

AUTHOR'S NOTE

This paper was a convoluted exercise in the use of an invitation to address one topic—to vent my dislike for the then popular price and income support programs. My recollection is that the talk was given at a dinner meeting held in the ballroom of the Waldorf Astoria with a large and influential audience. I did not have a recognized claim to expertise in matters pertaining to general agricultural policy, but the sorting out of the impacts of various price and control programs had led me to negative conclusions about existing and proposed programs. I constructed an opportunity to put current programs in broad perspective.

My honorarium was an expense account that included transportation for my wife and tickets to the Broadway presentation of "The Sound of Music." Would that my comments had found as large an audience as "The Sound of Music."

AGRICULTURAL SUPPLY MANAGEMENT

CHAPTER 18

We are starting this evening's discussion at odds with each other—it is my impression that you want me to talk about the price of corn this season and for the 1962 crop. I want to talk about "supply management," or, to put it differently, the general nature of the farm programs advanced by the current national administration. These two seemingly diverse topics are closer to the same topic than they seem at first glance.

What I should like to try is to move from the current corn price situation to the situation for next crop year and finally to the broader aspects of agricultural legislation.

CURRENT CORN SITUATION

The price of corn until new crop is available will focus on the question of whether a sufficient amount of corn is tied up in inventory and under loan to force the price up to, near, or above the support price.

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Finally, the general tightness that I have projected rests upon some assumptions about government sales. I think the government wants the price of corn to go up and will limit sales to the amounts I have indicated, but it has enough corn to severely depress the price if it elects to do so. This threat will continue to hang over the market.

In this discussion of the current corn price outlook, I have been talking about "supply management." You will note that there is virtually no economics in it. It is a matter of trying to appraise the effects of the governmental manipulation of the supply, use, and price of corn.

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Suppose that we repeat the feed-grain program over and over. At the outset, it becomes a supplemental price payment system with the government buying at one price and selling at a lower price to force compliance with the program the fol-

T. A. Hieronymus is professor of agricultural marketing, University of Illinois. Talk given to the Commodity Club of New York, May 17, 1962.

lowing year. Either the differential must be kept large, or the payment for retiring land must be large if a high level of compliance is to be maintained. All commercial corn channels through government with accompanying large losses.

As the inventory owned by government declines, the differential becomes increasingly difficult to maintain. If compliance with the program in the year ahead is as large as is currently indicated and CCC inventory is 300 million bushels less on October 1, essentially all of the inventory will have to be sold to maintain a differential. A further liquidation of stocks in 1962–63 makes it essentially impossible to maintain a price differential in the 1963 program. This reduces compliance in subsequent years, and the whole cycle is started over.

The only way to break out of this sequence is to increase the payment per acre in relation to the support price. What I am suggesting is that in the final analysis the feed-grain program comes back to a land rental scheme. Its effectiveness as a land rental scheme is hampered by the existence of a support price. The higher the support price, the more expensive land retirement becomes.

In central Illinois, the full cost of producing corn is about 85 cents a bushel. The marginal cost—the amount that can be saved by letting land remain idle—is on the general order of 37 cents: \$1.20 minus \$.37 is \$.83.

This examination of the extension of a voluntary supply management scheme serves to illustrate two points: (1) land rental is a very expensive way to reduce production, and (2) the existence of a support price increases the cost of a program and the difficulty of making it operate.

THEORY OF “SUPPLY MANAGEMENT”

At this point, it is worthwhile to digress from the trees to a more distant look at the total forest of “supply management.” The first problem is one of terminology. The question is often asked whether we should have supply management. It is a foolish question. We have supply management; we always have had supply management; and we always will have supply management. There is no such thing as un-management of supplies. The only question is, Do we manage supplies (and consequently utilization) by a system of market price interrelationships, or do we manage supplies by a system of governmental decree? The real question is whether it is desirable to manage by a system of administrative supply control. In some areas of agriculture, we have had systems of administrative control of supply for quite some time, but these have had a tendency to simply shift problems to other commodities. So, what we are really talking about now is a system of comprehensive administrative supply control.

This system is presumably designed to solve a problem or problems. During the past thirty years of tinkering with various schemes, we have not done a very good job of identifying problems. The first problem that seems to stand out is that incomes of people who are identified as farmers are lower than those of the rest of the population. We have not taken a careful look at which farmers get how much. We have dealt with averages, and they can be deceptive. We have never asked: What is the income situation of a farmer whose labor resources are fully and efficiently employed and properly balanced with land and capital inputs? The first crude look indicates that such a farmer has, and has had for the past twenty years, an income that very few people would consider low enough to be worthy of public assistance. For example, the average income of farm operator families in 1959 whose sales were \$10,000 and over was \$9,960. A gross sale of \$10,000 is not much for a farming operation. It does not meet the minimum threshold implicit in the question above, nor does it meet most definitions of a "family farm."

