FORWARD PRICES FOR AGRICULTURAL PRODUCTS.

(K.O. Campbell)

Forward pricing is probably the most significant and promising proposal in the field of administrative price fixing in agriculture that has appeared for some time. Although suggested originally as a means of meeting specific problems in agricultural administration in the United States, the proposal, nevertheless, should be of interest to those giving attention to like problems in this country. In this article an attempt is made to set out the more significant features of the proposal, its inherent assumptions and the probable practical difficulties which might arise if such a programme were implemented under "normal" peace-time conditions.

A forward price for a commodity may be briefly defined as a price announced by a government agency in advance of the planning operations on farms producing that particular commodity. It is a guaranteed price (or price 'floor') fixed at such a level as is necessary to induce farmers to produce a quantity of a commodity, which would prove desirable from the point of view of possible estimated requirements, and announced sufficiently far in advance to enable farmers to plan their production effectively. It is an attempt to set the price in advance at what the economist technically refers to as the "equilibrium point" between the forces of supply and demand. It is also necessary that the price decided upon should be guaranteed for a sufficiently long time and be sufficiently well defined as regards grades, place and time, so that farmers can carry out their production programme with some degree of certainty. The length of time between the announcement of a given price and the maturity of the crop to which it refers would, naturally, vary from commodity to commodity.

The price announced recently by the Wheat Board for 1946/47 wheat is in one sense a forward price. However, it does not strictly come in this catogory since it appears to be based more on "fair price" considerations rather than on any consideration of the quantity of wheat likely to be forthcoming in the circumstances. Furthermore, little or no consideration has apparently been given to the relationship of this price to the prices of other agricultural commodities which compete with wheat for land, labour and other resources. The problem of price interrelationships is of paramount importance in administrative price fixing for primary products. Prices for some other products have been announced in advance during the wartime period, but examination will show that they also are not forward prices in the strict sense of the term.

Advantages to Farmers.

From the farmer's standpoint, the great advantage of forward prices would be that they would shift from him the

responsibility for anticipating the market outlook for commodities, and accordingly remove some of the risk and uncertainty which is the bane of his existence. Under most circumstances when a farmer sows his crops or mates his livestock he is not aware what the state of the market will be when he is ready to sell his products. In the great majority of cases the farmer takes existing prices or prices which have been current for the immediately preceding period as a guide to likely prices in the future. More often than not he is in error in his assumption.

In the past, farmers have reacted in two main ways when confronted with price uncertainty. Some have given up hope of ever being able to forecast price movements and have tended to adopt a traditional or routine scale of operations, which they maintain irrespective of price changes. The second group have endeavoured to incorporate some measure of flexibility into their farming operations. Scope for such activity is rather limited in agriculture, but it does occur in some crop and livestock enterprises. Both of these methods of attempting to overcome price uncertainty result in inefficient use of agricultural resources and involve additional costs of production. Both result in lower efficiency of production than would otherwise occur. If a system of forward prices were in operation, responsibility for assessing future market movements would pass from the individual farmer to the Government, which would be expected to be in a much better position than the farmer to compute expected demand and to determine farmers' responses to various prices. The Government would bear the consequences if its forecasts proved incorrect. It should, however, be remembered that forward prices would not remove uncertainty from farming altogether. There still remains technological uncertainty to which crop insurance and like measures are the partial answer.

Another important consideration is the fact that with a properly administered forward price scheme there would be no need for production control measures and such clumsy and administratively costly devices which have characteristically been associated with guaranteed price schemes in the past. Farmers would be free to enter into the production of a new commodity if the price prove sufficiently attractive and, in general, to concentrate on those products which they could produce most cheaply. This would result again in the commodities being produced much more efficiently than is the case when commodity production is tied to existing farms or areas because production control schemes are related to an historical base period.

Forward pricing means that prices are returned to their former function of guiding and co-ordinating the volume of production and also the use of resources as between different commodities. Forward prices are based on a consideration of the prices necessary to bring forward a given quantity of production. Prices would not be determined by any arbitrary relationship to "fair price", "cost of production", etc., but would be determined

from known facts concerning the supply and demand position. While this distinction between prices as economic directives and prices as "income producers" is long overdue, nevertheless forward prices would necessarily have to be associated with other measures to ensure adequate incomes for marginal farmers if the latter were to be retained on the land. In all probability, forward prices would be somewhat lower than prices have traditionally been in the past, both for the above reason and also because of the fact that farmers will produce more in response to lower prices, which are guaranteed, than they will in response to comparatively higher prices for which they have no assurance as to their permanency.

Administrative Considerations.

While it is part of the essential nature of forward prices that they are guaranteed for one production period in advance, provision must be made for some degree of flexibility in movement of prices between those fixed for one period and those fixed for the next. Not only would prospective supply and demand position have to be considered anew at the end of each production period, but attention would have to be given also to longer-term trends in consumer tastes, incomes, technical conditions and all the other factors affecting production and consumption. This type of price flexibility would be absolutely essential for agricultural efficiency and would not result in uncertainty for the farmer except insofar as long-term commitments were concerned. Even this uncertainty could be reduced by making an announcement that the price would not be altered up or down at the end of a production period, by more than a given percentage of the existing price. By such a method, it would be possible to preserve sufficient flexibility in prices to induce changes necessary to keep production in line with food requirements, while at the same time reducing price uncertainty of the type described earlier. To do this effectively, it would be essential to announce price at an appropriate time in the production cycle of crops and livestock.

