first-hand knowledge of the nature of our agricultural economy in South Dakota, I'd like to just quickly review it for you.

Sales of agricultural products produced at the farm and ranch level historically have run as high as 50% of the State's gross sales. To date, farmers and ranchers have looked to livestock for efficient utilization of South Dakota's agricultural resources and for maximizing profits. Livestock sales have represented as high as 70% of the gross agricultural sales with the remainder being primarily in the sale of grain and dairy products.

The past decade began with unprecendented growth in terms of production, prices and profits. In 1973, agricultural sales reached 44% of gross state sales. Most of us are aware of what followed. Cycle highs in livestock together with the drought experience in the Upper Midwest propelled the cattle industry into a major liquidation. Grain prices turned downward in a response to a sharp decline in demand. The cost of agricultural production escalated as transportation and energy-related problems were compounded. The management skills of farmers, ranchers and lenders were put to the test in a world of changing fundamentals.

At this point, Government became more involved as a lending partner with direct, guaranteed and disaster loans adding to the debt leverage and often substituted for or postponed sound decision processes. All of you have had sufficient input, I'm sure, from a variety of sources detailing our current situation with a continued depressed price environment coupled with further escalation of costs of production. In the aggregate, agriculture continues to have a reasonably healthy balance sheet, but with severe current problems centered on cash flow deficiencies.

To preface my thoughts on the future role of government in its partnership with a healthy agricultural sector, which hopefully will reinforce what others have suggested to you, I'd like to spend a minute or two to add a further prospective by outlining some of the significant similarities and differences that we face in our region compared to some of the other agricultural regions of the country.

Two factors highlight the differences between South Dakota and our surrounding region from the other agricultural states. They are the transportation situation and our climatic influence. The uncertainties that surround the climate and growing season are significant. Crop production risks due to the uncertainties in our climate are much higher than in the Minnesota-Ohio corridor which is just adjacent to us to the East. In addition to risks being higher in just getting a crop, our crop yields in the area of South Dakota-North Dakota and Montana show a much greater production variability. There are parts of our country that have much more arid land than we do, but farmers and ranchers in those areas have the advantage of being less reliant on dry land farming. They use more irrigation and use greater areas for pasture.

In South Dakota particularly, we have a great deal of marginal land since we are on the borderline between the more fertile corn and bean growing areas and the wheat and small grain areas and in the transition belt between the short and tall grass ranch or range lands.

One doesn't have to be a mathematician to be able to understand the transportation situation in the Upper Midwest. Whether looking at major domestic markets and population centers of our major ports for international trade, it very quickly becomes obvious what area of the country is the furthest from those centers. Prior to the development of foreign markets, it wasn't a significant factor but now we do have to take a lesser price for our corn or soybeans or livestock than those areas geographically closer to these major markets.

The railroad industry is going through a very painful restructuring at this point in time. Hopefully, we in South Dakota, by taking the initiative for a state-owned rail system, are assisting in solving our own transportation problems. We feel with expanding farm production that we will be able to generate a growing demand for transportation; and, with the flexible pricing structure that the railroads now have in terms of rates and tariffs, that we will be able to generate more interest in transporting South Dakota goods and services.

Until such time as a more integrated and efficient rail system is established, not only in our part of the country, but nation-wide, all of us have to rely much more on our highway system. We can recall the major construction boom in highways back in the 30's and 40's where the federal government, in essence bribed the states to construct those highways and then left the states with the burden of maintenance. Those highways and bridges were designed with a 40 and 50-year life. Today, most of those structures have reached or are exceeding their life spans. The major source for maintaining and improving those roads has been the motor fuels tax levied by the states. One of the ironies of our concerns with energy efficiency, decreasing our reliance on foreign oil, and the mandated improvements in the operation of our automobiles, is that the income from the motor fuel's tax has decreased significantly. States find themselves trapped in a vicious circle of decreased revenues and increased obsolescence of roads and bridges.

While regional differences exist, there are also some key similarities facing all aspects of agriculture nation-wide. These similarities include the financial impact of the current interest rate environment and the existing capital structure of agriculture; and, secondly, the dependence on water and water development, past, present and future.

The average capital structure of the farms and ranches seems to have a great deal of similarity nation-wide despite wide differences in production of crops and livestock. The latest statistics indicate that the average equity in a farm or ranch is approximately $350,000. Despite this sizable equity position, farmers have invariably had liquidity problems. Our concern is not with the balance sheet but with the income statement.

High interest rates, increased operating expenses, and the resulting lowered net income, will have an impact on the equity picture within agriculture. Historically, agriculture has enjoyed a strong equity position, but the return on equity or return on investment, if you will, has been very low over several years -- approximately in the 5% range. With interest rates at near record highs in the past few years, a return on equity of 5% becomes very unattractive to anyone making an investment decision. Recent USDA figure indicated that for the overall agricultural sector the rate of return on equity on farm assets fell to 1.5 percent in 1980. (This would be the lowest since the 1930's - lower in 1981.) If this situation persists, the value of farms assets--three-fourths of which is real estate--may be subject to declines, at least temporarily. The implication of a faltering real estate market among farmers and ranchers is not encouraging. A loss of equity implies farmers have less borrowing power to cushion a period of lowered earnings and in some cases, liquidations.

Without sounding defensive, we think that investment alternatives are singularly much more significant than the impact of a 16 or 17% interest rate. Our bank's agricultural people have done an analysis which shows that even at lower borrowing rates our unprofitable farms and ranches would still be unprofitable in present pricing of commodities. Reinforcing this observation is the experience of governmental financing agencies. In fact, in many cases low interest rate loan programs have solved very few problems for farmers and ranchers and in most instances just delayed the day of reckoning. The Farmers Home Administration had no foreclosures in S.D. from 1973 - 1978. Since then the number has been increasing each year as the impact of emergency loan programs wears off. (9 todate in 1981)

There are problems of financing the capital structure of agriculture, particularly in passing on the farm operation to the next generation. Various alternatives for long-term financing will be developed, including the family farm corporation. The usual corporate structure is not well adapted to Midwest farm operations. It has been tested and found wanting.

The history and significance of water development is well recorded. Given the current political climate, it's very obvious to those of us in the Midwest that if water development is to continue it is going to take much more initiative from both the public and the private sectors. In South Dakota we have doubled our irrigated acres in the last four or five years but still have only about 400,000 acres under irrigation. For the most part, those that have made investments in irrigation have found that despite the rather depressed prices we've experienced over that period of time, it still can be a profitable investment. In addition, South Dakota has taken an imaginative step in selling Missouri River water for a coal-slurry pipeline. If this sale is eventually completed, the revenue will be used to finance other water projects. Hopefully, this kind of initiative will continue, but the major incentives will have to come from outside our State, including the continuing development of external markets.

Expanded markets, improving demand for food and fiber, and improving farm commodity prices, will be a great assistance to the economics of future water development. I guess it's really not much different than any of our natural resources whether those be oil, coal or water. With the appropriate price in the marketplace, it can become economically feasible to develop any one of these natural resources.

Whether you analyze our current agricultural economic circumstances in a manner similar to what I have done or pick some other approach, the bottom line still comes down to a very fundamental fact. We have a desperate need to refocus our attention from the production side of agriculture to that of the marketing side. This refocussing must include educational institutions, financial communities, and other entities in the public and private sector that have a significant impact on our agricultural economy. If you take a look at the 1981-82 curricula of our agriculturally oriented land grant colleges, you can quickly notice that at least 90% of the material available to students concentrates on the production side of agriculture. If you look at the bulk of the financial institutions active in agricultural lending, you don't see their agricultural departments staffed with marketing experts but with people who have expertise on the financial and production side, usually with a personal farm background. In essence, we have developed an industry of production experts while few have adequate knowledge of the national commodity markets and their function and the factors effecting price movements. This transition will not be an easy one, whether one is a farmer, educator, banker or member of a government agency involved in agriculture.

The role of the federal government in this transition can assume several dimensions. Of primary importance is its role in the development of foreign markets. We concur with Secretary Block that cultivating existing foreign markets and breaking new ground to expand foreign demand for food and feed grains ought to be the federal government's number one priority when establishing this nation's agricultural policy. We believe this effort ought to include meat products as well. Because this nation is rich in basic agricultural resources and because we are the world leader in developing and deploying technological production inputs into agriculture, we produce twice as much wheat and roughly a third more feed grains than we consume. It follows that this nation ought to be a primary, dependable supplier rather than a residual supplier of agricultural products to the world market. As many foreign purchasers of our agricultural products are governments themselves, it logically follows that our government should be a key negotiator and developer of those markets. A strong and consistent foreign market demand for our products could spur the upgrading of our transportation and water systems and would improve the net prices received by the farmer.

We in the Upper Midwest can benefit most significantly from the development of those markets that are West Coast related. Being on the western edge of the corn and bean production area, we have a transportation advantage, for one, to those markets that are reached from the West Coast ports. It is the responsibility of government to insure fairness in trade policies and tariffs. There's strong doubt in my mind whether the farm producer is being fairly treated in our trade agreements with some of our principal trading partners, e.g., the extraordinarily high tariff on imported beef in Japan. I'm not suggesting a trade war by imposing barriers in this country, although the threat of imposition of trade barriers may be necessary to obtain some form of reciprocity from them. Not only does the development of foreign markets assist in sustaining the health of our domestic agricultural economy, but agriculture also plays a key role in our balance of payments. In fiscal 1981 agricultural had a positive trade balance of $27 billion. We believe that our region of the country on a per capita basis, already contributes a higher amount to a favorable balance of trade than any other region.

Another key role of government in market development is in the area of education. This is a role that should be shared by the private sector and our educational institutions. All of us, bankers included, must take a much more active role in educating and alerting farmers to market opportunities and how to take advantage of them. The farmer needs more, better and timely information if he is going to deal on an equal basis with large marketing firms that obviously have much greater bargaining strength and a much wider intelligence network. We recognize that technical production know-how through research and education has produced the most efficient food machine in the world. However, we need to place greater emphasis in marketing knowledge going ahead. Knowledge that is available on a timely basis at the grass roots or farmer/rancher level.

A third area of government involvement is not related to marketing and that, of course, is the emergency loan program. We believe that Federal Government should re-evaluate its current role as a lender to the production agricultural community, and should limit its activities to those specific situations in which farm and ranch operations are dealing with natural disasters such as floods, hail, drought, etc., and the implementation of such programs should be strictly interpreted. The liberal programs of the past have only added to the debt leverage and were often substituted for sound decision processes. Whether the government intervention is through a direct loan program, through a guaranteed program, through some type of federal crop insurance program, is something that can be debated elsewhere. If we would direct just a small portion of the funds that have been disbursed to the farm community through various disaster programs of the Farm Home and the SBA, to a productive use in export market development, I'm sure it would pay great dividends for the farmer/rancher in the long run.

Although of a lesser priority, going hand in hand with an aggressive foreign market development program is the need to maintain a quality control program. Price adjustments for inferior products are ultimately passed down to the producer which lowers his price and profit potential. Accordingly, we believe it is imperative that the Federal Government maintain inspection programs as foreign sales can only be maintained if we insure that quality products are delivered to our customers.

I've tried to focus my attention today on long-term fundamental issues. Current issues such as price support levels are already being determined by the Congress; and the issue of assistance for the beginning farmer is being explored at the federal and state levels by both the public and private sectors. My basic theme is to reinforce that of the present administration -- leave more of agriculture in the private sector and market place. Government, bankers, and other private entities need to place as much emphasis on the marketing aspect of agriculture as on production. Government's priority in the 1980's should be in foreign market development, a strong educational program, an adequate inspection service, and financial assistance when natural disasters strike.

Thank you for the opportunity to share these thoughts with you.

NOTE: Attached are recent statistics as background for some of these issues.