What farm income figures really show is that there are a lot of low-income, semi-employed people who are identified as farmers. Obviously, the income situation of people who have nothing, or very little, to sell is not going to be helped by a system that increases prices.

The second problem is the high cost of past farm programs. Whatever the real merits of the matter, the large expenditures in the agricultural sector are causing a lot of criticism. To keep the record straight, I agree with the criticism.

A third problem is that, while income of commercial farmers is livable, it would be ruinously low if a system of market prices were substituted for administrative control of supply and price. Whether this is truly a problem is open to discussion. The point is that the administration has identified it as a problem.

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The basic assumption underlying administrative supply control is that the demand for farm products is extremely inelastic. Therefore, a decrease in supply will result in a greater increase in price and, hence, an increase in revenue. It is said that food and clothing are necessities that command a high priority of expenditures, but once the food priority is met, increases in the domestic demand for food depend primarily on population growth. The human food requirements are only so large, and we will pay almost any price to meet them, but when this need is met we will buy no more and will spend additional income on other things.

If this assumption is true, then it follows that we must reduce prices a great deal to induce additional use, and this reduces farm income. On the other hand, by moderately reducing supplies we can materially increase prices and, hence, increase farm income. Reduced to its simplest terms, administrative supply control means

extracting a monopoly revenue from consumers to be transferred to producers. This practice solves two problems. It alleviates the farm income problem that would result if we went to a system of market prices, and it essentially eliminates the governmental cost of income support for commercial agriculture.

The people who project this theory also project a long-term imbalance of production and use at prices that will yield equitable incomes to producers; that is, they see no end to this monopoly operation. A system of administrative supply control would become permanent.

The basic decision is whether such a scheme should be adopted or whether something else should be done. We have begged the question since the end of World War II. We have established few monopolies for such products as peanuts, tobacco, and rice, while allowing agricultural production to expand in a different direction. We have taken halfway measures, such as with wheat, where we have said we will restrict production to maintain price but will not cut allotted acreage below 55 million and will exempt from restrictions farmers who raise fewer than 15 acres. We have supported prices of feed grain without production controls, etc. The high cost of agricultural programs appears finally to be forcing at least a partial decision.

PROGRAM OPERATION

The grand scheme, and the inevitable final result, is a comprehensive system of administrative supply control. We reach this final destination by a succession of commodity programs. The basic problem in a production control program is to allot production rights. Until this time, virtually every such program has been tied to land. One exception is the proposed turkey order, which would attach production rights to people.

There are several problems that develop out of commodity programs. The first is that the monopoly value of production rights gets capitalized into the item of input to which the production right is attached. Land on which there is authorization to produce tobacco is worth several thousand dollars per acre more than similar land without production rights. If we attached production rights to people, there would be a windfall capital gain. We must face the problem of transfer of production rights because people are mortal. If we withdraw production rights on death or retirement, we have the problem of licensing entry. If the government sells production rights, it defeats the income purpose of control, and the scheme becomes a tax on consumers to give value to the salable production rights. A basic point stands out. It is difficult, if not impossible, to avoid putting a market price on something of value.

A second problem is that new technology is not initiated because institutional and geographic patterns of production become frozen. For example, the production of cotton has been slow in moving westward because of acreage allotments. It is far from certain that we have the best locations for assignment of current production rights. We have been slow in increasing the scale of operation of cotton production. To the extent to which it has proceeded, the values of production rights have been included in rentals charged current operators. The large-scale cotton operations on the Delta are purely competitive and would not long be affected if the price of cotton were substantially reduced. Only the rentals would be affected.

Agriculture has an amazing record of advancing technology that reduces unit costs. The most outstanding instance is probably broilers. Improvements in feeding, medicine, and breeding have improved quality of product and reduced unit costs. It is a dramatic success story. Last year the broiler industry got into trouble. We are now contemplating a broiler marketing order that would, by law, restrict production to amounts that would clear the market at "fair" prices. Perhaps we have gone as far as we can technologically and should freeze current production and price. However, the situation is no more troublesome now than it was eight years ago. Just as good a case could be made then as can be made now. With the benefits of hindsight, we know that to have restricted production then would have been a mistake. Where would Georgia broiler producers be today if a rigid market order scheme had been established a decade ago?

The administration's food and agriculture program looks forward to 1980. Do we want to freeze today's agricultural production structure for twenty years? Perhaps, but the advances of the past twenty years argue to the contrary.

Third, productive inputs are not adjusted to optimal levels. Let us take the current corn situation. We have taken land out of production and greatly increased fertilizer and cultivation. We are wasting land resources. Land is, in and of itself, inherently productive at no cost. Not to use it is to waste it. To waste a natural resource makes no economic sense.

