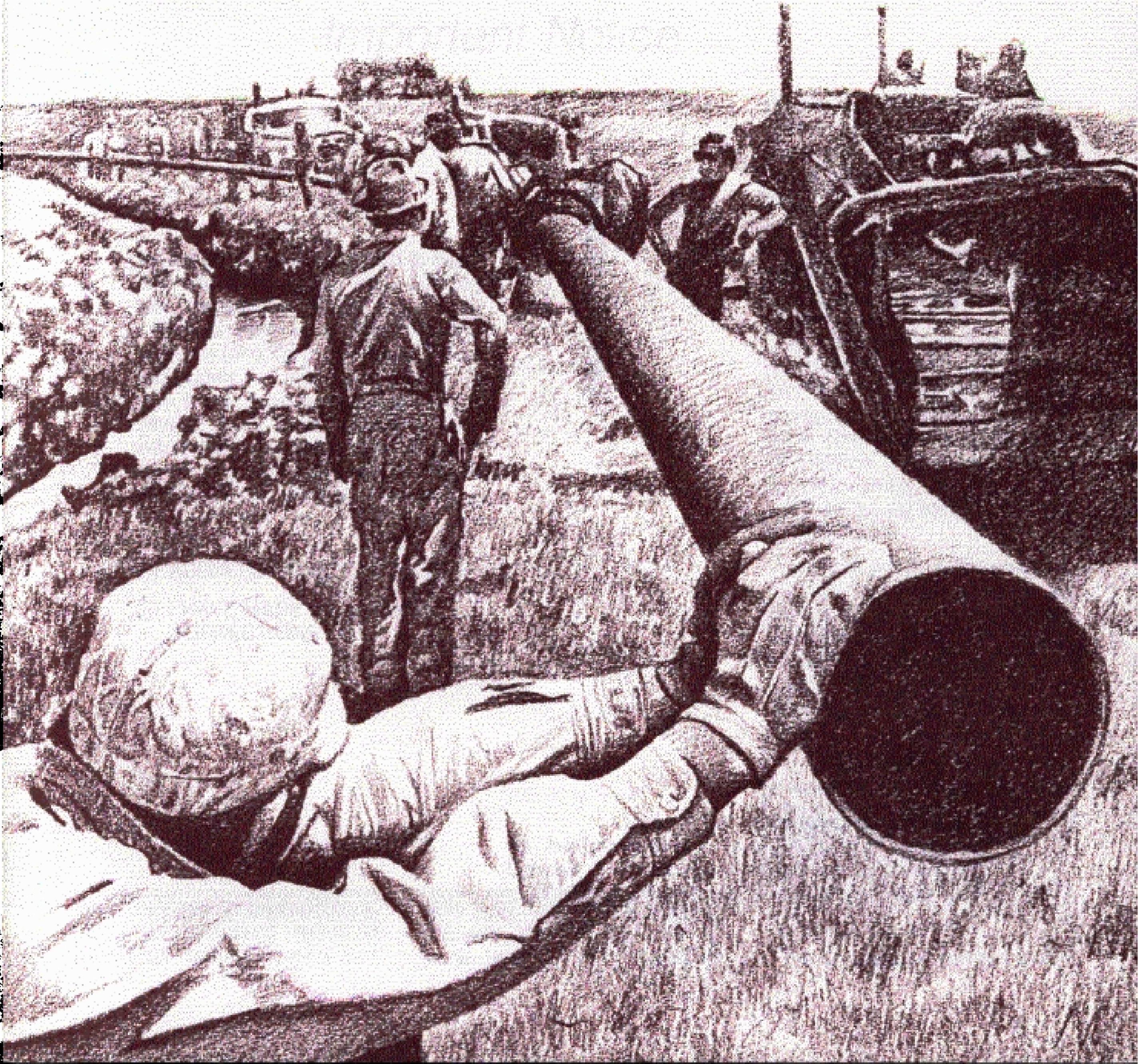
Ninth District Quarterly

Federal Reserve Bank of Minneapolis
February 1974

Implementing
the Rural Development Act



Review & Outlook

1973

While the energy crisis, baling wire and newsprint shortages were making news in 1973, the district's economy kept moving along.

The farm sector had a tremendous year. Both cash marketings and farm incomes were well above 1972 levels. Ag credit demand was strong throughout the year as farmers borrowed to cover the rising costs of production inputs.