FARM FORECLOSURES

by Farm Home Administration

SOUTH DAKOTA

1971	-	4
1972	-	4
1973	-	1
1974 - 1978	-	0
1979	-	2
1980	-	5
1981	-	9

Source: FmHA
Huron, SD

SOUTH DAKOTA GSP BY INDUSTRY

($ Millions)

Year	GSP	Agriculture	Ag / GSP
1971	$3,210	$ 682	21%
1972	3,156	1,026	33
1973	4,191	1,831	44
1974	3,958	1,245	31
1975	3,969	967	24
1976	3,541	759	21

Source: University of South Dakota
Business Research Bureau

Farm Real Estate Values

Average Value per Acre
(land & buildings)

	1970	1975	1978	1981	% Change 70-81
			Dollars		
SD	84	145	227	290	245.2
ND	94	195	300	423	350.0
MINN	226	429	761	1,231	444.7
MONT	60	112	176	239	298.3
U.S.	196	340	531	796	306.1

Source: USDA

Average Value per Operating Unit

	1975	1978	1981
		($000)	
SD	153.1	255.4	343.5
ND	196.4	304.7	440.8
MINN	124.6	219.4	351.8
MONT	297.7	463.3	620.5
U.S.	142.5	227.4	342.1

Source: USDA

LAND IN FARMS

(1,000 Acres)

	75	77	79	81	% Change 75-81
SD	45,400	45,100	45,000	45,000	(.88)
ND	42,300	41,800	41,700	41,700	(1.42)
MINN	30,200	30,100	30,000	30,000	(.66)
MONT	62,200	62,100	62,100	62,100	(.16)
U.S.	1,059,420	1,047,785	1,043,195	1,041,370	(1.7)

Source: USDA

NUMBER OF FARMS

	75	77	79	81	% Change 75-81
SD	43,000	44,000	39,000	38,000	(11.6)
ND	42,000	41,000	40,500	40,000	(4.8)
MINN	104,000	104,000	104,000	105,000	1.0
MONT	23,400	23,500	23,700	23,900	2.1
U.S. (000)	2,521.4	2,455.8	2,429.9	2,418.7	(4.1)

Source: USDA

Farm Real Estate Transfers

Estimated number by type
48 states

Average per year

	Voluntary	Estate Settlement	Fore Closure (000)	Others	Total
1950 - 59	155	36	8	25	224
1960 - 69	94	28	4	18	144
1970 - 79	76	17	3	15	111
1980	56	14	2	13	85
1981	48	14	3	12	77

Percentage Breakdown

1950 - 59	69	16	3.5	11	100
1960 - 69	65	19	2.8	13	100
1970 - 79	68	15	2.7	13	100
1980	66	16	2.4	15	100
1981	62	18	3.9	16	100

Source: USDA

Senator ABDNOR. Mr. Turnquist, I know you know first-hand what the situation really is out on the agricultural sector and I know the same can be said about our next witness, "Buck" Moore.

STATEMENT OF CHARLES P. "BUCK" MOORE, PRESIDENT, NORTHWESTERN NATIONAL BANK, SIOUX FALLS, S. DAK., REPRESENTING THE NORTHWEST BANCORPORATION, MINNEAPOLIS, MINN.

Mr. MOORE. Mr. Chairman, as president of the Northwestern National Bank of Sioux Falls, I'm here today representing Northwest Bancorporation with headquarters in Minneapolis, Minn. There are 87 Banco banks located in a seven-State area in the Upper Midwest with nonbank affiliates operating over a multistate region.

I have been directly involved in agricultural landing for 31 years, all but 2 of these years as an agricultural banker. The bank I am associated with has over $400 million in deposits, over $300 million in loans of which $84 million are directly to agriculture. Our bank ranks 15th in the top 100 lenders in agriculture as reported by the Agriculture Bankers Division of the American Bankers Association. There are five other Banco banks listed in the top 100 banks.

The seven-State area that Banco serves contains a diversified agriculture representing approximately one-fourth of the Nation's annual output, currently totaling $31 billion. This basic and growing food and fiber industry also fuels a large agri-business complex and provides a considerable portion of U.S. exports.

Non-real estate credit demand in this market has tripled in the last 10 years and is expected to double again by 1985 to $36 billion. Mortgage totals in this market increased 206 percent in the past 10 years to $23 billion.

Future demands for agricultural production will rise to new levels of importance in coming decades in the United States and around the world. This is not to say that the United States is to feed the world: that is impractical if not impossible. There is a need for the United States and other developed nations to find ways to upgrade the overall economies of the developing countries as well as their agriculture production. Ultimately this will give those countries more money to buy food and other goods and services from the producing nations and to have the wherewithal to pay for it.

Farm commodity demand will continue to rise at a rate of 1 to 3 per year on the average with the biggest gains being in overseas sales. As living conditions continue to improve in Japan, Eastern Europe, the Middle East, and Russia and these people earn more money, they will buy more and better quality agricultural products, developing a greater potential for sales from the United States.

The number of farms will keep shrinking; the average farm will be larger, perhaps by 25 percent within the next 10 to 15 years.

Farms will continue to be family farms even though they will require increasingly large investments. Perhaps the majority of owner/operators will be people who inherit farms. Many of these will be run by family corporations. In no case, however, will outside investors dominate agriculture—no takeover by large corporations.

There is a pessimism that prevails throughout rural communities in our region. Currently, farmers face three major problems:

One, depressed farm earnings;

Two, high interest rates; and

Three, in some instances, weather-related problems.

Farmers are being squeezed by depressed crop prices which have resulted from bumper U.S. crops and weak demand. In part, this weak demand can be traced to high interest rates and the resulting strong dollar abroad which have made our products less attractive in world markets. Livestock producers also face depressed prices. Cattle and hog feeders have incurred losses during much of the last 2 years. The causes of these problems can be traced to fairly large supplies and weak consumer demand. The weak demand can further be traced to a sluggish economy and the slow growth in consumer income. On top of depressed earnings, farmers have been hit by inflation and high interest rates. Rural communities are now tied more closely to the national business cycle and monetary policy than they have been in the past.

During most of the seventies interest rates charged on loans by country banks remained relatively stable, regardless of fluctuations in the national credit market. All this has changed with the advent of the 6-month money market certificate in 1978. We now have the 2½-year certificate which is tied directly to the cost of Treasury financing as is the money market certificate. As a result of deregulation, rates that country banks pay for deposits have risen sharply, as they are most closely tied to the rates in the national money market. Consequently, the interest rates country banks charge on loans become more responsive to fluctuations in the rates in the national credit market; farm communities are no longer immune to the effects of tight money policies. Along with farm income, interest rates are now an important factor affecting expenditure decisions of farmers and ranchers.

As a consequence of unprofitable livestock prices, depressed crop prices, and high interest rates, real farm income in 1981 is expected to fall short of depressed 1980 levels. Current conditions and the prognosis for the year ahead vary greatly throughout our region. Economic conditions tend to be weakest in South Dakota, Montana, and portions of North Dakota. Prior to the most recent bad economic news, many farmers and ranchers in these localities were already suffering from last year's poor harvest. In some instances drought conditions have extended over a 3-year period. The depressed state of the lumber and wood products industry has also weakened the economy of western Montana as well as areas of Minnesota and Wisconsin and also western South Dakota.

On the other hand, oil and gas exploration in the Williston basin is offsetting depressed farm conditions in portions of North Dakota and eastern Montana. Oil income from both leases and production is expected to continue to stimulate overall economic activity in that area, however, conditions are expected to be rough on farmers and ranchers not receiving this supplemental mineral income.

Bankers indicate conditions in the Red River Valley and parts of North Dakota have improved from the depressed state resulting from last year's drought, yet business activity is expected to improve very slowly during 1982. Weak economic conditions have also spread to the previously stronger portions of the region which include central and southern Minnesota, Iowa, Wisconsin, and parts of Nebraska. Nevertheless, economic conditions are still not expected to be as weak as those prevailing elsewhere. While farm earnings will decline in these localities, excellent crop yields will soften the impact of poor market prices.

Despite changes in dairy price supports, the dairy sector is still expected to provide stability to portions of the Upper Midwest, especially Minnesota and Wisconsin. Established dairy farmers are expected to expand herd size to maintain a cash flow. Low feed costs this year will help offset reduced dairy price supports.

The ramifications of continued weak farm income are far reaching; economic stress is being felt on Main Street. Sales are down and profit margins are becoming very thin. Industries that are most adversely affected are farm supply and equipment, the auto industry, and businesses that sell capital improvements to agriculture. These agribusinesses are much the same as our farm and ranch enterprises, in that there are those that are surviving and getting along quite well, and there are those that, due to high leverage position or lack of management talent, are in deep financial trouble.

A recent survey of banks in our region revealed that most agricultural bankers anticipate farmers will continue to delay major purchases and improvements. Capital expenditures will be held to the bare necessities.

Despite all of the problems, overall quality of agricultural credit appears to remain high while operators heavily in debt and some beginning farmers and ranchers face a real bind. Problem loans constitute a very small percentage of the total loan package to farmers. As one Iowa banker explained, "Although we expect farm income to be reduced in 1982, the great majority of our farm operators are in relatively good financial shape. They will get along by reducing their purchases of machinery and equipment and general 'belt tightening.' "

Some of the problems in farming and urban businesses did not begin with high interest rates, they started back in the sixties when some operators were marginal at best and barely getting along at 6- to 8-percent interest. The seventies brought on a period of inflation when interest rates were from 8 to 10 percent and inflation as high as 15 percent or more. The marginal operators looked better as they were able to pay their interest and operate with cheaper dollars. Some people went further into debt, buying land, expanding their business, increasing inventory, and living up to the inflation psychology "Buy it today because it will cost more tomorrow."

It was then determined that controlling inflation was an absolute must; the way to do it was to control the money supply and let interest rates seek their own level. That is what happened. Inflation has been controlled—in a holding pattern—but interest rates have reached record highs. The real culprit is the deficit between what the Government spends and what the Government takes in. This gap has to be financed which puts Government borrowing in competition with the private sector.

The current administration is attempting to change this, and I believe they will, but they are walking a tight rope at this time. The question is whether we have the guts and patience to stay with this program a few months and see whether or not it will work—whether the deficit can be held to the planned level, the tax cut will work, and whether the economy will "get on track" and start moving in the desired direction. We have to give it a chance.

Despite the current gloomy outlook, some improvement is around the corner. I believe farm commodity prices are near their low point. Crop prices are likely to improve by more than the normal seasonal increase in 1982. This optimism is based on a number of factors. First of all, the opening up of the farmer-owned grain reserve to 1981 crops will remove some of the large supplies from the free market, thereby strengthening prices. Second, the poor Russian crop will stimulate demand for American grains. There is a very positive effect on wheat prices at this time, as we see contracts being negotiated with foreign countries for our wheat with a strong demand for export. With the large amount that has gone under loan, prices will have to go higher to pull this wheat out and make it available for either domestic consumption or foreign export. And finally, lower interest rates and the somewhat weaker dollar should spur U.S. agricultural exports and thereby strengthen crop prices.

Although the livestock sector is not expected to be restored to complete health, some improvement is expected here as well. Aided by lower feed costs, 1982 earnings of feedlot operators are expected to exceed depressed levels existing during most of the last 2 years. However, due to a long string of losses incurred by cattle feeders, feeder cattle prices are expected to remain under some pressure.

Despite some improvement in the agricultural sector in 1982, a more complete recovery is probably at least a year or more down the line. There is no quick fix to the current problems facing agriculture in our rural communities nor am I calling for a quick fix. Efforts to artificially prop up commodity prices would simply be capitalized into higher land values and would not offer a lasting solution to our problems. The root of our problem goes well beyond weak farm income. Agriculture has been a victim of inflation and an irresponsible government fiscal policy. In particular, the underlying causes of our problem can be traced to:

One, unacceptable high inflation;

Two, a much too rapid growth in Federal Government expenditures; and

Three, an explosion in the Government providing credit on easy terms.

The latter is evident from various farm loan programs of the Farmers Home Administration since 1975. The Farmers Home Administration's share of total nonreal estate farm debt was less than 3 percent on January 1, 1975; it increased to over 14 percent at the beginning of 1981. This provided an easy credit program during a period of inflation which had the effect of inflating land prices, livestock prices, and stimulated a rapid expansion of credit on easy terms. This trend needs to be halted, and I believe that the current administration's policies will ultimately turn things around.

The adjustment process will not be painless; but in the long run we will all be better off. There will be less competition from the Government, the law of supply and demand will be more effective as the private sector will determine where the dollars will be invested. We believe that the administration's policies are beginning to pay off and will set the stage for a healthier economy in the future and that the American public supports these efforts.

Reducing the growth in Federal Government expenditures and off-budget borrowing will ultimately "wring out" inflation and hopefully lead to a decline in interest rates. I would not project interest rates going back to previous low levels, as deregulation in banking will allow financial institutions to pay any competitive market rate to acquire deposits if needed. There will be no free demand deposits that banks formerly had for investment purposes.

