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CONTROLS AND SUPPORTS — PROBLEMS AND SOLUTIONS

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Three major points are discussed in this paper: (1) the impact of major governmental price and income programs in commercial agriculture; (2) an analysis of (a) basic changes in the structure of commercial agricultural industries which affect the nature of income problems in agriculture and (b) of possible solutions thereto; and (3) possible means of industry stabilization largely by industry action which might be usable either together with or separate from the present types of programs.

Presentation of these three points, and conclusions drawn therefrom represent a sort of personal bias. First, the conclusions apply primarily to the Pacific Coast. Consequently, the orientation is not sociological or ethical. These agricultural industries on the West Coast are not sick; they are not depressed; they are not confronted with immobility of resources; and the standard description of the farm problem general in the Middle West and the South is not applicable here. These statements do not reflect parochial complacency. The West has different types of farm problems. Some of these may spread to other areas as farming becomes more commercial. Also, some of the industry adjustments thoroughly tested on the smaller crops in the West may ultimately—and perhaps with modifications—be applicable to other areas.

Description and appraisal of the old-line monopolistic price-support and control programs is biased by experience with relatively small operations in highly organized specialty industries. These industries have a long political history of control, involving various administrative mechanisms which employ essentially monopoloid techniques to deal with a wide variety of commodities and economic problems.

Description of the basic changes is also biased by exposure to a series of drastic changes in market structure in many western industries. These changes are not generated by government programs, nor are the problems they create soluble through government programs. This process of change appears to be creating problems in three areas: (1) the product and product mixes to be produced by industries; (2) the organization of the agricultural industry necessary to participate effectively in the distribution of such products; and (3) possibly, industry organizations to counter the increasing influence on price of large conglomerates in other levels of the processing and distributive chain.

Many western industries are large in scale, and the solution of some of the difficulties besetting these industries would require very difficult adjustments. The present system of governmental intervention is not effectively aimed at the difficulties of the West.

The farm problem, as vaguely defined in other parts of this program, does not—to my knowledge at least—exist in California. The problems which do exist in the commercial industries of the West do not appear to be capable of solution or adjustment through the present system of price supports and controls.

Some examples of long-run industry programs—fruits and vegetables, wine, rice, and other commodities—might be adapted to other industries. Consistent with commodity, geographical, and industry characteristics, and present market structures, some of these western developments might conceivably be considered as bases for developing adjustment alternatives to those now in use.

THE PRESENT MONOPOLISTIC SYSTEM

Methods of Intervention

The monopoloid devices represented by price support, price control, and the associated battery of interventionist programs, has operated in various forms on the West Coast almost continuously for more than 75 years. Operationally, all of the major policy programs designed, nominally at least, to stabilize or to enhance farm incomes are systems of fairly simple monopoly intervention. This observation is equally applicable to the specialty crops and the basic commodity operations in the West and in other areas. Nearly all of these interventionist systems resolve in operation into programs of market segmentation.

Nearly any type of agricultural policy program involves either limitation of inputs of productive factors, or of production itself, or of sale of already produced crops. Each of these, however, resolves into simple market discrimination. The programs of the last few decades have involved various types of differential pricing and of supply control to implement these monopoly devices.

Operating recently under federal law and for many decades through voluntary activity in western industries, the more complex interventionist programs involving rate-of-flow control, grade-and-size control, and similar devices are not in fact simple monopoly mechanisms. These are devices primarily designed to recognize the relationship of demand levels and shapes to various demand determinants over time or among other interrelated markets. They represent

intervention but they cannot easily be analyzed in terms of simple monopoly models.

Analytically and operationally, production control, most market controls, minimum price supports, maximum price control, and most varieties of subsidies may be classified under a relatively small number of monopoly methods.

Objectives

To my knowledge, there is no explicit statutory statement of the objectives of the interventionist policies affecting agricultural industries over the past 25 years. Aims to increase or to stabilize farm incomes have been enunciated. References have also been made to parity of price, and often an administrative mechanism has been developed to make this an operational objective. Apparently, two major objectives have been implicit in these monopoloid programs.

The first—arising primarily out of depression conditions—has been an income transfer from other segments of the economy to agriculture via the federal treasury. This goal apparently was also associated with some vaguely defined notion of a desirable multiplier relationship consequent on the income transfer.

Second, both federal and state laws have long recognized certain fundamentally different characteristics of agricultural production and marketing. The special demand-elasticity and income-elasticity characteristics leading to instability and lack of control over agricultural production and prices have frequently been described. Similarly, differences in production period for short-run crops and in capital accumulation periods in other types of crops result in temporally unstable production, compounded by a fundamentally competitive structure in most parts of the agricultural industry. Because of this instability, government appears in many cases to have justified its own monopolistic intervention, or to have authorized monopolistic activities of agricultural industries which would have been declared illegal in most other parts of the American economy.