Manufacturing sales, especially of durable goods, ran well ahead of 1972 through the first three quarters; manufacturers report that growth rates were down slightly in the fourth quarter, however. The district's unemployment rate averaged 4.9 percent in the first half but rose to 5.2 percent as employment bottlenecks developed in the second half.

Homebuilding fell far below 1972's record pace, but other segments of the construction industry helped make up the difference.

Retail sales were good most of the year thanks to rising personal incomes through September. A fourth-quarter survey of district car sales managers and large retailers indicated a slowdown in consumer spending as the year ended.

1974

The general outlook for the district in 1974 reflects the uncertainty and pessimism brought on by the energy crisis.

- Decreased export demand and increased costs may depress farm incomes below 1973's record levels.
- The unemployment rate is expected to rise as firms are confronted with fuel and materials shortages. Capacity constraints are already being felt in some manufacturing industries.
- Sharp cost increases and materials shortages will continue to depress homebuilding.
- Consumer attitude surveys are pessimistic, and consumer spending for new cars and other durables will probably decline.

Agriculture

When year-end data is tallied, the district's 1973 gross farm income may exceed $8 billion. Cash marketings in the four-state area of Montana, Minnesota and the Dakotas had already reached $7.3 billion by November 30, and the surge in farm income continued through December. Cash marketings for crops alone more than doubled over 1972.

Final USDA estimates of district crop production, revised downward from earlier estimates, were still large enough to break records.

Total corn production was estimated at 666 million bushels for 1973. Valued at average fourth quarter prices, the district's corn crop should be worth $1.5 billion. The district's record soybean crop of 142 million bushels should bring in another $776 million.

Wheat prices advanced dramatically in December as rumors of renewed export demand and the possibility of subsequent wheat shortages circulated. Once started, this price upswing continued into the new year.

Farm prices recovered somewhat in December after falling substantially below their August highs. The Index of Prices Received by Farmers fell 12.5 percent between August and November but gained 1.5 percent in December.

Increased marketings in the

Average Prices Paid and Received by U.S. Farmers, 1973

	Aug. 15	Sept. 15	Oct. 15	Nov. 15	Dec. 15
Farm Price Indexes (1967=100)					
Prices Paid	151	150	151	151	153
Prices Received	207	191	184	181	184
Wheat, $ per bu.	4.45	4.62	4.22	4.20	4.78
Corn, $ per bu.	2.68	2.15	2.17	2.18	2.39
Soybeans, $ per bu.	8.99	5.81	5.63	5.14	5.65
Cattle, $ per cwt.	51.70	47.20	42.60	39.50	37.60
Hogs, $ per cwt.	56.50	43.60	40.80	40.40	38.20
Milk, $ per cwt.	7.17	7.81	8.29	8.55	8.78

fourth quarter forced beef prices more than 30 percent below their August high of $56.38 per cwt. However, feeder placements were below 1972 levels for most of 1973, and analysts foresee prices in the first quarter averaging $45 per cwt. or better. An increased supply of feeder cattle and flagging consumer demand may lead to lower prices later in the year.

The rise in milk prices also merits comments. November milk production in the district was down 3 to 4 percent from last year; nationwide it was down 5 percent. In recent months the milk/feed ratio has been at its lowest level in nearly a decade. Both the number of cows and productivity per cow have been declining, and it is hoped that the rise in milk prices will halt the decline in productivity.

The export demand for farm products remains strong. Exports in fiscal 1974 are now being estimated by the USDA at $19 billion, up from $12.9 billion in fiscal 1973 and nearly triple the 1969-72 average of $7.1 billion.

The strong export demand has placed heavy pressure on stocks of U.S. commodities. The stocks of corn at the end of the current crop year (September 30, 1974) are now projected at 750 million bushels, enough to supply domestic needs for less than two months. The wheat carryover on June 30, 1974, should last three to four months, unless export demand increases.

