IMPLICATIONS FOR ORGANIZATION OF FARM RELATED MARKETS:
A DISCUSSION

by John C. Redman*

In reading, listening, and reflecting on the general topic of this conference I am reminded of what a professor told me recently. He said that one day he dreamed that he was lecturing to a class and that when he awoke he discovered that he was. I am afraid that most of us have been sleeping; and now, after dreaming of a changing economy, we have awaked to discover that changes have been going on and will likely continue to accelerate in the next 15 or 20 years.

There seems to be present in agriculture and closely related sectors a primary revolution which is largely technological in nature, and this is generating some secondary revolutions which are largely economic and cultural in scope. The technology being developed is enabling the American farmer to produce a volume of output much larger than the capacity of the economy to utilize at a price sufficient to reward resource owners with returns comparable with nonfarm earnings. This gap between what exists and the potential at a particular time is an uprooting factor in causing re-allocative action by the members of the economy. Associated with this uprooting act is a cultural and intellectual approach to the problems involved. In addition, the time dimension is becoming more pronounced in all mainstreams of American life, while at the same time our values and beliefs are being examined. We are experiencing the feeling that we either have the wrong or inappropriate answers to the right questions or the wrong question to the correct answer. Perhaps, our problem is illustrated by the response of a professor when questioned as to why his students fail even through his questions are always known in advance. Replied the professor: "The questions don't change but the answers do". No doubt, within the next 20 years the answers will be very much different to the same questions which face us today.

The paper by Sims on "Factor Supply Firms and Markets" dealt largely with the effect of the structural changes on firms which handle expendable inputs. It was pointed out that the farm supply firm faces an uncertain future. This would be true for the firm as currently organized and operated. However, the supply firm can be expected to undergo rather important changes to meet the changing needs of the farm firm. The question seems to center around the extent and direction of the change. Will there be an opportunity for the small supply firm to provide a share of the large commercial farm's requirements? Will the large commercial farm or a group of commercial farms buy inputs according to specifications cheaper by buying direct from the manufacturer.

*Professor of agricultural economics, University of Kentucky

1In more precise economic terms, new technology shifts the supply schedule to the right.
and thus bypass the supply firm? This practice has been followed in the fertilizer inputs category for some time and it is likely to spread for all types of farm inputs. In some areas there may be some interest in rediscovering and adapting the old general store idea. However, this approach is not likely to get very far unless it assumes the functions of a broker representing the farmer or the manufacturer.

An increased need for a supply of advisory services was suggested, and this need may be met from many sources, such as the extension service, sales engineers, or consulting firms. It is my opinion that the equality of advisory service needed by the commercial farm of tomorrow is much greater than these sources are now able to provide.

A major resource market of which no mention was made is that of labor. No doubt, the farm of tomorrow will substitute capital for labor, but how far this substitution will go will depend not only on the substitution rate but on the relative cost of labor and capital. The principal factor determining the cost of labor in farming likely is the available alternative opportunities. A much higher quality of the labor input will be needed, and this will be forthcoming as a result of the cultural and intellectual revolution now taking place. As special farm skills are developed and utilized by the bigger commercial farms, there seems to be a good possibility that farm laborers will organized into unions which could be rather demanding since farmers are subjected to a rather exacting time schedule in their production process.

The land input will take on increased significance. The price for real estate promises to be rather high for some time to come. It is true that with the heavy applications of technology and capital along with higher levels of management, productivity of an acre of land will be increased, and a given output can be produced with less acreage. There will be a need for considerable consolidation to achieve an optimum level of land input. Other competing uses for land -- recreational areas, highways, lakes, urban developments, farm residences, etc. also -- hold the market price up. Will there be any innovations in the land input category.

The paper on "Finance and Capital Markets" had the objective of discussing the implication of the changes in the farm sector on the finance and capital markets. The nontraditional ways of acquiring control over capital centered around the leasing of capital equipment, vertical integration, horizontal combination, incorporation of farms, and living with permanent debt rather than seeking to achieve the time honored goal of a debt-free farm. While a bare mention was made of cooperative farm credit agencies and insurance companies, only commercial banks received any attention as traditional institutional sources of credit. It is doubted very much that only commercial banks will experience any impact of structural changes in agriculture. However, because of their very nature, the commercial banks may experience greater difficulty in adjusting to the impact of the structural changes.

2In more precise economic terms, the marginal physical productivity of the land input will be increased.
It is likely that unless the legal framework under which the commercial bank operates is changed, this source of credit will become increasingly less important. The commercial bank being engaged in a profit-making activity will be facing the usual problem of allocating its loanable funds among the various opportunities which promise the greatest profit. What alternative opportunities are available to the bank? Recent trends in loans outstanding suggest that installment credit is a very profitable field which will offer approximately twice the return that can be expected from farm loans.

The sales finance corporation, which may be a subsidiary of the parent corporation, appears to hold an important place in the credit field, particularly in the more durable input category. This type of corporation can offer a reasonable rate and terms to the farmer and at the same time achieve a reasonable return to the company on the amount of funds outstanding. The capital leasing activity will undergo modifications, the nature of which are open to speculation.