There are adequate dollars in the financial system to finance agriculture; however, all financial institutions must be allowed to compete on equal terms. Let me further emphasize that lack of credit is not the problem in agriculture today. Moreover, providing more credit is not the solution to the lack of income in agriculture today.

Agricultural credit needs are expected to continue to grow with changes in farm ownership and further consolidation of farm units. Developing outside sources of funds will be a major key to providing adequate credit for agriculture in the future.

All of agriculture needs to have through private treaty a level of income that will create an incentive for the application of new technological inputs that improve our productivity and help to do a more efficient job. Even though agriculture is efficient today, it will need to continue to be so in the future as we will need the added production relatively soon. Collectively, agriculture will continue to be the underlying strength of the United States, the areas of productivity in which we have the greatest expertise in the world. We need an understanding public, a sympathetic political climate, and Mother Nature on our side.

Thank you, Mr. Chairman.

Senator ABDNOR. Thank you, Mr. Moore.

[The prepared statement of Mr. Moore, together with appendixes, follows:]

91-609 O - 82 - 6

PREPARED STATEMENT OF CHARLES P. "BUCK" MOORE

MR. CHAIRMAN:

MY NAME IS C. P. "BUCK" MOORE. I AM PRESIDENT OF THE NORTHWESTERN NATIONAL BANK OF SIOUX FALLS, SOUTH DAKOTA AND AM HERE TODAY REPRESENTING NORTHWEST BANCORPORATION WITH HEADQUARTERS IN MINNEAPOLIS, MINNESOTA. THERE ARE 87 BANCO BANKS LOCATED IN A SEVEN-STATE AREA IN THE UPPER MIDWEST WITH NON-BANK AFFILIATES OPERATING OVER A MULTI-STATE REGION.

I HAVE BEEN DIRECTLY INVOLVED IN AGRICULTURAL LENDING FOR 31 YEARS, ALL BUT TWO OF THESE YEARS AS AN AGRICULTURAL BANKER. THE BANK I AM ASSOCIATED WITH HAS OVER $400 MILLION IN DEPOSITS, OVER $300 MILLION IN LOANS OF WHICH $84 MILLION ARE DIRECTLY TO AGRICULTURE. OUR BANK RANKS 15TH IN THE TOP 100 LENDERS IN AGRICULTURE AS REPORTED BY THE AGRICULTURE BANKERS DIVISION OF THE AMERICAN BANKERS ASSOCIATION. THERE ARE FIVE OTHER BANCO BANKS LISTED IN THE TOP 100 BANKS.

THE SEVEN-STATE AREA THAT BANCO SERVES CONTAINS A DIVERSIFIED AGRICULTURE REPRESENTING APPROXIMATELY ONE-FOURTH OF THE NATION'S ANNUAL OUTPUT, CURRENTLY TOTALING $31 BILLION. THIS BASIC AND GROWING FOOD AND FIBER INDUSTRY ALSO FUELS A LARGE AGRI-BUSINESS

COMPLEX AND PROVIDES A CONSIDERABLE PORTION OF U.S. EXPORTS.

NON-REAL ESTATE CREDIT DEMAND IN THIS MARKET HAS TRIPLED IN THE LAST TEN YEARS AND IS EXPECTED TO DOUBLE AGAIN BY 1985 TO $36 BILLION DOLLARS. MORTGAGE TOTALS IN THIS MARKET INCREASED 206% IN THE PAST TEN YEARS TO $ 23 BILLION DOLLARS.

EARLY FARMING METHODS WERE ILL-ADAPTED TO THIS REGION. MANY HARDSHIPS WERE ENDURED BY THE EARLY SETTLERS. <u>THEY ACCEPTED OCCASIONAL WET YEARS AS NORMAL, BASED THEIR WAY OF LIVING ON THOSE YEARS AND THOUGHT OF DRY YEARS AS ABNORMAL</u>. IN TIMES OF DISAPPOINTMENT, THEY PLACED THEIR FAITH IN NEXT YEAR'S BUMPER CROP. THROUGH TECHNOLOGICAL ADVANCEMENTS FARMERS HAVE ADAPTED SUITABLE FARMING METHODS, CROP VARIETIES AND MACHINERY TO THIS AGRICULTURAL REGION.

MOST FARMERS AND RANCHERS ARE ABLE TO SURVIVE LOW PRICES <u>TEMPORARILY</u> AND EVEN A DROUGHT WITHOUT PLUNGING "HEAD LONG" INTO DEBT DUE TO THE FACT THAT PEOPLE WHO LIVE IN THIS REGION HAVE RESOURCES IN THE FORM OF CASH, GRAIN, FEED (HAY AND GRASS), AND WATER. MOST OPERATORS IN TROUBLE WERE THE YOUNG OPERATORS WHO HADN'T HAD THE OPPORTUNITY TO BUILD RESERVES OR OLDER FARMERS AND RANCHERS THAT OVER-EXPANDED WHEN CATTLE PRICES WERE HIGH AND WHEAT, CORN AND SOYBEANS APPEARED TO BE THE COMMODITY TO RAISE. THEY HAD FORGOTTEN HOW TO SURVIVE IN THE PLAINS REGION.

DURING THE WET YEARS, THE EARLY 70'S, LIVESTOCK RANGES WERE OVERSTOCKED, FARMERS RIPPED UP GRASSLAND TO PLANT MORE

GRAIN ATTEMPTING TO CAPITALIZE ON THE "HIGH PRICES". THIS WAS ABOUT THE TIME THAT OUR GOVERNMENT MADE AN AGREEMENT WITH CHINA AND RUSSIA FOR THE SALE OF GRAIN; AND THE DEPARTMENT OF AGRICULTURE WAS ENCOURAGING FARMING "FENCE ROW TO FENCE ROW". NEEDLESS TO SAY, THIS WAS BAD ADVICE! WE HAD SEVERE DROUGHT AND EROSION IN PARTS OF THE GREAT PLAINS AND EVEN INTO MINNESOTA AND IOWA, PARTIALLY AS A RESULT OF USING FARMING AND OTHER MANAGEMENT PRACTICES NOT ADAPTED TO THE REGION. I AM GREATLY CONCERNED THAT UNLESS WE ADAPT CONSERVATION MEASURES, THERE WILL BE INCREASING PRESSURE FOR A FEDERAL LAND USE POLICY DICTATING HOW URBAN AND RURAL SOCIETIES WILL MANAGE THEIR LAND. <u>THIS WE DO NOT NEED</u>!!

THE UPPER MIDWEST IS AN AREA OF SPECIALIZATION IN AGRICULTURE CLASSIFIED AS CASH GRAIN, LIVESTOCK FEEDING, LIVESTOCK RANCHING OR A COMBINATION OF GRAIN AND LIVESTOCK. PEOPLE DEPEND HEAVILY UPON THE EXPORT OF COMMODITIES TO OTHER REGIONS FOR THE MONEY TO BUY INDUSTRIAL GOODS TO BE USED IN MECHANIZED FARMING AND IN MODERN LIVING. THERE IS A STRONG INDUSTRIAL BASE IN MINNESOTA AND IOWA, AND WE SEE PROMISE AHEAD FOR A MORE SELF-SUSTAINING ECONOMY IN OTHER PARTS OF THE REGION THROUGH THE GROWTH OF A STRONGER INDUSTRIAL BASE. THERE IS LITTLE REASON TO SUGGEST ANYTHING APPROACHING INDUSTRIAL SELF-SUFFICIENCY FOR THIS AREA IN THE NEXT DECADE. THERE COULD BE MUCH PROGRESS AND STABILITY IF MORE SMALL-SCALE FACTORIES FOR PROCESSING OF AGRICULTURAL GOODS AS WELL AS OTHER LIGHT INDUSTRIES WERE DEVELOPED WHICH COULD EMPLOY THE <u>UNDER-EMPLOYED PEOPLE WHO LIVE IN OUR RURAL COMMUNITIES</u>. I BELIEVE THE FUTURE IS BRIGHT FOR ADDITIONAL

INDUSTRY BECAUSE OF THE NATURE OF OUR REGION. WE HAVE PEOPLE WITH A HIGH WORK ETHIC, OUR ENVIRONMENT HAS AN EXCELLENT QUALITY OF LIFE WHICH IS NOT UNDERSTOOD OUTSIDE THE REGION; AND OUR RECREATIONAL RESOURCES ARE BOUNTIFUL AND APPRECIATED BY PEOPLE FROM OTHER AREAS WHEN GIVEN AN OPPORTUNITY TO ENJOY THEM FIRST-HAND.

FUTURE DEMANDS FOR AGRICULTURAL PRODUCTION WILL RISE TO NEW LEVELS OF IMPORTANCE IN COMING DECADES IN THE UNITED STATES AND AROUND THE WORLD. THIS IS NOT TO SAY THAT THE UNITED STATES IS TO FEED THE WORLD; THAT IS IMPRACTICAL IF NOT IMPOSSIBLE. THERE IS A NEED FOR THE UNITED STATES AND OTHER DEVELOPED NATIONS TO FIND WAYS TO UPGRADE THE OVERALL ECONOMIES OF THE DEVELOPING COUNTRIES AS WELL AS THEIR AGRICULTURE PRODUCTION. ULTIMATELY THIS WILL GIVE THOSE COUNTRIES MORE MONEY TO BUY FOOD AND OTHER GOODS AND SERVICES FROM THE PRODUCING NATIONS AND <u>TO HAVE THE WHEREWITHAL TO PAY FOR IT</u>.

FARM COMMODITY DEMAND WILL CONTINUE TO RISE AT A RATE OF 1% TO 2% PER YEAR ON THE AVERAGE WITH THE BIGGEST GAINS BEING IN OVERSEAS SALES. AS LIVING CONDITIONS CONTINUE TO IMPROVE IN JAPAN, EASTERN EUROPE, THE MIDDLE EAST AND RUSSIA AND THESE PEOPLE EARN MORE MONEY, THEY WILL BUY MORE AND BETTER QUALITY AGRICULTURAL PRODUCTS, DEVELOPING A GREATER POTENTIAL FOR SALES FROM THE UNITED STATES.

THE NUMBER OF FARMS WILL KEEP SHRINKING; THE AVERAGE FARM WILL BE LARGER, PERHAPS BY 25% WITHIN THE NEXT 10 TO 15 YEARS. FARMS WILL CONTINUE TO BE FAMILY FARMS EVEN THOUGH THEY WILL REQUIRE INCREASINGLY LARGE INVESTMENTS. PERHAPS THE MAJORITY

OF OWNER/OPERATORS WILL BE PEOPLE WHO INHERIT FARMS. MANY OF THESE WILL BE RUN BY FAMILY CORPORATIONS. IN NO CASE, HOWEVER, WILL OUTSIDE INVESTORS DOMINATE AGRICULTURE -- NO TAKE OVER BY LARGE CORPORATIONS.

THERE IS A PESSIMISM THAT PREVAILS THROUGHOUT RURAL COMMUNITIES IN OUR REGION. CURRENTLY, FARMERS FACE THREE MAJOR PROBLEMS:

1) DEPRESSED FARM EARNINGS
2) HIGH INTEREST RATES
3) IN SOME INSTANCES - WEATHER RELATED PROBLEMS

FARMERS ARE BEING SQUEEZED BY DEPRESSED CROP PRICES WHICH HAVE RESULTED FROM BUMPER U.S. CROPS AND WEAK DEMAND. IN PART THIS WEAK DEMAND CAN BE TRACED TO HIGH INTEREST RATES AND THE RESULTING STRONG DOLLAR ABROAD WHICH HAVE MADE OUR PRODUCTS LESS ATTRACTIVE IN WORLD MARKETS. LIVESTOCK PRODUCERS ALSO FACE DEPRESSED PRICES. CATTLE AND HOG FEEDERS HAVE INCURRED LOSSES DURING MUCH OF THE LAST TWO YEARS. THE CAUSES OF THESE PROBLEMS CAN BE TRACED TO FAIRLY LARGE SUPPLIES AND WEAK CONSUMER DEMAND. THE WEAK DEMAND CAN FURTHER BE TRACED TO A SLUGGISH ECONOMY AND THE SLOW GROWTH IN CONSUMER INCOME. ON TOP OF DEPRESSED EARNINGS, FARMERS HAVE BEEN HIT BY INFLATION AND HIGH INTEREST RATES. RURAL COMMUNITIES ARE NOW TIED MORE CLOSELY TO THE NATIONAL BUSINESS CYCLE AND MONETARY POLICY THAN THEY HAVE BEEN IN THE PAST.