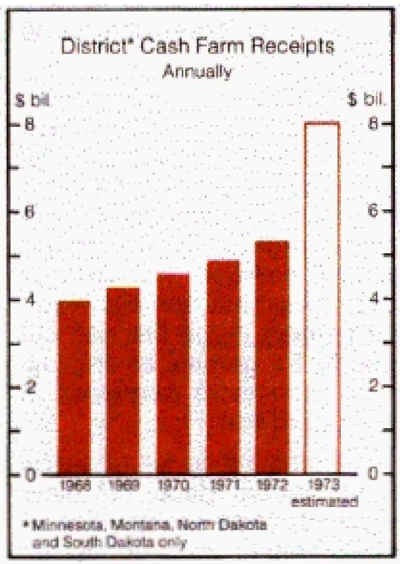
Ag Credit

As usually happens when times are good, the demand for farm credit advanced strongly in 1973. New loans by Production Credit Agencies (PCA) in the Ninth District through November 30 were up 28.5 percent over 1972, and new loans by Federal Land Banks (FLB) were up 27.3 percent. PCA and FLB loans outstanding on November 30 were 12.2 percent and 11.8 percent, respectively, above January 1 levels.

The loan volume (adjusted) of commercial banks as of December 1 had increased 19.4 percent over the start of the year. Total deposits at ag banks were up 11.8 percent.

One of the factors underlying the increased demand for credit was higher prices for farm inputs. The Index of Prices Paid by Farmers rose 16.1 percent in the past year. Nationally, real estate prices advanced 20 percent; some farmland reportedly sold for more than $1,000 per acre.

Judging the early signs, 1974 should be a good year for farmers but probably not as good as 1973. Net farm income in both the district and the na-

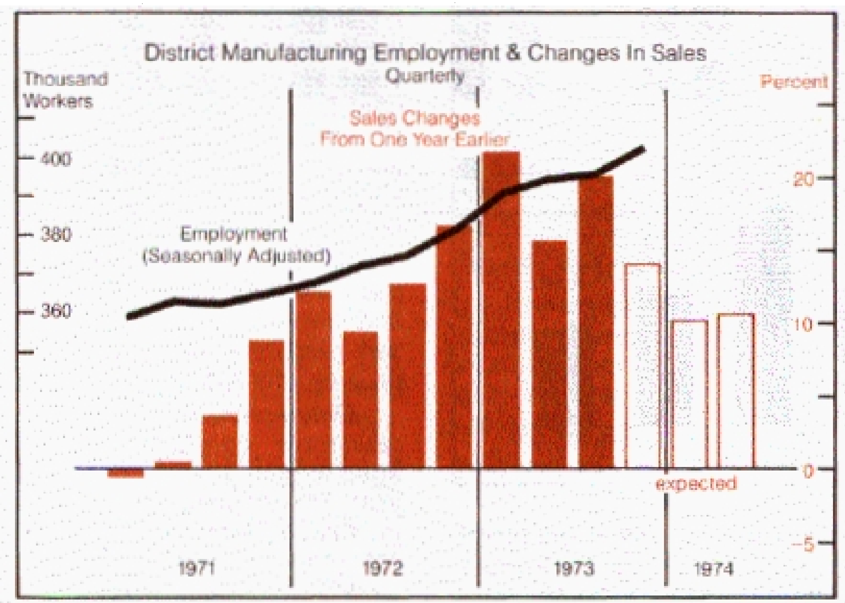


tion may decline from 1973 levels.

Substantial increases in wheat and corn production will push commodity prices down later in the year, and export demand may slow somewhat because of worldwide increases in grain production. Input prices will continue to rise in 1974. Another substantial jump in land prices can be expected, and prices of fuel, fertilizer and machinery will also increase, raising the possibility of a renewed squeeze on farm incomes.

Industrial Activity

In line with the country's strong economic expansion, district manufacturing activity rose appreciably last year.



Year-to-year sales gains averaged 19.2 percent during the first three quarters of 1973, bettering advances of 1.3 and 11.5 percent in comparable periods of 1971 and 1972.

Price increases undoubtedly accounted for much of this, but real output also rose. Manufacturing employment grew an average 5.9 percent in this three-quarter period compared to a 6.3 percent decline in 1971 and a 2.8 percent increase in 1972.

The largest boost to district manufacturing came from the durable goods industries where sales were up 24.4 percent from a year earlier and employment expanded 8.7 percent.

Nondurable goods sales were 13.7 percent greater than a year ago and employment was up 2.4 percent. Large food price increases inflated nondurable sales, while employment growth was held down by last summer's price freeze which caused meat packing layoffs and other food industry disruptions.

District manufacturing continued to expand in the fourth quarter. Manufacturers surveyed in November expected fourth quarter sales to be 14.1 percent higher than a year ago, with durables and nondurables increasing 19.5 and 8.2 percent, respectively. Although smaller than gains in the third quarter, these would be sizable by historical standards.