The introduction of forward price guarantees implies that the Government must at the same time develop some scheme whereby it can dispose of any quantities of commodities acquired in the process of the operation of the scheme. (It is inconceivable that price supports subsidised from general revenue could become a permanent policy). The stabilisation operations of the U.S. Commodity Credit Corporation provide an example of one approach. Such a scheme would necessitate the restriction of the programme to non-perishable commodities. Another alternative would be the introduction of some type of equalisation scheme. However, this is a separate problem, quite outside the scope of the present discussion.

Difficulties in Implementing a Forward Price Programme.

One of the most obvious difficulties which would confront any government agency which attempted to implement a forward price

programme would be that of determining a level of prices which would be appropriate if the objectives of the scheme were to be achieved. The task calls for an intimate knowledge of price, demand and supply relationships and trends, if forecasts of the outlook for various products are to be accurately assessed. The whole success of the scheme would depend on the accuracy with which such forecasts were made. It is no reflection on Australian economists and statisticians to say that we are not in possession of sufficient facts to enable such a programme to be put into operation in this country. However, even if the necessary knowledge were available, the procedure would necessarily involve an experimental approach, because farmers' reactions to such a scheme could not be completely anticipated in advance.

The second difficulty arises from the fact that prices which may be appropriate for redirecting production and ensuring efficient use of agricultural resources (the primary objectives of a forward price scheme) may not be those which would be most effective for the efficient distribution of the product. For instance, if a bumper crop, far in excess of anticipated requirements, resulted in any given season, it is obvious that a forward price set prior to the sowing of the crop would not be an appropriate one to ensure that the crop surplus was disposed of. A similar difficulty arises in the case of livestock enterprises in which agricultural commodities are used as raw materials. A forward price set, for example, for a particular wheat crop might not be a suitable price at which to distribute the grain to poultry, pigs and other livestock enterprises eighteen months later. The only effective counter to such difficulties would be the extension of governmental control over wholesale and retail market prices for agricultural products. Whatever the inherent advantages of forward prices, it seems unlikely that they would be implemented if they necessitated such widespread extension of control.

Price fluctuations, which it was suggested above, enable crop surpluses resulting from weather conditions to be disposed of, are of considerable importance to the primary producers. In any appraisal of guaranteed price schemes, the value of price fluctuations should not be overlooked. Stability of production, although much sought after, cannot be achieved in agriculture because the level of production is largely a function of weather and other factors which are beyond human control. Given such conditions price changes are desirable, for they enable farmers with short crops to be compensated by receiving higher prices, thus tending to stabilise farm income - a much more important consideration from the farmer's standpoint than stabilisation of prices. (This observation does not refer to major price declines and advances caused as a result of depression and inflation, the effective counter to which lies in the field of monetary and fiscal policy). Preliminary investigations into the effect of crop size on gross income suggest that, in Australia, the gross farm income derived from several primary products would

have fluctuated as widely, if not more widely, had a stabilised price been in operation, than they have in the past under the so-called competitive price system.

The effect of the general price level in determining the level of primary product prices is also of considerable importance. It seems extremely unlikely that a forward price mechanism would effectively stave off a major decline in primary product prices if another major business depression were to eventuate. To meet such an emergency, far more drastic Government measures would be required than the mere fixing of forward prices.

Quite apart from the economic considerations as to the feasibility of a forward price scheme, the political implications of such a scheme are of far-reaching importance. Briefly, the riddle to be solved is one of finding a way of implementing a programme (which is presumably in the interests of public welfare) so that it will not be subject to either political pressures on the one hand, or to the possibility of corruption of administrators on the other hand. To avoid the latter, an agency must be made accountable to Parliament. But, if it is accountable to Parliament it would be inevitably subject to pressure from groups with special interests who would probably seek the establishment of prices at levels which would defeat the ends of the scheme.

Farmers in the last twenty years have become more active in pressing their claims for higher prices, more especially since the expanded intervention by Governments in agriculture dating from the early nineteen-thirties. On the basis of recent experience, it seems probable that farmers would look unfavourably upon a forward price plan which, for reasons set out above, would result in lower prices than have operated in the immediate past. Furthermore, it is extremely doubtful whether farmers would be prepared at the present time to accept the introduction of a system of forward prices involving a considerable degree of control over the production and distribution of primary products.

In view of all these considerations, it does not seem that the time is ripe for the wholesale adoption of a scheme of the nature outlined. However, if the concerted actions of Governments result in some degree of economic stabilisation in future, if recent trends in Government administration in agriculture continue and if farmers become more conscious of the need for an effective programme to ensure stabilisation of farm incomes, we may yet see the introduction of some of the more enlightened ideas which are part of the new concept of forward prices.