DURING MOST OF THE 70'S INTEREST RATES CHARGED ON LOANS BY COUNTRY BANKS REMAINED RELATIVELY STABLE, REGARDLESS OF FLUCTUATIONS IN THE NATIONAL CREDIT MARKET. ALL THIS HAS CHANGED

WITH THE ADVENT OF THE SIX MONTH MONEY MARKET CERTIFICATE IN 1978. WE NOW HAVE THE 2½ YEAR CERTIFICATE WHICH IS TIED DIRECTLY TO THE COST OF TREASURY FINANCING AS IS THE MONEY MARKET CERTIFICATE. AS A RESULT OF DEREGULATION, RATES THAT COUNTRY BANKS PAY FOR DEPOSITS HAVE RISEN SHARPLY, AS THEY ARE MORE CLOSELY TIED TO THE RATES IN THE NATIONAL MONEY MARKET. CONSEQUENTLY, THE INTEREST RATES COUNTRY BANKS CHARGE ON LOANS BECOME MORE RESPONSIVE TO FLUCTUATIONS IN THE RATES IN THE NATIONAL CREDIT MARKET; FARM COMMUNITIES ARE NO LONGER IMMUNE TO THE EFFECTS OF TIGHT MONEY POLICIES. ALONG WITH FARM INCOME, <u>INTEREST RATES ARE NOW AN IMPORTANT FACTOR AFFECTING EXPENDITURE DECISIONS OF FARMERS AND RANCHERS</u>.

AS A CONSEQUENCE OF UNPROFITABLE LIVESTOCK PRICES, DEPRESSED CROP PRICES AND HIGH INTEREST RATES, REAL FARM INCOME IN 1981 IS EXPECTED TO FALL SHORT OF DEPRESSED 1980 LEVELS. CURRENT CONDITIONS AND THE PROGNOSIS FOR THE YEAR AHEAD VARY GREATLY THROUGHOUT OUR REGION. ECONOMIC CONDITIONS TEND TO BE WEAKEST IN SOUTH DAKOTA, MONTANA AND PORTIONS OF NORTH DAKOTA. PRIOR TO THE MOST RECENT BAD ECONOMIC NEWS, MANY FARMERS AND RANCHERS IN THESE LOCALITIES WERE ALREADY SUFFERING FROM LAST YEAR'S POOR HARVEST. IN SOME INSTANCES DROUGHT CONDITIONS HAVE EXTENDED OVER A THREE-YEAR PERIOD. THE DEPRESSED STATE OF THE LUMBER AND WOOD PRODUCTS INDUSTRY HAS ALSO WEAKENED THE ECONOMY OF WESTERN MONTANA AS WELL AS AREAS OF MINNESOTA AND WISCONSIN.

ON THE OTHER HAND, OIL AND GAS EXPLORATION IN THE WILLISTON BASIN IS OFF-SETTING DEPRESSED FARM CONDITIONS IN PORTIONS OF

NORTH DAKOTA AND EASTERN MONTANA. OIL INCOME FROM BOTH LEASES AND PRODUCTION IS EXPECTED TO CONTINUE TO STIMULATE OVERALL ECONOMIC ACTIVITY IN THAT AREA; HOWEVER, CONDITIONS ARE EXPECTED TO BE ROUGH ON FARMERS AND RANCHERS NOT RECEIVING THIS SUPPLEMENTAL MINERAL INCOME.

BANKERS INDICATE CONDITIONS IN THE RED RIVER VALLEY AND PARTS OF NORTH DAKOTA HAVE IMPROVED FROM THE DEPRESSED STATE RESULTING FROM LAST YEAR'S DROUGHT, YET BUSINESS ACTIVITY IS EXPECTED TO IMPROVE VERY SLOWLY DURING 1982. WEAK ECONOMIC CONDITIONS HAVE ALSO SPREAD TO THE PREVIOUSLY STRONGER PORTIONS OF THE REGION WHICH INCLUDE CENTRAL AND SOUTHERN MINNESOTA, IOWA, WISCONSIN AND PARTS OF NEBRASKA. NEVERTHELESS, ECONOMIC CONDITIONS ARE STILL NOT EXPECTED TO BE AS WEAK AS THOSE PREVAILING ELSEWHERE. WHILE FARM EARNINGS WILL DECLINE IN THESE LOCALITIES, <u>EXCELLENT CROP YIELDS WILL SOFTEN THE IMPACT OF POOR MARKET PRICES</u>.

DESPITE CHANGES IN DAIRY PRICE SUPPORTS, THE DAIRY SECTOR IS STILL EXPECTED TO PROVIDE STABILITY TO PORTIONS OF THE UPPER MIDWEST, ESPECIALLY MINNESOTA AND WISCONSIN. ESTABLISHED DAIRY FARMERS ARE EXPECTED TO EXPAND HERD SIZE TO MAINTAIN CASH FLOW. LOW FEED COSTS THIS YEAR WILL HELP OFFSET REDUCED DAIRY PRICE SUPPORTS.

THE RAMIFICATIONS OF CONTINUED WEAK FARM INCOME ARE FAR REACHING; ECONOMIC STRESS IS BEING FELT ON MAIN STREET. SALES ARE DOWN AND PROFIT MARGINS ARE BECOMING VERY THIN. INDUSTRIES THAT ARE MOST ADVERSELY AFFECTED ARE FARM SUPPLY AND EQUIPMENT,

THE AUTO INDUSTRY AND BUSINESSES THAT SELL CAPITAL IMPROVEMENTS TO AGRICULTURE. THESE AGRI-BUSINESSES ARE MUCH THE SAME AS OUR FARM AND RANCH ENTERPRISES, IN THAT THERE ARE THOSE THAT ARE SURVIVING AN. /GETTING ALONG QUITE WELL, AND THERE ARE THOSE THAT, DUE TO HIGH LEVERAGE POSITION OR LACK OF MANAGEMENT TALENT, ARE IN DEEP FINANCIAL TROUBLE.

A RECENT SURVEY OF BANKS IN OUR REGION REVEALED THAT MOST AGRICULTURAL BANKERS ANTICIPATE FARMERS WILL CONTINUE TO DELAY MAJOR PURCHASES AND IMPROVEMENTS. CAPITAL EXPENDITURES WILL BE HELD TO THE BARE NECESSITIES.

DESPITE ALL OF THE PROBLEMS, OVERALL QUALITY OF AGRICULTURAL CREDIT APPEARS TO REMAIN HIGH WHILE OPERATORS HEAVILY IN DEBT AND SOME BEGINNING FARMERS AND RANCHERS FACE A REAL BIND. PROBLEM LOANS CONSTITUTE A VERY SMALL PERCENTAGE OF THE TOTAL LOAN PACKAGE TO FARMERS. AS ONE IOWA BANKER EXPLAINED: "ALTHOUGH WE EXPECT FARM INCOME TO BE REDUCED IN 1982, THE GREAT MAJORITY OF OUR FARM OPERATORS ARE IN RELATIVELY GOOD FINANCIAL SHAPE. THEY WILL GET ALONG BY REDUCING THEIR PURCHASES OF MACHINERY AND EQUIPMENT AND GENERAL 'BELT TIGHTENING'."

SOME OF THE PROBLEMS IN FARMING AND URBAN BUSINESSES DID NOT BEGIN WITH HIGH INTEREST RATES, THEY STARTED BACK IN THE 60'S WHEN SOME OPERATORS WERE MARGINAL AT BEST AND BARELY GETTING ALONG AT 6% TO 8% INTEREST. THE 1970'S BROUGHT ON A PERIOD OF INFLATION WHEN INTEREST RATES WERE FROM 8% TO 10% AND INFLATION AS HIGH AS 15% OR MORE. THE MARGINAL OPERATORS LOOKED BETTER

AS THEY WERE ABLE TO PAY THEIR INTEREST AND OPERATE WITH CHEAPER DOLLARS. SOME PEOPLE WENT FURTHER INTO DEBT, BUYING LAND, EXPANDING THEIR BUSINESS, INCREASING INVENTORY, AND LIVING UP TO THE INFLATION PSYCHOLOGY "BUY IT TODAY BECAUSE IT WILL COST MORE TOMORROW".

IT WAS THEN DETERMINED THAT CONTROLLING INFLATION WAS AN ABSOLUTE MUST; THE WAY TO DO IT WAS TO CONTROL THE MONEY SUPPLY AND LET INTEREST RATES SEEK THEIR OWN LEVEL. THAT IS WHAT HAPPENED. INFLATION HAS BEEN CONTROLLED (IN A HOLDING PATTERN) BUT INTEREST RATES HAVE REACHED RECORD HIGHS. THE REAL CULPRIT IS THE DEFICIT BETWEEN WHAT THE GOVERNMENT SPENDS AND WHAT THE GOVERNMENT TAKES IN. THIS GAP HAS TO BE FINANCED WHICH PUTS GOVERNMENT BORROWING IN COMPETITION WITH THE PRIVATE SECTOR.

THE CURRENT ADMINISTRATION IS ATTEMPTING TO CHANGE THIS, AND I BELIEVE THEY WILL; BUT THEY ARE WALKING A TIGHT ROPE AT THIS TIME. THE QUESTION IS WHETHER WE HAVE THE GUTS AND PATIENCE TO STAY WITH THIS PROGRAM A FEW MONTHS AND SEE WHETHER OR NOT IT WILL WORK -- WHETHER THE DEFICIT CAN BE HELD TO THE PLANNED LEVEL, THE TAX CUT WILL WORK AND WHETHER THE ECONOMY WILL "GET ON TRACK" AND START MOVING IN THE DESIRED DIRECTION. WE HAVE TO GIVE IT A CHANCE.

DESPITE THE CURRENT GLOOMY OUTLOOK, SOME IMPROVEMENT IS AROUND THE CORNER. I BELIEVE FARM COMMODITY PRICES ARE NEAR THEIR LOW POINT. CROP PRICES ARE LIKELY TO IMPROVE BY MORE THAN THE NORMAL SEASONAL INCREASE IN 1982. THIS OPTIMISM IS BASED ON A NUMBER OF FACTORS. FIRST OF ALL, THE OPENING UP OF THE

FARMER-OWNED GRAIN RESERVE TO 1981 CROPS WILL REMOVE SOME OF THE LARGE SUPPLIES FROM THE FREE MARKET, THEREBY STRENGTHENING PRICES. SECONDLY, THE POOR RUSSIAN CROP WILL STIMULATE DEMAND FOR AMERICAN GRAINS. THERE IS A VERY POSITIVE EFFECT ON WHEAT PRICES AT THIS TIME, AS WE SEE CONTRACTS BEING NEGOTIATED WITH FOREIGN COUNTRIES FOR OUR WHEAT WITH A STRONG DEMAND FOR EXPORT. WITH THE LARGE AMOUNT THAT HAS GONE UNDER LOAN, PRICES WILL HAVE TO GO HIGHER TO PULL THIS WHEAT OUT AND MAKE IT AVAILABLE FOR EITHER DOMESTIC CONSUMPTION OR FOREIGN EXPORT. AND FINALLY, LOWER INTEREST RATES AND THE SOMEWHAT WEAKER DOLLAR SHOULD SPUR U.S. AGRICULTURAL EXPORTS AND THEREBY STRENGTHEN CROP PRICES.

ALTHOUGH THE LIVESTOCK SECTOR IS NOT EXPECTED TO BE RESTORED TO COMPLETE HEALTH, SOME IMPROVEMENT IS EXPECTED HERE AS WELL. AIDED BY LOWER FEED COSTS, 1982 EARNINGS OF FEEDLOT OPERATORS ARE EXPECTED TO EXCEED DEPRESSED LEVELS EXISTING DURING MOST OF THE LAST TWO YEARS. HOWEVER, DUE TO A LONG STRING OF LOSSES INCURRED BY CATTLE FEEDERS, FEEDER CATTLE PRICES ARE EXPECTED TO REMAIN UNDER SOME PRESSURE.