Manufacturing employment in the fourth quarter was up 1.7 percent from its third quarter level, indicating a further increase in manufacturing activity.

The health of district industry in 1974 pretty much depends on the availability of fuel and other materials. Even before the Arab oil embargo, district manufacturers expected their sales growth to drop from 14.1 percent in the last quarter of 1973 to 10.5 percent in the first and second quarters. Fuel shortages may reinforce these expectations.

Supply and capacity constraints could also cut into sales growth. Respondents to our latest Quarterly Industrial Expectations Survey generally thought their plant and equipment and inventories inadequate to meet expected sales demand.

Milder than normal weather in December and January has eased the industrial heating fuel situation and averted widespread work stoppages in the district. Production inputs are still tight, though, and manufacturers will find it increasingly difficult to obtain such items as petrochemicals and steel.

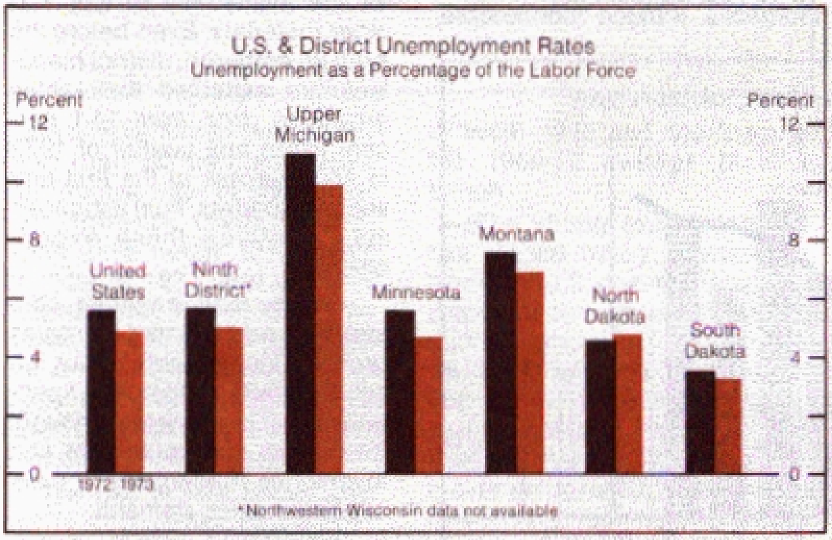
Consequently, 1974 will probably not be as good a year for district industry as was 1973.

Labor Market Conditions

Following an annual unemployment rate of 5.7 percent in 1972, the district's unemployment rate fell to 5.0 percent in 1973. Unemployment in the nation dropped from 5.6 percent in 1972 to 4.9 percent.

Regionally, the most pronounced employment gains occurred in Minnesota and Upper Michigan, while joblessness increased slightly in North Dakota.

District unemployment had declined to an average 4.9 percent for the first half of 1973, only to rise to an average 5.2 percent in the second half as labor force expansion exceeded employment growth.



Employment bottlenecks partially explained this rise since job openings were actually higher than a year ago. Manufacturing job vacancies in Minnesota, for example, were almost three times higher at the beginning of November 1973, and nonmanufacturing job vacancies were up slightly.

Toward the end of the year, available evidence also suggested that the demand for labor was softening. District initial claims for unemployment compensation in November and December were up from a year ago, and the district's help wanted advertising index had not grown in the final months of 1973.

The combination of petroleum shortages and labor market softening will undoubtedly lead to higher unemployment for the district in 1974. Some businesses, especially winter recreational industries, may be forced to close or cut back their operations early in the year.

Looking beyond the first quarter, materials shortages will probably limit industrial expansion and therefore restrict employment growth in the industrial sector.

Employment growth in the service sector, especially in the district's travel and tourist industries, will be held down by gasoline shortages. The outlook for construction employment in 1974 is somewhat bleak, given the dropoff in residential building. No large increases in retail sales are foreseen, so employment growth in the trade sector should only be modest.

Construction

For the construction industry, 1973 never quite lived up to its auspicious beginnings.