In a broader sense, production restriction wastes the labor and management skills of farmers. If it is successful in raising income, it tends to hold people in farming, and it certainly partly idles those people who are already farming. One of the factors creating income problems of rural people is only partial employment. We do not cure it by aggravating it.

Fourth, the opportunity to succeed or fail is denied. We hear a great deal about the loss of freedom of farmers as the result of control programs. We also hear the answer that not many farmers are concerned about whether they are told to put the south forty in corn or soybeans, and with this I would disagree only moderately. Comprehensive control programs do inhibit the opportunity of people to enter

and succeed or fail by their own skill, energy, and **venturesomeness**. The opportunity to be good and succeed, or to be poor and fail, is **important**. **It is important** socially because it increases overall economic productivity. **It is important** individually because the very fundamentals of freedom rest upon the opportunity of a man to compete and better himself.

Let us take tobacco. The production rights have been reduced and spread around to the point where few men can make a good living as tobacco farmers. **We have** socialized poverty. Is this the model scheme that we would extend to the whole of agriculture?

Fifth, people other than farmers are affected by production controls. The volume of business of people who supply farmers with production materials and market their products depends on the amount of agricultural production. **The restriction** of agricultural production would act to further shrink rural communities. **I might** add parenthetically that these are people, too, and that their interests cannot reasonably be disregarded in the interests of reaping monopoly profits for farmers.

Sixth, adjustments in the nature and size of the market for farm products are slowed down if not entirely prevented. To this point, in talking about problems generated by production controls, I have assumed that they would actually work to transfer income from consumers to producers. This is far from certain in spite of the various studies showing an extreme inelasticity of demand. In fact, the logic of the matter is that they will not work.

The studies showing the price inelasticity of demand are based on annual quantities taken and annual average prices. They tell us nothing about secondary effects of supply changes. In current traffic, there are citations of four "independent" studies of the impacts of the absence of support schemes for agriculture. They all show "ruinously low" prices. The fact that all come out the same is not impressive. In these studies, similar assumptions, data, and analytical techniques were used. That the results are alike only indicates that computing machines respond similarly to similar stimuli. None of them is a proper study of long-term market reaction to varying levels of supply of different mixes of agricultural product.

In the food sector, the crux of the matter is the response of consumers to varying relative prices of different food items, to relative food and nonfood prices, and to changes in disposable income. The objective is to extract the maximum amount of money from the housewife in the supermarket. What happens if we raise prices? Before we do, we had better reckon with a hard fact: We are not in the business of selling necessities. The typical family spends several times as much money for food as it needs to spend for nutritionally optimum diets. This extra expenditure is for the higher quality foods.

When we first increase prices, housewives will grumble and pay, but quickly the press of keeping up payments on the television set and paying for Papa's Thursday night bowling will force these housewives to lower cost foods, and the contest will be a standoff.

The third effect of higher food prices is likely to be a decrease in food expenditures. Consumers equate the marginal utility of the last dollar spent in the various categories, such as food, housing, recreation, clothing, travel, education, etc. If the price level of one of these several categories is increased in relation to the others, the utility provided by the last dollar spent in that category will be less than the utility provided by the last dollar spent in other categories, and it will be withdrawn and transferred to some other category. The validity of this statement rests on the proposition that the utility of the last dollar spent for food provides nearly as much utility as the next to the last dollar, etc. The close relationship between consumer disposable income and food expenditures indicates that this is the case.

Put differently, the proposition is that when you sell a housewife a bargain, you can get her money; but when you charge her a high price, she will take her money where there is a bargain.

Food has stood the test of competition with other categories very well. As consumer incomes have gone up, food expenditures have also gone up. During the decade of the 1950s, food expenditures went up about 70 percent as fast as incomes. This per-capita increase from higher incomes, plus the population growth, resulted in an increase of about 3 percent a year in domestic market size. Agriculture is a growth industry. This fact argues strongly against freezing it or cutting it back.

Some agricultural products have expanded their markets at rapid rates. We have mentioned broilers. A second outstanding example is soybeans. This crop has increased from a World War II level of less than 200 million bushels to a current level of over 600 million. A good product, attractively priced, will move.

I recall an analysis of the competitive positions of soybeans and peanuts made at the end of World War II that concluded that soybean production would decrease and peanut production would increase. The opposite has been true. There are several reasons, but high on the list must be the fact that peanuts went the control route and soybeans went the competitive price route. Yet the peanut program is one of the examples cited in advocating extension of administrative supply control!

Let us take the prosaic crop corn. In 1952-53, total disappearance was 2.7 billion bushels. I have estimated total disappearance in 1961-62 at 3.7 billion. This is a 37 percent increase in nine years. Corn makes high-quality preferred foods and so finds a good market when consumers are prosperous.