DESPITE SOME IMPROVEMENT IN THE AGRICULTURAL SECTOR IN 1982, A MORE COMPLETE RECOVERY IS PROBABLY AT LEAST A YEAR OR MORE DOWN THE LINE. THERE IS NO QUICK FIX TO THE CURRENT PROBLEMS FACING AGRICULTURE IN OUR RURAL COMMUNITIES NOR AM I CALLING FOR A QUICK FIX. <u>EFFORTS TO ARTIFICIALLY PROP-UP COMMODITY PRICES</u> WOULD SIMPLY BE CAPITALIZED INTO HIGHER LAND VALUES AND WOULD NOT OFFER A LASTING SOLUTION TO OUR PROBLEMS. THE ROOT OF OUR PROBLEM GOES WELL BEYOND WEAK FARM INCOME. AGRICULTURE HAS BEEN A VICTIM OF

INFLATION AND AN IRRESPONSIBLE GOVERNMENT FISCAL POLICY. IN PARTICULAR, THE UNDERLYING CAUSES OF OUR PROBLEM CAN BE TRACED TO:

1) UNACCEPTABLE HIGH INFLATION
2) A MUCH TOO RAPID GROWTH IN FEDERAL GOVERNMENT EXPENDITURES
3) AN EXPLOSION IN THE GOVERNMENT PROVIDING CREDIT ON EASY TERMS.

THE LATTER IS EVIDENT FROM VARIOUS FARM LOAN PROGRAMS OF THE FARMERS HOME ADMINISTRATION SINCE 1975. THE FARMERS HOME ADMINISTRATION'S SHARE OF TOTAL NON-REAL ESTATE FARM DEBT WAS LESS THAN 3% ON JANUARY 1, 1975; IT INCREASED TO OVER 14% AT THE BEGINNING OF 1981. THIS PROVIDED AN EASY CREDIT PROGRAM DURING A PERIOD OF INFLATION WHICH HAD THE EFFECT OF INFLATING LAND PRICES, LIVESTOCK PRICES AND STIMULATED A RAPID EXPANSION OF CREDIT ON EASY TERMS. THIS TREND NEEDS TO BE HALTED, AND I BELIEVE THAT THE CURRENT ADMINISTRATION'S POLICIES WILL ULTIMATELY TURN THINGS AROUND.

THE ADJUSTMENT PROCESS WILL NOT BE PAINLESS; BUT IN THE LONG RUN, WE WILL ALL BE BETTER OFF. THERE WILL BE LESS COMPETITION FROM THE GOVERNMENT, THE LAW OF SUPPLY AND DEMAND WILL BE MORE EFFECTIVE AS THE PRIVATE SECTOR WILL DETERMINE WHERE THE DOLLARS WILL BE INVESTED. WE BELIEVE THAT THE ADMINISTRATION'S POLICIES ARE BEGINNING TO PAY OFF AND WILL SET THE STAGE FOR A HEALTHIER ECONOMY IN THE FUTURE AND THAT THE AMERICAN PUBLIC SUPPORTS THESE EFFORTS.

REDUCING THE GROWTH IN FEDERAL GOVERNMENT EXPENDITURES AND OFF-BUDGET BORROWING WILL ULTIMATELY "WRING OUT" INFLATION AND

HOPEFULLY LEAD TO A DECLINE IN INTEREST RATES. I WOULD NOT PROJECT INTEREST RATES GOING BACK TO PREVIOUS LOW LEVELS, AS DEREGULATION IN BANKING WILL ALLOW FINANCIAL INSTITUTIONS TO PAY ANY COMPETITIVE MARKET RATE TO ACQUIRE DEPOSITS IF NEEDED. THERE WILL BE NO FREE DEMAND DEPOSITS THAT BANKS FORMERLY HAD FOR INVESTMENT PURPOSES.

THERE ARE ADEQUATE DOLLARS IN THE FINANCIAL SYSTEM TO FINANCE AGRICULTURE; HOWEVER, ALL FINANCIAL INSTITUTIONS MUST BE ALLOWED TO COMPETE ON EQUAL TERMS. LET ME FURTHER EMPHASIZE THAT LACK OF CREDIT IS NOT THE PROBLEM IN AGRICULTURE TODAY. MOREOVER, PROVIDING MORE CREDIT IS NOT THE SOLUTION TO THE LACK OF INCOME IN AGRICULTURE TODAY.

AGRICULTURE HAS BEEN A MAJOR STRENGTH IN THIS COUNTRY, AND IT IS TRULY EXCITING TO LOOK TO THE 80'S AND BEYOND. WE HAVE THE HIGHEST LEVEL OF EXPERTISE IN THE WORLD IN THE PRODUCTION OF FOOD AND FIBER, AND A STRONG DEMAND STILL EXISTS IN FOREIGN MARKETS.

THERE IS A STRONG FEELING ABOUT THE NEED FOR YOUNG PEOPLE TO GO INTO AGRICULTURE PRODUCTION AND FOR OUR SOCIETY TO CREATE A <u>REASONABLE OPPORTUNITY</u> FOR THEIR SUCCESS. WE NEED GOOD MANAGEMENT <u>TALENT AND ABILITY</u> TO UTILIZE THE RESOURCES THAT PROVIDE FOOD AND FIBER IN AN EFFICIENT WAY. INDIVIDUAL ENTREPRENEURSHIP (OWNER/ OPERATOR) IS THE BEST METHOD TO MAXIMIZE OUR COUNTRY'S AGRICULTURAL PRODUCTION EFFICIENCY -- THIS MEANS OPPORTUNITIES IN FARMING MUST BE AT LEAST <u>EQUAL TO OTHER BUSINESS OPPORTUNITIES</u> FACING YOUNG PEOPLE AS THEY CHOOSE THEIR LIFE'S WORK. THE YOUNG AGRICULTURALIST

HAS TO START WITH SOME KIND OF BASE; BUT A LARGE CAPITAL BASE WITH COMPARABLE DEBT, FOR THE MOST PART, IS UNREALISTIC. IT'S LIKE SAYING THAT A COLLEGE STUDENT IS GOING TO WALK INTO A COMPANY STARTING AS PRESIDENT!

THERE WILL BE AN OPPORTUNITY FOR YOUNG PEOPLE WISHING TO ENGAGE IN AGRICULTURE AS FARM OPERATORS; BUT IT MUST BE RECOGNIZED AS A BUSINESS THAT THE OPERATOR WORKS HIS WAY INTO AS A PROFESSIONAL WHO IS EDUCATED IN BUSINESS METHODS AS WELL AS FARM PRODUCTION. FARMING AND RANCHING IS NOT A BUSINESS THAT "JUST ANYBODY" CAN MANAGE, AND THE OLD ADAGE OF <u>ENTITLEMENT TO FARM</u> IS NO LONGER TRUE. IT IS A BUSINESS IN WHICH THE MANAGEMENT MUST BE <u>PROFIT-ORIENTED AND NOT IN IT AS "JUST A WAY OF LIFE"</u>.

SINCE THE FARM OF THE FUTURE WILL REQUIRE INCREASINGLY LARGE INVESTMENTS (HUNDREDS OF THOUSANDS OR MILLIONS OF DOLLARS TO OWN AND OPERATE), ABSENTEE LANDOWNERS MAY OWN PROPERTY AND RENT IT TO A MANAGER TO OPERATE. THERE WILL BE MANY OF THE OWNER/OPERATORS THAT WILL OPERATE UNDER FAMILY CORPORATIONS; BUT IN NO CASE WILL OUTSIDE INVESTORS DOMINATE AGRICULTURE -- NO TAKEOVER BY LARGE CORPORATIONS.

ALL OF AGRICULTURE NEEDS TO HAVE THROUGH PRIVATE TREATY A LEVEL OF INCOME THAT WILL CREATE AN INCENTIVE FOR THE APPLICATION OF NEW TECHNOLOGICAL INPUTS THAT IMPROVE OUR PRODUCTIVITY AND HELP TO DO A MORE EFFICIENT JOB. EVEN THOUGH AGRICULTURE IS EFFICIENT TODAY, IT WILL NEED TO CONTINUE TO BE SO IN THE FUTURE AS WE WILL

NEED THE ADDED PRODUCTION RELATIVELY SOON! COLLECTIVELY, AGRICULTURE WILL CONTINUE TO BE THE UNDERLYING STRENGTH OF THE UNITED STATES (THE AREA OF PRODUCTIVITY IN WHICH WE HAVE THE GREATEST EXPERTISE IN THE WORLD). WE NEED AN UNDERSTANDING PUBLIC, A SYMPATHETIC POLITICAL CLIMATE AND MOTHER NATURE ON OUR SIDE!!

APPENDIX CONTENTS

ANNUAL COMPOUND RATE OF GROWTH OF U.S. FARM DEBT

Time Period	Real Estate Debt	Non-Real Estate Debt Excluding CCC Loans	Non-Real Estate Debt Including CCC Loans
	(Percent)		
1950s	8.0	8.4	6.3
1960s	9.2	6.3	6.5
1970-75	9.7	10.7	8.3
1975-80	12.3	15.0	16.2
1980	11.3	10.5	9.7

APPENDIX II

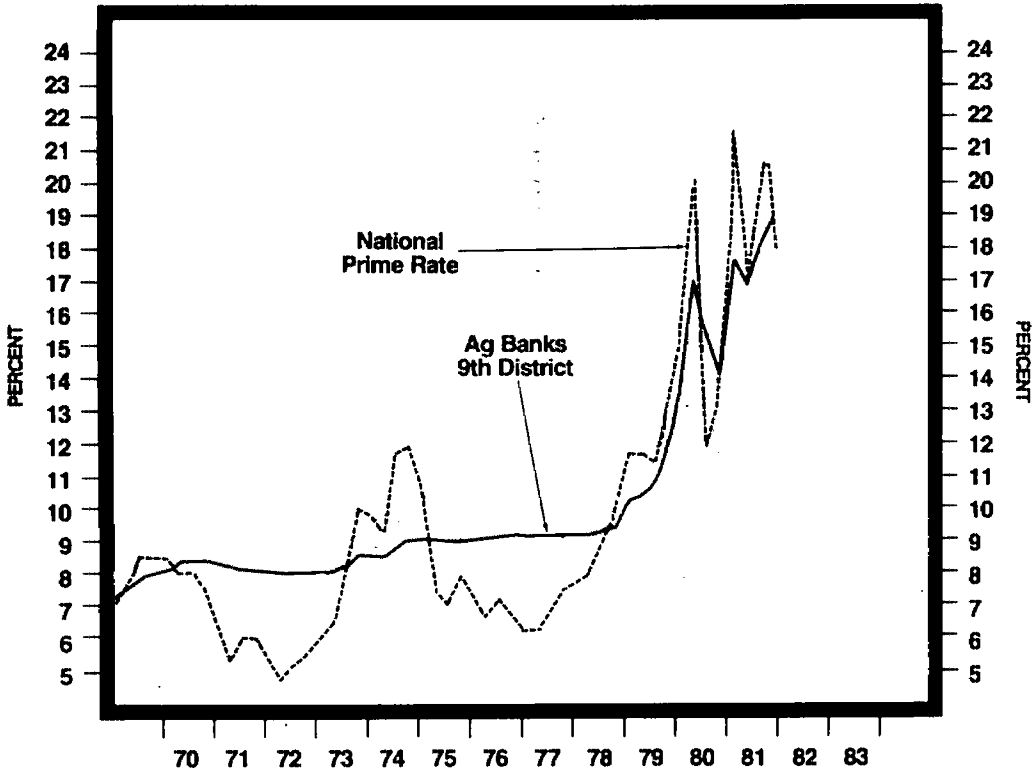
U.S. NON-REAL ESTATE FARM DEBT OUTSTANDING MARKET SHARE BY LENDER

Beginning of Year	Banks	PCAs	Ag Credit Companies	FmHA	SBA	Merchants & Dealers	CCC	TOTAL
			(Percent of Total)					
1960	38.0	10.7	0.7	3.1	0.0	38.3	9.2	100.0
1965	39.0	12.7	0.7	3.6	0.0	35.3	8.6	100.0
1970	43.3	18.9	0.9	3.3	0.0	22.4	11.2	100.0
1975	51.3	26.8	1.1	2.9	0.0	17.0	0.9	100.0
1980	41.3	24.3	0.9	11.9	3.2	12.4	6.0	100.0
1981	38.3	24.3	1.0	14.2	3.2	13.8	5.3	100.0

PCAs: Production Credit Associations
Ag Credit Companies: Loans discounted for agricultural credit companies by the Federal Intermediate Credit Banks.
FmHA: Farmers Home Administration
SBA: Small Business Administration
CCC: Commodity Credit Corporation