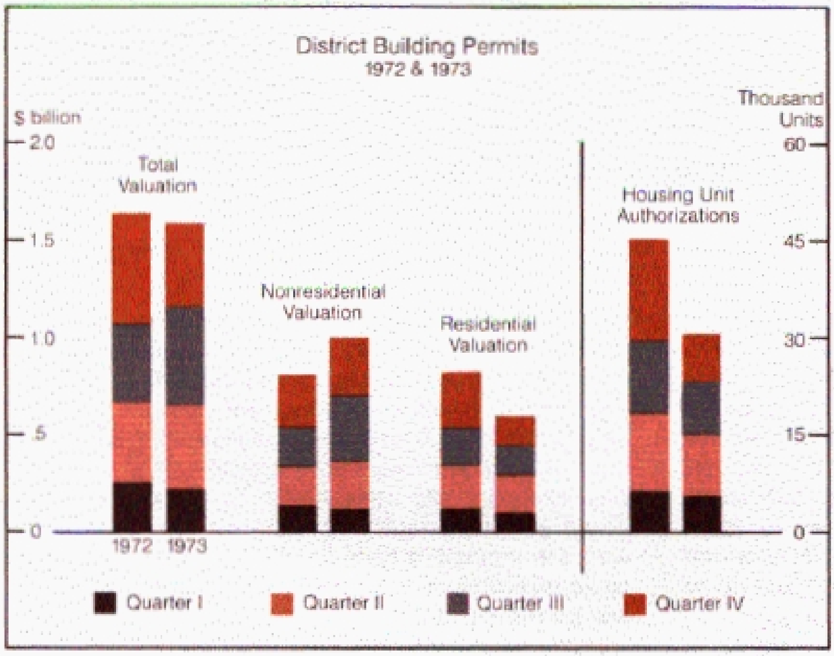
As the year progressed, housing unit authorizations in the district fell from a 31 percent year-over-year increase in January to a 32 percent decrease for the year ending December; the nominal dollar valuation of these units also fell 28 percent below 1972 levels.

By year end it was obvious that prevailing mortgage market and homebuilding conditions had exacted a heavy toll from housing unit authorizations.

Only nonbuilding and nonresidential construction managed to gain ground during the year. Power plant construction in eastern Montana, although not reflected in permit data, gave a continuing boost to the industry.

The valuation of nonresidential permits through December was up 23 percent. Private nonresidential building assumed new importance as its share of new nonresidential building valuation swelled from 68 percent in 1972 to 81 percent through December 1973.

Due to the strength in these building components, total dis-



trict valuation was only 3 percent below the historic 1972 level.

Turning to 1974, utility construction promises to be one of the few sources of optimism.

Residential construction is not expected to recover in the first half. The consensus of economists at the Home Loan Bank Board's annual forecasting conference last November was a drop in national housing starts to 1.5 or 1.7 million units in 1974 from the 2.4 million high in 1972. A slight easing in available mortgage money may stimulate effective housing demand somewhat, but sharp increases in construction costs (lumber prices through November were 27 percent higher than a year ago) and materials shortages offer little hope for a homebuilding rebound.

Nonresidential and nonbuilding construction, furthermore, may not be strong enough to bail out the industry this year.

The Minnesota Highway Department has reported a slowdown in highway construction and a reduction in the number of projects for 1974 because materials shortages have made future costs almost impossible to predict. The department plans to defer first quarter contract lettings until April or May to counteract an expected reduction in gasoline sales and revenues from gasoline taxes.

Consumer Spending

District consumers had more money in their pockets last year, and their 13 percent rise in personal income through the third quarter showed up in large gains in retail sales.

Minnesota retail sales were up 11 percent over 1972 by the end of October. Sales growth was probably even larger in Montana and the Dakotas where farming, which had a great year, is relatively more important.

The retail business was so good, in fact, that regional sales may well exceed the 13 percent rate of growth recorded nationally through October. Not only were personal income gains 3 percentage points higher in the district than in the nation, but

Annual Growth in Personal Income and Retail Sales

	Personal Income		Retail Sales	
	District	U.S.	Minn.	U.S.
1971	6.1%	6.8%	8.1%	6.3%
1972	9.1	8.8	9.7	9.5
1973	13.3*	10.1*	10.9**	13.5**

*January-September 1973 over January-September 1972
**January-October 1973 over January-October 1972

inflation seems to have been slower, so district retail sales totals were affected less by price increases. For the 12 months ending in October, both the Consumer Price Index and its food component rose less in the Twin Cities than in the nation.

Consumer spending tapered off as the year drew to a close.

New car sales were especially slow. Several regional car sales managers contacted in a December telephone survey reported declines in unit sales of 10 to 20 percent from year-ago levels. In general, the shift in consumer demand to smaller cars seemed to have caught them off guard, and their supplies of small cars were inadequate.