The production credit associations have experienced rapid growth since about 1955, when they were more or less pressured into making adjustments in lending terms and purposes. Since they are now virtually farmer-owned agencies, there is no reason why they can not make rather rapid adjustments to meet the needs of the farm of tomorrow. These are organizations specializing in loans designed for farming activities. Some PCA's are adding fieldmen to assist in general advisory work. It is the on-spot contacts which acquire loan business, get it utilized properly, and get it repaid. PCA loans are very flexible and can be tailored to fit the needs of the farmer. PCA's loan not only for production purposes but for purchase of real estate, automobiles, medical expenses, etc. The future role of the PCA in serving farmers seems to be very bright, while the commercial bank with all the problems of traditionalism (six months note, collateral requirements, etc.), restrictions imposed, supervisory agencies, lack of specialization in farm lending business, and alternative opportunities for greater return may become a less important source of short-term credit for farmers. In addition, the commercial bank must be in position to meet the demand of the public it serves, and this necessity places an added burden on the commercial bank in competing with nonbanking agencies engaged in the loan business. In my opinion, correspondent banking is not the answer. Nor do I think that such gimmicks as certificates of deposits will have a great impact on tomorrow's activities. It will not be easy for the commercial bank to overcome these problems.

It is somewhat surprising that a discussion relative to long-term financing was completely eliminated. With fewer and larger farms in prospect, the problem of long-term financing looms as a major concern. Permanent debt has received some attention, but most agencies appear to insist that some plan be followed to liquidate the debt. In practice, the debt in many cases becomes permanent through constant use of the refinancing privileges. A loan to the large commercial farmer is what life insurance companies relish: thus with their low equity requirements and long-term loans, life insurance companies should occupy a more dominant role in long-term agricultural credit in the future.
Pressures are mounting in the Federal Land Bank to modify the concept underlying the loan limits and to give the Federal Land Bank Association manager more authority in making loans. Whether or not the Federal Land Banks will continue to be a major lender will depend upon how quickly they adjust their institutional setting and the values and beliefs held by the officials in the system. Since PCA and the Federal Land Bank Associations compete for much of the same type of business, there appears to be a need for consolidation of these agencies to serve the needs of the farmer adequately.

Savings and loan associations, which are now entering the area of residential farms and seeking to enter the consumer installment field, may find further ventures into large-scale financing of farms worth pursuing. Credit unions, which rank third in volume of consumer credit, have an opportunity to team up with supply cooperatives to handle the problem of accounts receivable.

Other agencies may become interested in the farm financing, particularly when large commercial units are in the market for funds. Managers of trusts, pension funds, etc., are looking for diversification of their portfolios and may find an outlet in this area. The most important source of financing is the farm firm itself. Through internal financing, the firm can meet most of its financial obligations. The management of these internally generated funds will be more critical in the future than in the past, and this is the area about which we know very little. While there are many agencies willing to offer partial financing for various purposes, there will be greater need to think of financing as sort of a package plan, utilizing internally generated funds and using supplemental funds from other sources.

Heimberger's stimulating paper had much to offer which is very important and useful in approaching a study of the current evolving pattern of the market place. However, I wish he had elaborated and committed himself more clearly and concisely on what changes are implied in product markets as a consequence of projected changes in the structure of agriculture as set out in the background papers (first four chapters of this report.) If we accept the idea that economic incentive is the principal reason for the existence of the firm, then I predict that the market firm of tomorrow, rather than procuring resources in the traditional market, will be a vertically integrated one which influences decisions from the farm level to the final disposal in order to gain coordination of activities. Thus, open markets are expected to diminish in the commercial sector of agriculture. The judgment was expressed that it was wholly proper for governments to seek ways and means for improving or safeguarding the declining open market. Opportunities may exist to make price a more accurate signal. These opportunities will be largely through concentration and standardization of the small lots, reducing uncertainty (chiefly by improving the state of knowledge) improving knowledge of input-output relationships, lowering the transfer cost through reducing the influence of oligopsonistic elements, and finding adequate control to prevent an abuse of market power. The question remaining here is how far society should go in safeguarding a traditional market structure which is declining in economic importance. Perhaps, it can be justified on noneconomic grounds.
Largely because of economic reasons, vertical integration in farm markets can be expected to increase. The question was correctly asked, "Who will end up in control?" An additional question would center around the economic and social desirability of accepting monopsonistic elements in the market procurement practices. Not all monopsonies are bad, but care must be exercised to see that society benefits by permitting these deviations from the highly competitive structures to occur. How much of the farmer's freedom can he afford to give up under vertically integrated arrangements? Will he, over a long period of time, lose some of this decision-making ability? It is possible that we may be oversold on the economic advantages of vertical integration and may neglect some of the non-economic costs.

Bargaining associations will be encouraged to help protect and advance the cause of the farmer component of the farmer-market firm integrated process. Dependent on the purposes of the bargaining associations, they may have varying degrees of success in an oligopolistic setting.

I fully agree that we know very little about the impact of technological change on the market organization. There appears to be considerable lag in the impact of technology, creating a considerable gap in what currently exists and the potential. But, as technology is adopted, we can expect adjustments to take place in the boundaries of the market, changes in forces affecting the competitive structure of the market, and changes in the internal organization of the market firm. Many persons will argue that in market firms where ownership and management are rather widely separated, the motivating goal of management becomes one not of maximizing profits but of maximizing gross sales or gross volume of business.

It appears that Helmberger has mixed emotions, and I share this feeling. Integration is an accepted market policy to be fostered and guided. Yet I am very reluctant to see the traditional open market erode away. Perhaps, these adjustments will be so gradual that no serious pain will be experienced.