INTEREST RATES CHARGED ON FARM OPERATING LOANS

COMPARISON WITH PRIME RATE

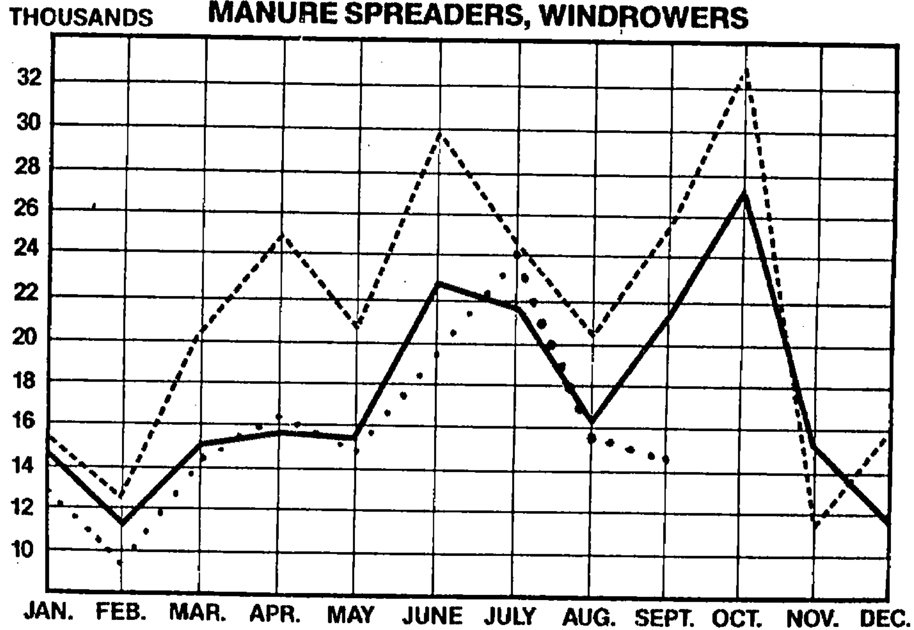


SELECTED MEASURES OF CREDIT CONDITIONS

	Loan Demand (Index)*	Deposit Growth (Index)*	Loan Repayment Rates (Index)*	Typical Interest Rate (Percent)	Average Loan/Deposit Ratio (Percent)
AGRICULTURAL BANKS					
Fall 1976	N.A.	N.A.	63	8.9	57.5
Spring 1977	175	116	52	9.0	58.4
Fall 1977	182	121	69	9.0	62.5
Spring 1978	163	145	90	9.1	62.1
Fall 1978	179	157	105	9.4	64.9
Spring 1979	181	135	99	10.1	65.6
Fall 1979	187	124	67	11.4	68.9
Spring 1980	161	143	39	17.0	67.8
Fall 1980	102	175	98	14.2	62.7
Spring 1981	95	185	96	16.6	59.8
Fall 1981	138	178	71	18.8	60.3
TWIN CITIES BANKS					
Fall 1976	N.A.	N.A.	128	9.1	63.6
Spring 1977	175	175	114	9.4	61.4
Fall 1977	186	180	106	9.1	64.1
Spring 1978	188	166	105	9.7	64.4
Fall 1978	192	181	107	10.7	67.8
Spring 1979	186	169	102	12.0	68.9
Fall 1979	183	179	79	13.3	68.7
Spring 1980	162	157	90	18.2	71.1
Fall 1980	118	180	93	14.9	66.5
Spring 1981	104	166	94	18.9	65.6
Fall 1981	142	151	81	20.6	67.2
IRON RANGE BANKS					
Fall 1976	N.A.	N.A.	128	9.1	63.6
Spring 1977	150	144	119	9.4	60.4
Fall 1977	172	157	64	8.6	58.8
Spring 1978	187	150	107	10.0	70.7
Fall 1978	185	143	136	10.7	69.0
Spring 1979	162	139	123	11.9	70.9
Fall 1979	192	108	62	13.2	71.4
Spring 1980	123	162	92	18.7	69.9
Fall 1980	64	171	57	15.2	64.3
Spring 1981	0	143	79	18.0	61.1
Fall 1981	92	183	58	19.7	62.8

*Bankers responded to each item by indicating whether conditions at the present time are higher, lower or the same as a year ago. The index numbers are computed by subtracting the percent of bankers that responded "lower" from the percent that responded "higher" and adding 100.

UNIT SALES
TRACTORS,[1] COMBINES, BALERS, FORAGE HARVESTERS, MOWER CONDITIONERS, MANURE SPREADERS, WINDROWERS



----5 YEAR AVERAGE ——1980 . . . .1981 FLASH REPORT

(1) OVER 40 hp

APPENDIX VI

FALL 1981 AGRICULTURAL ECONOMIC SURVEY
Conducted in Late September by Economics Department
Northwestern National Bank of Minneapolis

Bankers were asked to respond to the following question: "What is your appraisal of the economic outlook for your area in 1982?"

Central & Southern Minnesota

1. Overall Outlook: Farm earnings will suffer some but the crop yields in our area may be enough to offset price drops.

2. We have a bumper crop and have had ideal weather and rain. However, grain prices are very low in relation to production costs, so farmers are storing grain and not selling at the present time, and probably will hold until prices increase.

3. The crops in our area are excellent. If the prices come back into line our outlook is good.

4. Our area is mostly dairy farming. We have felt "crunch" less than some areas but anticipate tougher times because of dairy price support. Am not very optimistic about short term -- long term looks better.

5. The economic outlook for our area will be down due to high interest rates. The dairy industry will keep our area in a fairly good economic outlook.

6. As we are primarily a dairy area, we expect conditions to remain fairly stable.

7. Those operations using minimum amount of debt will have no problem meeting cash flow requirements. Those highly "levered" are seeing some of their equity disappear. Good managers and marketers will get by -- others will be looking for new occupations.

8. Farmers must become more market oriented. Marketing is a personal "thing" and until the farmer establishes a plan he will continue to be caught up in the "low" price "grumble"! Minnesota Bankers Association's financial computer program will help those farmers wanting to establish a good marketing program.

9. Farm prices are very low. Farm operators are very cautious about purchasing anything that leads to more debt. Many poor operators on marginal land will have great difficulty finding financing in 1982.

10. Interest rates have curbed capital expenditures by leveraged operators.

11. Effects of high (interest) rates will start taking its toll on the merchants in farming communities.

12. High interest rates will continue to curtail large consumer purchases such as autos and housing. Farm income will continue to be pressed by high interest rates. Economy will move slowly forward or stay stagnant.

13. High interest rates are having their effect on farming and the business sector. Profit margins are becoming very thin.

14. High interest rates are taking their toll on small business and farmers, and poor grain prices are going to hurt our economy.

Red River Valley Minnesota

1. If grain prices remain the same or lower than present, I look for this area to be depressed. Because of the drought problems this area suffered last year, unless grain prices increase, there will be very little in the way of farm expenditure. If prices increase, we have sufficient crop on hand that our farms will have a good income. At present levels farmers are not breaking even.

2. Somewhat depressed as grain prices are severely depressed and, with current interest rate trends, it appears that margins will be closer than expected.

3. We believe that the economic outlook is favorable. Crop yields are good. Prices are weak but these yields help in comparison with last year. Still we do not expect machinery sales, etc. to be strong.

4. High cash grain yields will boost area income even with lower cash grain prices.

Red River Valley North Dakota

1. Farm income will be less on the average. We will see more small farmers getting out of business. Land prices will continue to

increase, but not as fast as the past. Sales of machinery, equipment, autos, trucks will remain about the same in dollar volume, but number of units will decrease.

2. Pinto bean crop has given the economic outlook a little boost and if the soybeans are as good, the conditions could be improved over last year.

3. Probably the biggest single factor in the health of the economy in this area is the fact that we have had no crop failures. No business failures and the outlook for the coming year is good.

Central and Western North Dakota

1. In 1980 our area had a drought. In 1981 crop yields about normal for our area, but grain prices are below our cost of production for small grains, so I expect net income to be below normal, but better than 1981.

2. If interest rates stay high, we feel this will slow borrowing for any expenditures except spring operating expenses in 1982.

3. At present interest rates and low grain prices, we do not look for alot of expenditures for buildings and equipment.

4. In this area of South Central North Dakota, we have a good feed and grain crop this year after last year's near failure, and in spite of low grain prices is a plus factor over last year. Overall, the outlook for agriculture in this farm area is grim, especially for the heavily indebted operator.

5. The average farmer will have about the same income as last year. May see more farm failures than anytime in recent years, as several farms have been marginal, hoping for the good year, that apparently is not coming.

6. Economic outlook is not good. Shops on Main Street are struggling. Farmers will do good to break even due to prices for their product as well as the cost of production increasing. House sales are down, consumer spending is down.

7. Oil income from both leases and production will continue to stimulate our overall economy. The farming sector has now gone through two poor years and without outside income many of them are feeling severe financial pressure and lost buying power.

8. The economic conditions of Southwestern North Dakota are excellent and getting better because of the energy development. The farming economy is terrible and shows no sign of being improved in the next six months.

9. Grain and livestock prices too low but good crops will help hold total income fairly steady. Oil exploration and service company activity is a major contributor to our local economy -- will hold economy from being too depressed.

Eastern South Dakota

1. There is very little fall crop planting because of lack of moisture. Cost of production is too high compared to receipts from farm products. About 25 percent of our area farmers are in serious financial trouble.

2. Our trade area has had severe drought conditions for the third year in a row. Ag customers need some stability in operating costs and in market prices.

3. Outlook in our predominantly agricultural area is poor due to a lack of subsoil moisture -- depressed farm prices, and high costs of operation. The biggest plus factor in the 1980s will be if our Federal Government reduces the ridiculous wasteful spending and we feel President Reagan is heading that in the right direction.

4. Outlook -- very poor unless interest rate decreases a great deal and livestock prices increase.

5. With good moisture, somewhat better commodity prices and possibly a better overall economy and lower interest rates, I can foresee some renewed growth in the ag sector, although I think there will be cautious by both borrowers and lenders. Would expect some gradual overall strengthening of commodity prices -- both livestock and grains (nothing great, however) into 1982 from present levels. Overall moisture situation is not good -- need some good fall rains. Highly leveraged customers face some real problems -- probably some major adjustments or complete liquidations. A number of these still relatively low when looking at total farm and ranch operators.

6. Moisture shortage is critical. Farmers are suffering because of extremely high interest rates as are main street businesses. We aren't very optimistic about the short term outlook.

7. Interest rates are having an effect on farm economy, and will determine to a great extent as to what happens in the rural area and in turn will affect the future of small town merchants.

8. Outlook about the same. Have good crops in our area so farmers should have funds available for personal purchases. High interest rates will continue to hold back any major purchases or improvements.

Western South Dakota

1. Weak economy expected.

2. Interest rates killing everything. Just out of drought with no reserves of moisture. Everything hinges on interest rates and spring rain plus prices.

3. The outlook is very bleak unless there is improvement in the price of grains and feeder cattle.

Eastern Montana

1. Outlook poor due to lack of moisture and depressed livestock and grain prices.

2. Current high interest rates coupled with increases in operating expenses has depleted the profit margin for the majority of farmers and ranchers.

3. Alot of oil money in circulation. Top lease money will pay operating debts.

Western Montana

1. Farmers with only farm income are hurting due to prices.

2. Livestock operations will probably see better prices as well as lower cost of purchased feeds and should show some strengthening. Overall, I expect to see some decline in net worth positions of a majority of local producers due to slowed land appreciation, high operating costs and depressed prices.

3. Poor livestock and grain prices will have an adverse effect on local and statewide economy.

4. Our main industries in our area are agriculture and logging. Both are depressed, especially the lumber industry.

Western Wisconsin

1. Flat outlook. Good climate for corn and good yields. No substantial change up or down. All business holding cautiously.

2. Dairy farming area -- outlook is good; farm managers of reasonable debt ratio will do all right. Some of the marginal FmHA type farmers, even with lower than competitive rates, won't make it, should not have been set up in first place. Up to now we have not felt any recession and do not anticipate any change.

3. Considerable retrenchment expected by farmers. They will pull in their horns and try to make due with what they have. Will effect deposit and retail sales.

4. Economic outlook: Tight situation between income and expenses giving reduced net incomes.

Iowa

1. I anticipate a sluggish economy due to grain and livestock prices. High grain yields will buffer prices somewhat. Machinery and vehicle dealers will be hurting severely as farmers keep tight fists on cash flow.