These managers noted that the demand for large luxury cars has remained strong, which suggests that changes in fuel costs have not been of particular importance in this market.

Large retailers contacted in the survey also reported a slowdown in expected year-to-year sales gains during the fourth quarter, partly because Christmas sales were expected to be only slightly above those in 1972.

It's likely that district consumer spending in the early part of 1974 will be more temperate than it was in 1973. Income gains may not be as large, particularly if net farm incomes decline or employment growth slows. If large increases in food and energy prices materialize, discretionary incomes would be reduced and durable goods sales would suffer.

Short supplies of a number of goods—small cars and retail items with plastic components—would also limit sales growth.

And in the face of all this, national surveys continue to report pessimistic consumer attitudes and buying intentions.

Implementing the Rural Development Act

John Rosine

Passed by Congress in August 1972, the Rural Development Act (RDA) was designed to attract business and industry to rural areas, to create jobs and to improve the living conditions of rural citizens. To realize these objectives, the Act authorized numerous rural assistance measures, perhaps the most important of which were the business and industrial loan program and the community facilities loan program. These loan programs are now operational. The Farmers Home Administration (FHA) issued the final regulations governing the programs in October and recently began approving the loan requests of rural communities.

In implementing the new loan programs authorized by the RDA, the FHA has moved cautiously. Officials have emphasized the need for careful planning rather than pushing for swift implementation. Accordingly, the programs have been funded at only a modest level in their first year of operation, and their impact on rural communities in fiscal 1974 will be fairly small. If they are to have a greater impact in future years, levels of funding will need to be increased.

Funding the New Programs

The thrust of the new rural industrialization effort is embodied in Title I of the RDA. As indicated in the table, several provisions of Title I have not been funded in the final 1974 appropriations, although in some cases programs providing similar services are funded by other federal agencies.

The key provisions of Title I which were funded are (1) guaranteed and insured business and industrial loans (B&I loans), (2) direct community facility loans (CF loans) and (3) industrial development grants to rural communities. All three programs will be administered by the FHA.

B&I loans can be used by public bodies or private enterprises in a variety of ways to encourage rural industrial development. The same is true of industrial development grants, except that they will be made only to public bodies. CF loans can be used to construct or improve water, sewage and waste disposal systems or to finance the development of facilities for fire and rescue services, transportation, traffic control and social, cultural or recreational facilities.

The final authorization for B&I loans in the current fiscal year was set at $200 million. CF loans are authorized up to a limit of $50 million and industrial development grants to $10 million. These nationwide totals will be allocated among the states on a formula basis, taking into account such factors as rural population and per capita income.

There has been much confusion about the $200 million ceiling on B&I loans. Some Congressmen had hoped that the limit would apply only to insured loans or that the $200 million could be used as a hedge against loan losses. Other Congressmen assumed that both guaranteed and insured loans were covered by the ceiling; this stricter interpretation was accepted in the end.

The average allocation of B&I loans per state in fiscal 1974 will therefore be $4 million. According to officials at the Minnesota FHA office, the state's allocation has been set at $4.3 million, but requests for B&I loans as of December 1, 1973, had already exceeded $8 million.

The per state allocation of industrial development grants will be much smaller than the loan allocations, averaging only $200,000. This will probably be enough for only one or two grants per state.

Implementing Title I of the Rural Development Act of 1972
Progress Through December 1973

Section of Title I	Description	Type of Program	RDA Authorization	Final Appropriations For Fiscal Year 1974
102	Small Enterprise Real Estate Loans	Loans	Unlimited	(Included in Sec. 118)
104	Community Facility Loans	Loans	Unlimited	$50 million
105	Grants for Water and Waste Disposal Systems	Payments	$300 million	—
108	Water and Waste Disposal Planning Grants	Payments	$30 million	—
111	Rural Development Planning Grants	Payments	$10 million	—
118(a)	Business & Industrial Loans	Loans	Unlimited	$200 million
118(b)	Pollution Abatement Grants	Capital Grants	$50 million	—
118(c)	Industrial Development Grants	Grants	$50 million	$10 million
121	Small Enterprise Operating Loans	Loans	Unlimited	(Included in Sec. 118)
121	Small Enterprise Antipollution Loans	Loans	Unlimited	—
121	Small Enterprise Antipollution Grants	Grants	$25 million	—