In the final analysis, the size of the agricultural production plant will depend on the size of the market for its products; its growth, upon market growth; the number of family farms, if you please, on the size of the market. Agriculture had better take a long, hard look at programs that will restrict market size.

BROADER IMPACTS OF PROGRAMS

In looking at the detail of impacts of programs, we are in danger of overlooking the serious general impact of compulsory supply control. It is this: The overall economic efficiency of agricultural production is reduced. Human and land resources are wasted, and the resources used are improperly organized.

The first god that must be served in organizing and operating an economic system is production efficiency. The size of the pie that we have to cut determines the welfare of the people of a nation. The time was when three-fourths of the people in the United States were occupied in farming. Now, 1.5 million farmers produce most of the food and fiber for domestic consumption and export. This is a remarkable achievement. It has enabled us to move ahead of the rest of the world in production and consumption of other consumer goods. We will be well advised indeed to avoid changing a system that has worked so well, especially when we can so readily find examples of systems that work poorly. We should note, in passing, that such examples are state control systems.

THE ALTERNATIVES

We have finally gotten to our crux of the matter. It is this: How should we manage supply and utilization? Should we do it by a market price system or a state control system?

We have been looking at a system of state control all the way from the current corn situation to the very general impacts of comprehensive supply control. The goal of the state system is to stop the operation of a competitive market price system to a greater or lesser degree.

We have seen that when we follow regulation through to its logical conclusion, complete state ordering is involved. One suppression of a market pricing system leads to another.

Before we undertake to replace a competitive market price system, we should first review what it does when it is allowed to function. The first area of accomplishment of a competitive market price system is in ordering production and utilization. In a complex economic system, we have a myriad of jobs to do. Countless decisions are based upon price interrelationships. We cannot, here and now, begin to list them, but a few illustrations are in order.

With regard to agriculture, a first decision is how many people and which ones. Left alone, the relative attractiveness of employment in or out of farming will make the decision. The huge decrease in agricultural employment has been the result of attractiveness of employment elsewhere.

How much land shall be used for farming? How much machinery, fuel, and fertilizer? The most profitable employment as expressed through relative price will provide an answer.

What kinds and qualities of products? Fat hogs or lean hogs? Wheat or grain sorghum? Do we make starch or whiskey or chicken feed from corn? How much corn do we feed in Iowa and how much do we send to Georgia and Alabama? How much do we store, and how much do we use now? If we each in our own areas of familiarity let our thoughts range over the whole gamut of activity, we can quickly see the vastness of the job that price interrelationships accomplish.

What kind of job do market prices do? The quick answer is to say: Look at the tremendous productivity of our economic system. The more thoughtful answer is to say that competitive market prices order the economic processes in the way in which people spending the fruits of their own productiveness want them ordered. This is the most democratic of all possible procedures. People spend their money where they get the greatest satisfaction. It is not all on television sets and tail fins, or beer and bowling. It is also in sharing with less fortunate people and building for the future. It is also in saving versus consuming and in working versus leisure. Production will go where the profit is, and profit is where people want production. Anything other than a market price system is an infringement on individual freedom and a negation of democracy.

I do not want to paint a rosy picture of a competitive price system. It is a hard task master, imposing rigorous discipline on producers. There is not only profit, there is also loss. There are both lavish and niggardly rewards failure as well as success.

The second area of accomplishment of market prices is in allocating the fruits of production, in dividing up the product. Here, again, market prices are rigorous. If left alone, they will divide the product up on the basis of individual productivity. They will reward the productive and punish the unproductive.

In the thinking of some people, this is fair; in that of others, it is not. There are a lot of unproductive people in the world. In the aggregate social judgment, some of the unproductive people should be cared for, and others should be helped to become productive. The extent to which this is done is a difficult decision to make.

It may well be that, in the instance of agriculture, some redistribution of income from other sectors of the economy is desirable. A stronger case can be made for

increasing the productivity of semi-employed agricultural workers than for direct income supplements.

If this is to be done, there must be a better way than the extensive impairment of the pricing system. The simple solution is to do it directly out of public funds. In this way, we can keep track of precisely what we are doing.

If we separate income support from commodity prices, we can then make deliberate decisions about the food stamp plan, school lunches, direct distribution, and foreign food aid. These should be considered on their own merits instead of as part of the farm income problem as they are now.

CONCLUSION

How do we get out of this maze that we are now in? The solution is perfectly simple: Eliminate price supports and commodity inventory activities of the federal government. In my opinion, the adjustment would be much less drastic than is generally thought. However, the longer we let the problem compound, the more drastic the adjustment will become. If we are afraid of the impacts, we can build in income safeguards, extend credit, and hold inventories where they are, but there is no gradual route to the elimination of price supports. It should be done immediately.