2. Although we expect farm income to be reduced in 1982, we feel that the great majority of our farm operators are in relatively good financial shape and can get along in fairly good shape. They will reduce their buying of machinery, equipment, etc. and curb spending for improvements. They will spend less freely. Some of the retail business establishments may feel this and some may be hurt.

3. Rather bleak outlook for 1982. High interest rates are hurting the farmer and small businessmen. Low grain prices are affecting all. We expect limited growth.

4. First half 1982 not much improvement, with second half some improvement.

5. Expect weak economy through early 1982. Heavy reliance on grain prices in our area.

6. Beef producers are reeling under continual losses in feeding operations. Hog enterprisers are now struggling to recoup 1979 -- early 1980 losses. The near-term economic outlook is not good.

Nebraska

1. The economic outlook is not good. Grain prices are poor. Cattle have not made any money for several years. Hogs are about a break even sitution.

2. Higher yields will somewhat soften the effects of poor market prices, however, 1982 may well be a year for the farmer to re-align his program. A positive cut in federal deficit spending with lower interest rate benefits are a must for the survival of agribusiness this coming year.

3. Young farmers with debts are having and will have problems in 1982. Weather conditions have improved -- yields have improved. Costs of operation are too high compared to weaker cattle, hog and grain prices. Until Federal-cutback programs show results, farming is in trouble for the next two years.

4. There is going to be a problem with farm income over the next year. This affects all aspects of our local economy. The retail sales in the area are going to feel the pressure of the farm income being lower.

5. For 1982, outlook is fair. If the administration can hang tough on its economic program things will improve greatly in the next two or three years. If not and interest rates are artifically forced down and the money supply pumped up, then things will get temporarily better and in the long run -- terrible.

Senator ABDNOR. Mr. Moore, I think you stated it very well; we need an understanding public, a sympathetic political climate and Mother Nature on our side. That would help a lot of things.

We appreciate the testimony of both you gentlemen and, as I said, we will be inserting your entire prepared statements and the statistics that you submitted in the printed record.

Mr. Turnquist, you have some facts here that need to go into our record here. You have made a great contribution to what we are trying to accomplish in our hearings by these statements that you just made.

I don't want to put you on the spot, but do either one of you two gentlemen care to comment on Mr. Schultz' testimony? Do you agree with what he said or would you like to share any thoughts on it?

Mr. TURNQUIST. Yes, I would concur with the bulk of the testimony, if not all of the testimony, that he presented this morning. The inflation, getting the inflation under control is the No. 1 issue and that will solve many, many problems, not only in the agricultural economy but the balance of the economy.

Senator ABDNOR. Mr. Moore.

Mr. MOORE. I agree with that, Mr. Chairman. I think that that's the real culprit and I think further that we have been using only one arm and that's been the monetary policy in an attempt to control inflation and, as was stated this morning and I believe sincerely, the administration is attempting to have a sound fiscal policy which has been needed for a long time to really get inflation under control.

Senator ABDNOR. You two gentleman both have described the economic and financial conditions of the typical farm today and both of you are somewhat optimistic about the future, I guess: Providing that we in Congress and the administration are successful in getting some fiscal responsibility into Government, it is hoped that we can reduce inflation and interest rates.

From what you know today and your feelings such as they are, would you advise a young person to become a farmer under these conditions and to go into agriculture? I know you're very interested in the young farmers. What's your thought on that?

Mr. MOORE. Mr. Chairman, I think that the old myth that everybody can farm or is entitled to farm—I think those days are gone. Agriculture today is a highly technical business, a highly capital intensive business, and it's no different starting to farm with a high capital base than trying to start in any business with a high capital base. So I think that I would not discourage a young person from going into it, but I would discourage him if he had to go in with a high borrowed base, because you can't go into any business and start out as the president of the company. A lot of young farmers, a lot of people that go into it, have the idea that, "I want to go in and start with a large piece of land, a total economic unit," and unless they have a rich uncle or unless they inherit it, it's going to be very difficult to do. An easy credit program is not the solution because that merely relates to the price of land and has the effect of inflating or monetizing the price of that land.

Senator ABDNOR. Mr. Turnquist.

Mr. TURNQUIST. There was an interesting article in the Sioux Falls Leader a couple Sundays ago which described how four young farmers, ages 20 to 25, had started when they were in their grade school years with a couple heifers and raised those through the years while they were in high school and at South Dakota State University. They have built up to 30 or 40 head of cattle. They are leasing some land. They are running the farm with their parents and their uncle in a couple of cases, but this is the method that most young farmers are going to have to use to get into the business. They are going to have to start small and work their way into it.

Senator ABDNOR. I must remember to read that. That would be interesting. There are situations where young men will go and work on a ranch or farm and eventually will take them on a percentage basis. I guess that's probably one of the best ways, other than being fortunate enough to have somebody wealthy help you start from the family side.

Mr. MOORE. Mr. Chairman, just a comment on that. I think that is an area that we need to encourage. That is, a young person who wants to farm, he has to do the same thing with the abilities that he has that any of us have to do going out looking for a job. He has to go to a farmer that perhaps doesn't have any heirs and say, "I can manage this thing and give me an opportunity under your guidance to manage it and work into it as a manager." He has to sell his talents to that person just as we have to sell our talents to anybody when we're trying to get a job. I think that's been overlooked in the farming industry. We expect to go in as an owner/operator rather than going in as a worker, and the worker today in agriculture, if the owner is looking at it rightly, takes a talent. You've got to be an agronomist, a mechanic and you're working with a $100,000 piece of equipment and it takes a lot of talent to be able to do that. So I think that in the future there's going to be a greater opportunity, but I think we need to call to the attention of the farming community that they should be looking at young people that have the talent and the ability and want to do it to manage those resources.

Senator ABDNOR. That's very interesting because a year or so ago in my office we were talking about that very thing and were trying to figure out some program that would promote well-established farmers and ranchers to take in young people and give them a chance. I read an article not long ago that many students graduating in agricultural economics are looking into farming as a profession. I guess more and more of that is happening, and we should be promoting new methods of recruiting new farmers. It might beat the heck out of new Government programs of some kind.

I was interested, Mr. Turnquist, in your prepared statement, you said that even at lower borrowing rates our unprofitable farms and ranches will still be unprofitable under the present pricing of commodities. I guess you're saying the problems facing farmers is more than just high interest rates.

Mr. TURNQUIST. What I was saying, in effect, is that it's not just high interest rates that created the problem, and those operations that were unprofitable, highly unprofitable, even by lowering the rate, it really didn't make them profitable operations. So it wasn't totally the interest rates.

Senator ABDNOR. That wasn't it entirely, but was it because of inefficiency as well as prices?

Mr. TURNQUIST. No. Some inefficiency, coupled with low commodity prices.

Senator ABDNOR. But as I said earlier to Mr. Schultz, most of the farmers we have today are really quite efficient or they wouldn't have lasted this long. It is my feeling that we've done a pretty good job of weeding out the inefficient ones, I think, and I don't know if you agree with that. I don't want to put words in your mouth. Don't you think most farmers are pretty efficient today?

Mr. MOORE. Yes, I think so. I do think that with the high level of technology that there are going to be farmers that are going to go out of business voluntarily and some of their land they will either sell it or they may buy additional land. Most of the price of this land has been—the inflated price of land has generally been stimulated by farmer buying from farmer rather than outside interests.

Senator ABDNOR. Do you think sometimes that land is overpriced?

Mr. MOORE. Well, certainly in relation to income today, it's overpriced. I think that we look at the capital asset of the land and we look at the capital asset of a building, and the building has depreciated to look at a return on it, and the farmer, he appreciates his land even though he may not have paid—he may have paid $50 an acre but today it's $200 an acre, and that's what he likes to show it as. But I would also offer that land will probably continue to increase in value. It may be slow now, but we will continue to see land increase in value at a rate of 5, 6, or 7 percent a year probably.

Senator ABDNOR. Nels, how do you feel about this high priced land?

Mr. TURNQUIST. Well, just about the same as Mr. Moore, that based on return on investment, there's just no way you can justify buying that land if there isn't something else to go with it, and that's what the people are betting on that are buying it—the long pull. There needs to be some appreciation. There's just so much land and over a period of time it's going to appreciate.

Senator ABDNOR. Isn't it true that the vast majority of the small farmers—and I don't know quite how you define the small farmer—have off-farm work for income? That's basically where a lot of them make it pay off, even in our State of South Dakota.

Mr. MOORE. Very definitely. In our region, there's a lot of off-farm employment. I think there needs to be established, for the record, a point that I think is missed a lot of times on the relationship of borrowing ability and the value of the land. Land has moved up in value each year to the point where there's probably 25 percent of that value that is no good to the farmer except on his financial statement because, No. 1, he can't borrow against it because he can't generate enough cash flow to service the debt on that added value, if you see what I'm talking about, Mr. Chairman.

And second, if he dies, he pays a tax on it; or if he sells it, he has a tax to pay on it. So there's a 25 to 30 percent value on that land that really isn't there.

So we see a lot of figures that say the farmer—you can take this 18 percent of the farmer's debt-to-asset value, and if you bring that land down another 25 or 30 percent, the debt-to-asset value probably is a little bit higher than that.

Senator ABDNOR. That's a good point. In relation to that, I made a statement earler this year when we passed the new tax bill—I said, that maybe the best piece of legislation we'll have for agriculture this year is the estate tax reform. Would you agree with that?

Mr. MOORE. Yes.

Mr. TURNQUIST. Yes.

Senator ABDNOR. Because we have been forced to break up a lot of family operations that would have stayed in existence had there been any possible way for them to keep their ranch and farm intact.

Would you agree with Mr. Schultz that most of the loans to agricultural people have a lesser rate than the average rate? Is that true?

Mr. TURNQUIST. What he was saying is that the loans to agriculture in the aggregate were lower, but that's taking into account the Federal Land Bank loans of years ago that might have been at 4 or 5 percent, the Farmers Home Administration loans which were granted at preferred rates, and that, in the aggregate, would be lower.

Senator ABDNOR. In other words, they have more long-term loans at low rates that have been in effect over a longer period of time?

Mr. TURNQUIST. Yes, and I think you will find that banks in agricultural lending are really lower than the prime rate that industrial borrowers would get. That rate is below the prime rate.

Senator ABDNOR. Well, Mr. Moore, you apparently have great faith that the family farm is alive and going to stay that way. Do you see reason for this concern we've heard about corporations buying the family farms?

Mr. MOORE. I really don't. I've seen instances where the corporation farm has had trouble. They have had management problems and they have not been able to operate with the same efficiency that the family farm operates. So I guess I see the greatest efficiency in crop production, livestock feeding, even in the cow-calf or the ewe-lamb operations in the family farm, so-called, as being the most efficient operation, and the one that's going to prevail.

Senator ABDNOR. Do farmers have to get bigger to become more efficient?

Mr. MOORE. They have tractors today that you can't turn around on 160 acres out there, and farmers, by their very nature, like to have the biggest and the best. They always say they like the smell of burning paint.

Senator ABDNOR. I know. Do you think that's a problem, that some people have overpushed machinery?

Mr. MOORE. I think in time—people overspend just like they overspend in other consumer goods, but they have learned to use that welder and do a pretty good job of repairing that equipment in the last couple years.

Senator ABDNOR. Both of you gentlemen, I know, follow the export market. Do you feel that we could really touch the capability of the export market if we put our minds to it? You touched a little on the problems we have.

Mr. TURNQUIST. I think there's potential for much larger markets, foreign markets, than we have achieved so far, and it seems to me that other than two or three agreements that we have on grain with two or three countries, that the only time that we get to sell more grain is when the contracts importers have with other countries such as Argentina, Australia, and Canada—are not filled—we take up the slack.

Now it seems to me that we ought to be a primary supplier in many more instances than we are.

Senator ABDNOR. Do you think the Government should take a tougher action against countries that put up these various barriers? We have been told about high tariffs that are charged on our products entering Japan.

Mr. TURNQUIST. Absolutely. The trade ambassador and those who work with him need to take a firm role on those issues.

Mr. MOORE. Mr. Chairman, may I just address that? I have a real concern in this area that we might at times play politics with agricultural products abroad and this concerns me. We had an embargo and that hurt. Whether it was psychological or not, it hurt.

The other thing is that the European Common Market as well as the other countries to whom we export have to depend on us and we find that we are not as dependable as a source of agricultural exports as their neighbor to the north might be. I think that we have to be a dependable source of food if we're going into these markets and they're going to depend on us. We can't be a fair-weather friend there and I think that that has hurt our agricultural exports considerably in the past few years.