Employment Impact of the New Programs

Unless funding is increased the employment impact of the new program in 1974 will be fairly small relative to the needs of rural areas. A 1971 USDA study reported that to stop out-migration from rural areas and close by one-half the gap between labor force participation rates in metropolitan and nonmetropolitan areas would require about 3 million new nonmetropolitan jobs by 1980. The report estimated that this would cost $12.5 billion annually through the 1970s.[1]

Two years later in mid-1973 William Erwin, Deputy Under Secretary for Rural Development, estimated that 10,000 new primary jobs would be created as a result of the FHA's B&I loan program, given a funding level of $200 million. He further estimated that 10,000 secondary jobs would also be created by the program in its first year of operation. Neither figure accounts for temporary jobs which would be created in connection with project construction.[2]

Erwin assumed that it takes a $20,000 investment to create one permanent job. The actual number of jobs created may be greater or less than this, depending on the capital needs of approved projects, and the capital needs may vary greatly. If on the average $20,000 is needed to create one permanent job, then the number of new jobs created by the B&I loan program in Minnesota in fiscal 1974 will be 430. Half of these will be primary jobs; the remainder, secondary jobs created through multiplier effects.

At present levels of funding the B&I loan program will create about 20,000 jobs per year nationally—less than 7 percent of the number the USDA report said would be needed to stop out-migration and increase labor participation rates in rural areas.

Planning Rural Economic Development

The authority of regional planning commissions has been bolstered by the new regulations on B&I loans. The regulations stipulate that the FHA shall "cooperate fully with appropriate agencies...in a manner which will ensure maximum support in carrying out the state's strategies for development of its rural areas."[3] How much influence the authority wields in fact remains to be determined. A tip-off will be the number of loan requests denied or revised because they do not comply with regional development plans.

The regulations give some impetus to planned economic development in rural America. However, while the RDA authorized grants to planning bodies, no funds will be appropriated in the current fiscal year. Some planning grants will be available from HUD, though. Nothing in the regulations explicitly encourages particular patterns of regional growth such as the development of new cities or of regional growth centers.

Eligibility for Loans and Grants

B&I loans and industrial development grants will be available in communities of up to 50,000 people. CF loans will be made to communities of 10,000 or less. The legislation specifies that Indian tribes are eligible for loans and grants.

The Minnesota FHA office reports that most loan requests have come from cities of fewer than 10,000 and most have been for agribusiness projects.

Approval of Loans and Grants

In approving or denying requests for B&I loans, the FHA will take several factors into consideration, including the feasibility of the proposed project, the number of jobs created by the project and the project's cost. Priority for CF loans will be given to towns of fewer than 5,500 population in which quick action is needed to prevent a deterioration of a water supply system. Second priority will be given to projects which extend existing facilities and to projects which involve the merger of smaller systems.

Interest Incentives

In the past, some loan programs have used interest subsidies to attract capital into rural areas. However, no interest subsidies will be paid on guaranteed B&I loans; the interest rates on these loans will be negotiated between the borrower and lender and will presumably be at market rates. The interest rate on insured loans has been established at 9 percent.The FHA has set the borrower rate on CF loans to public bodies at 5 percent. Interest subsidies will continue to be paid by the FHA on various types of farmer loans.

USDA Rural Development Programs in the 1973 and 1974 Federal Budgets

	1973 Budget ($ million)	1974 Budget ($ million)
Appropriations from General or Special Funds		
Rural Development Service	$ 2.661	$ 2.661
Rural Development Grants and Technical Assistance	—	10.000
Rural Conservation and Development	26.600	17.217
Rural Electrification Administration	46.720	46.720
Farmers Home Administration		
Rural Housing Insurance Fund	51.461	89.170
Ag Credit Insurance Fund	56.762	74.554
Rural Water and Waste Disposal Grants	92.000	30.000
Rural Housing for Farm Labor	3.750	7.500
Mutual and Self-Help Housing	3.000	4.000
Salaries and Expenses	116.627	112.500
Total	$399.581	$394.322

	1973 Budget ($ million)	1974 Budget ($ million)
Authorized Loan Levels for Rural Development Programs Financed from Revolving Funds		
REA Loan Programs*	—	—
Electrification Loans	$ 488.000	$ 750.000
Telephone Loans	145.000	200.000
Ag Credit Insurance Fund	1,020.000	844.000
FHA Direct Loan Account for Operating Loans and Soil Conservation Loans	374.000	—
Rural Development Insurance Fund		
Water and Waste Disposal Loans	—	470.000
Industrial Development Loans (B&I Loans)	—	200.000
Community Facilities Loans (CF Loans)	—	50.000
Rural Housing Insurance Fund	2,154.000	2,154.000
Total	$4,181.000	$4,668.000

*The REA program was converted from a direct loan program in 1973 to a guaranteed loan program in 1974.

Other Regulations[4]

The guarantee on B&I loans will cover 90 percent of the loan loss, up to 90 percent of loan value. Thus the incentive to avoid making low quality loans remains since the lender must still make good at least 10 percent of the loan loss.

There are some restrictions on loan uses. No B&I loans will be made which would violate environmental standards or result in a transfer of employment from one region to another. CF loans will not be approved for the financing of schools or for the construction of community electrical or telephone systems.

A section of the proposed regulations would have required the holder of the loan to service it. This would have effectively barred the sale of credit instruments and was deleted in the final regulations. The initial lender will now continue to service the loan after sale unless the secondary holder agrees to do so.

A guarantee fee will be charged to the lender on guaranteed B&I loans. The fee is set at 1 percent of the principal on loans of more than one year and at 0.5 percent on short-term loans of less than one year. This fee cannot be passed on to the borrower. The rates are subject to change by the FHA.

The lender can charge the borrower a loan fee on guaranteed loans provided it is his or her customary practice to do so. The loan fee cannot exceed 0.5 percent of the principal for loans of less than three years or 1 percent of the principal on other loans.

Additional information about loans and grants is available from county FHA offices.

The Scope of Rural Development in 1974

According to the Congressional conference committee report on agricultural appropriations, the purpose of the RDA was not only to introduce new rural assistance programs but to amplify and extend existing programs. This has not happened to any great extent. The funding of some programs has been increased over 1973, but the funding of others has been reduced. In addition, several existing programs will be financed out of different revolving funds than in past years. Despite these changes, the overall funding of rural development programs is not much greater than in the past fiscal year. Because of inflation, the actual services delivered to rural areas in fiscal 1974 may be lower than in 1973.

The new loan programs of the FHA will be financed out of the revolving Rural Development Insurance Fund. Loans for water systems and waste disposal facilities will also be financed out of this fund; these programs had previously been included in the Agricultural Credit Insurance Fund.

The loan levels authorized for the programs in the Agricultural Credit Insurance Fund were reduced from $1.02 billion in 1973 to $844 million in 1974, owing largely to the transfer of the water and waste disposal loan program to the Rural Development Insurance Fund. The Insured Real Estate Loan Program and the Farm Operating Loan Program will be funded at the same levels as in 1973.

The Rural Electrification and Rural Telephone Programs have been converted from direct loan programs to guaranteed and insured loan programs in the 1974 budget. Whereas the programs had been financed out of public funds, private lenders will now become the main source of credit. The authorized loan levels of these programs have been increased fairly substantially over 1973.

The Rural Housing Insurance Fund has been authorized a fiscal 1974 loan level of $2.15 billion, the same as in 1973. The fund is used to insure rural housing loans to people with low or moderate incomes.

Most programs administered by the Economic Development Administration will be funded at about the same levels as in 1973. The one exception, the EDA industrial development loan program, presumably will now be covered under the FHA business and industrial loan program.

As in 1973, $20 million will be available to the EDA for grants for technical assistance, research and planning in rural communities. The EDA appropriation for grants and loans for facilities development is $157 million, down only slightly from the estimated 1973 level of expenditures.

Congress has also allocated $75 million to the Department of Housing and Urban Development for comprehensive community planning grants, but few of these grants will be available to nonmetropolitan communities.

Thus, despite the new programs, the overall rural development effort in fiscal 1974 looks very much like that of fiscal 1973.

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[1]U.S. Senate, Committee on Agriculture and Forestry, *Hearings on Rural Development, Part IV*, 92nd Congress, 2nd Session, p. 189.

[2]U.S. Senate, Committee on Agriculture and Forestry, *Hearings on Implementation of the Rural Development Act, Part II*, 93rd Congress, 1st Session, pp.22-23.

[3]*Federal Register*, October 18, 1973, p. 29048.

[4]*Federal Register*, October 18, 1973, pp. 29020-29061.