Senator ABDNOR. Well, from what we've heard today, I think I would be safe in saying you gentlemen feel that if we're going to pull ourselves out of this economic depression that agriculture is in it's not going to come from farm programs, easier loans. It's going to have to come from getting in control the inflation, high interest rates, and finding new markets. Is that it?

Mr. MOORE. You bet.

Mr. TURNQUIST. Yes.

Senator ABDNOR. Let me ask you this. Maybe I'm selfish, but I'm going out to speak to a banquet for young farmers. Do you think the young farmers today are looking more toward the Government for support or do you think they want the opportunity to go out and be able to produce like they have been in years gone by? Most young farmers are entrepreneurs, are they not?

Mr. MOORE. They are entrepreneurs; yes, they are, and I think they want an opportunity and I think they deserve an opportunity to farm; but they don't deserve—none of us deserve an opportunity to—or the guarantee to success; and there's quite a difference.

Senator ABDNOR. Gentlemen, I appreciate you coming all the way to Washington. Let me assure you, once again, that you've given us extremely important and valuable information. We will put the picture all together, and as the facts come out, our biggest concern will be shown to be that agriculture is overlooked in the part it plays in the overall economy. I guess you heard me say that earlier. Do you think I'm overstating that sometimes?

Mr. MOORE. No, I don't, Mr. Chairman. I think you're entirely right.

Senator ABDNOR. Thank you for coming, gentlemen. The subcommittee is adjourned.

[Whereupon, at 12:05 p.m., the subcommittee adjourned, subject to the call of the Chair.]

[The following information was subsequently supplied for the record:]

National Association of Wheat Growers

415 Second Street, N.E., Suite 300, Washington, D.C. 20002, (202) 547-7800

December 11, 1981

The Honorable James Abdnor
Chairman, Joint Economic Subcommittee on
Agriculture and Transportation
G-133 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Mr. Chairman:

The National Association of Wheat Growers would like to submit the attached study for the record of the hearings conducted by your Subcommittee on December 1, which examined the importance of agriculture to the U.S. economy. The study was conducted last year by Chase Econometrics for the NAWG.

The study illustrates that increased wheat exports not only stimulate wheat prices, but also have a positive economic effect on the overall U.S. economy. The study presents policy alternatives, including increased wheat exports, for achieving and holding wheat prices in the $5.60-6.00 per bushel range during the 1981 and 1982 seasons. Sufficiently increased wheat exports, combined with higher levels of reserve accumulations, and resulting in a 40 percent increase in wheat prices would cause an increase of only two-tenths percent (0.2%) in the food component of the Consumer Price Index. If this price increase is brought about only by higher wheat exports, then the benefits of a lower balance of trade deficit, increased jobs, and higher farm income which stimulates farmer purchases would more than offset the negative impact of slightly higher inflation in the U.S. economy.

The combination of moderately higher wheat exports and stock accumulation through the farmer-owned reserve program, the second alternative studied, indicated no significant negative impact of $6.00 per bushel wheat on the U.S. economy, since improved trade balances and stronger farm income offset nominal increases in food costs.

The NAWG has commissioned Chase Econometrics to update last year's wheat export analysis, and to relate the economic benefits to specific wheat production regions. We will provide the results of the study to the Subcommittee when they become available, and would be pleased to provide any additional information for the record upon your request.

Sincerely,

Carl F. Schwensen
Executive Vice President

CFS/esh

91-609 130

THE ECONOMIC IMPACT OF WHEAT EXPORTS AND GRAIN RESERVE LEVELS ON THE U.S. ECONOMY

Introduction

The major factor confronting American wheat farmers today is the continued double digit explosion in production costs. Our analysis indicates that by 1982 U.S. wheat farmers average cost of production will be $6.00/bu or 42% over 1979 levels.

The 1978/79 near-record buildup in U.S. wheat reserves and new-record production in 1980, however has held U.S. wheat prices to only $3.78/bu. U.S. wheat farmers cannot continue to sustain such a discrepancy between production costs and market prices.

The American wheat farmers, however, do not necessarily want to continue to rely on government loans or subsidies to make up the difference between market prices and production costs while world food shortages continue to force millions of people to remain undernourished. Since the demand for wheat does exist in the overseas markets, it therefore becomes increasingly important that the government make every effort to stimulate an expansion in U.S. food grain shipments to other countries. Concurrent with this objective, however, the government policy must insure adequate domestic food grain reserves to prevent a major explosion in food prices in times of crop failures.

Objective

The objective of this study was to analyze the impact on the farmer, consumer and the entire U.S. economy of a policy of domestic wheat reserves coupled with an aggressive export stimulation which would increase wheat prices sufficiently to cover farmers production costs.

Analysis

Option I:

During the 1979/80 marketing year (ending May 31, 1980), wheat exports were 1.375 billion bushels and are expected to reach approximately 1.4-1.5 billion bushels in 1981/82. We estimate that it would take an export level of approximately 1.95 billion bushels in 1980/81 and 1.8 billion bushels in 1981/82 to hold Kansas City wheat prices at $6.00/bushel or farm prices of around $5.60/bushel.

This expansion in wheat exports would boost farm income by an average of $8.6 billion, or 36% over the next two years; and would also increase U.S. agricultural exports by an average of $4.8 billion.

The increase in wheat prices of approximately 43% over the two-year period from the base-line forecast is estimated to increase food inflation by an average of only 0.8% over the period due to higher prices of cereal and bakery products. Since the food category enters the Consumer Price Index (CPI) with an approximate weight of 20%, the overall inflation rate in the economy increased in this scenario by only 0.2%.

The increase in agricultural dollar exports would reduce our net exports deficit by 52%. This improvement in the balance of trade combined with increased purchases by farmers of tractors, cars and other items, stimulated by the 36% increase in farm income, more than offset the negative impacts on the economy from the increase in inflation. The net positive impact from the improved farm income and trade balance is estimated to boost employment by 20,000 and increase real GNP by 0.1% in the first year. Both of these factors, however, are estimated to remain relatively unchanged from the base-line scenario during the second year.

Option II:

It could be very difficult to find a market for 1.8-1.9 billion bushels of wheat during the next two years. However, recent world grain shortages may have made it possible to export as much as 1.6 to 1.65 billion bushels over the next two years. Therefore, an alternative analysis was undertaken to access the impact of increasing exports to these levels and then utilize the current farmer-held reserve to boost wheat prices to $6.00 at Kansas City during 1981 and 1982. This program objective would require that approximately 526 million bushels of wheat be moved into the farmer-held reserve, compared to approximately 282 million bushels that are currently in the reserve.

This program would boost U.S. agricultural exports by 5% or 2.2 billion dollars, thus reducing net balance of trade by 43%. Farm income would increase by 13% or 3.4 billion dollars.

Food prices would again increase by only 0.8% and total inflation would be 0.2%.

This smaller increase in exports would not cause a net improvement in the economy. However, this scenario does not hurt the overall economy and does build food grain reserves to protect against future crop shortfalls.

Conclusion

In conclusion, our analysis shows that a 40% increase in wheat prices would cause an increase in food inflation of 0.8% and increase overall inflation by 0.2%. If this wheat price increase is brought about only by higher wheat exports then the benefits of a lower balance of trade deficit and increased farm income, which stimualtes farmers purchases, would offset the negative impact of slightly higher inflation in the U.S. economy.

The second scenario of supporting wheat prices through a combination of moderately higher wheat exports in connection with the farmer-held reserve program indicated no significant negative impact upon the U.S. economy as improved trade balances and stronger farm income offset increases in food costs.

Thus a combined policy of maintaining both strong exports and adequate foodgrain reserves would appear to be a very viable alternative which would protect farmers against higher energy and other costs and also provide reserves to protect consumers against food shortages during draughts or other major crop disasters. This approach would also have only a slight impact (around 0.2%) on inflation and this impact would be offset with improved trade balances and farm incomes.

Table 1. Agricultural Impact of Wheat Exports and Farmer Grain Reserve Program in 1980/1981 Wheat Marketing Year

	Base	Exports	Exports & Reserve
Wheat			
Exports	1400	1946	1635
Prices			
Kansas City #1 HRW	$4.09	$6.03	$6.05
Minneapolis	$4.00	$5.84	$5.86
Farm Price (U.S. Ave.)	$3.62	$5.60	$5.62
Wheat Reserves (mil bu)	282	0	400
Acreage (mil)	80.9	80.9	80.9
Total Agricultural Exports Current ($ bil.)	38.4	43.9	40.8
Proprietors Farm Income ($ bil.)	23.1	30.9	26.6

Table 2. Impact of Exports and Farmer Held Wheat Reserves on the Economy in the 1980/1981 Wheat Marketing Year

	Base	Exports	Exports & Reserve
Gross National Product (GNP, bil 72$)	1400.3	1401.9	1400.4
Industrial Production Index, 67 = 100	147.7	148.0	147.7
Employment, mil	90.6	90.6	90.6
Net Exports, Goods & Services, Bil	-8.6	-3.7	-4.9
Consumer Price Index, 67 = 100			
Food	269.3	271.7	271.7
Total	288.1	288.6	288.6

Table 3. Agricultural Impact of Wheat Exports and Farmer Wheat Reserve in 1981/82 Wheat Marketing Year

	Base	Exports	Exports & Reserve
Wheat			
Exports	1470	1780	1600
Prices			
Kansas City #1 NDK	$4.30	$6.12	$6.03
Minneapolis #1 NDK	$4.25	$5.99	$5.90
Farm Price (U.S. Ave.)	$3.78	$5.88	$5.79
Wheat Reserves	282	0	526
Wheat Acreage Planted (mil)	79.6	82.6	82.6
Agricultural Exports Current ($ bil.)	43.7	47.9	45.9
Proprietors Farm Income ($ bil.)	26.2	35.6	29.6

Table 4. Impact of Exports and Farmer Held Reserves on the Economy in the 1971/1982 Wheat Marketing Year

	Base	Exports	Exports & Reserve
Gross National Product (GNP, bil 72$)	1437.8	1437.4	1436.5
Industrial Production Index 67 = 100	156.3	156.4	156.2
Employment, mil	90.6	90.6	90.5
Net Exports Goods & Services, bil.	-5.3	-2.5	-3.0
Consumer Price Index, 67 = 100			
Food	295.6	297.6	297.6
Total	319.1	319.7	319.7

Table 5A. U.S. Wheat Supply/Disappearance Under Alternative Export and Reserve Scenarios, 1980/81

	Base	Exports	Exports & Reserve
Carry In	901	901	901
Production	2,332	2,332	2,332
SUPPLY	3,233	3,349	3,349
Domestic Use	855	825	825
Exports	1,400	1,946	1,635
DISAPPEARANCE	2,255	2,771	2,460
Total Carry-Out	978	462	773
Farmer Reserve	282	0	400
Market Carry-Out	696	462	373

Table 5B. U.S. Wheat Supply/Disappearance under Alternative Export and Reserve Scenarios, 1981/82

	Base	Exports	Exports & Reserve
Carry In	978	462	773
Production	2,333	2,440	2,440
SUPPLY	3,311	2,902	3,213
Domestic Use	831	765	765
Exports	1,470	1,780	1,600
DISAPPEARANCE	2,301	2,545	2,365
Total Carry-Out	1,010	357	848
Cumulative Reserve	282	0	425
Market Carry-Out	728	357	423

TABLE 6. CROP BUDGET: ALL WHEAT TOTAL U.S.

Costs per Acre	1980	1981	1982
Total Variable Costs	53.99	61.53	67.38
Seed	5.67	5.74	5.87
Fertilizer	12.13	13.98	15.16
Lime	0.18	0.20	0.21
Chemicals	2.58	3.04	3.30
Custom Operations	3.18	3.70	4.10
Labor	9.29	10.06	10.89
Fuel and Lubrication	11.04	13.86	15.88
Repairs	6.90	7.47	8.19
Purchased Water	0.27	0.32	0.36
Miscellaneous	0.15	0.17	0.18
Interest	2.60	2.99	3.24
Machinery	30.82	33.40	36.62
General Farm Overhead	8.74	9.52	10.27
Management	9.36	10.45	11.43
Total Cost Excluding Land	102.91	114.90	125.69
Land Costs (Renter Share)	51.45	57.45	62.84
Total Cost	154.36	172.35	188.53
Yield/Acreage	29.0	31.2	31.4
Cost Per Bushel	5.32	5.52	6.00