General Effects

This system of monopoly appears, under specific conditions, to transfer income successfully in the short run. In the long run, virtually all of these programs—either those initiated and administered by government or those which government has authorized agricultural groups to initiate—have been self-defeating. Almost invariably they have been self-defeated where regular or consistent limitation of inputs of productive factors, of production of the commodity, or of sale thereof has been necessary.

Under these conditions, demand shifts downward in the controlled commodity and usually upward in related products used as substitutes. At the same time, positive shifts have taken place in the supply functions of the controlled commodity, and the related commodities as well, since the monopoloid programs have raised average price levels above what they would have been without these programs.

Necessary Collateral Programs

Thus, collateral programs have always been necessary for voluntary or for statutory programs of an interventionist nature. The need for the Section 32 programs and the Public Law 480 programs, which involve either dumping or efforts to develop demand, grows directly out of demand shifts resulting from price support or other monopoly intervention, which in fact raises farm prices. The Section 22 programs are excellent examples, along with production quotas, of the need to control supply if monopoly programs really raise farm price levels. The emergence of this complex battery of related programs has one simple explanation. If demands are negatively sloped, if cross elasticities are positive, if supply functions are positively sloped, and if the treasury is limited, there can be no other result.

Meaning of Solution

In a commercial economy in which income disparity or short-run instability of income in periods of general prosperity is not relevant, it is difficult to know precisely what is meant by a "solution" of the farm problem. Using monopoly devices as outlined above, we can describe the adjustments which some industries in the western commercial areas consider to be a "solution."

Most of the industries would prefer to see the average price at the farm from all outlets higher than the price which would prevail in some atomistic context without programs. However, they quite naturally prefer to have no limitation on production or on total sales, with limitation only on sales in certain low-elasticity markets.

Some eight decades of experience with programs of this sort have yielded no solution which will insure a monopoloid price higher than the atomistic price without placing limitations on inputs, outputs, or sales.

Some industries have established certain criteria for use in appraising the types of programs traditionally used for price support or stabilization: (1) minimum government interference in the processes of price determination; (2) minimum government diversion, either open or disguised; (3) maintenance of normal trade channels; (4) "orderly"

marketing—temporally, geographically, and in terms of utilization; (5) free access over the long run to all markets; (6) minimum government interference with entrepreneurial decisions—this is the heart of a control program, and this is the price which enterprise must pay for support; (7) minimum inconsistencies among various governmental policies; (8) minimum cost and equitable distribution thereof; and (9) self-liquidation of the program over the long run.

No industry committee or group of industry committees, to my knowledge, has ever been able to devise a program for any purpose which would meet all of these requirements. So long as monopoloid devices are used, it is most doubtful that any program consistent with all of these criteria can be developed.

Use of Monopoly Supports

In consequence, many of the highly organized industries in the West are taking the attitude that monopoly devices of the support-control type should not be used permanently, nor should they be used as they are now employed for basic crops. They should be aimed at the second objective of intervention—to counter the instabilities stemming from the characteristics of agricultural production, markets, and industry structure. Many industries—with cotton and rice as outstanding examples—are now quite clearly damaged from continuous application of rigid price supports in a bright market. The more flexible agreements and orders have been more effective in countering uncontrollable and unforeseen fluctuations in output or demand, or both.

Certain administrative characteristics of support programs affect the views toward which many California farmers seem to be moving. California farmers look now toward enabling statutes which are not fixed or rigid. Many believe that all commodities might be supported essentially on the same basis as that on which the nonbasics are now supported. This would mean that administrative discretion would be quite broad within legally prescribed standards.

The agreement and order types and the present types of nonbasic price supports seem to be favored. Stand-by use of such restriction devices as Section 22 and the dumping and development devices, which consume so much of the present agricultural budget would still be needed, if limitation were necessary over two or several successive seasons. However, both limitation and support would be used only in periods of sudden demand depression or output increase, or both.

These programs have little relationship, either in their application or in their nominal objectives, to the major and permanent difficulties of the commercial and reasonably healthy segments of agriculture. Most important here is the continued pattern of change in these industries.

As noted above, these changes have affected agricultural producers from three standpoints: (1) the product and the product mix; (2) the terms of distribution; and (3) the process of price making. Therefore, the next two sections of this paper discuss: (1) the apparent major changes in these industries and (2) possible industry adjustments to the changes.

THE PATTERN OF CHANGE IN COMMERCIAL AGRICULTURE

The Major Changes

In studying these changes, we find that sociological problems of non-commercial farm operation and of extreme disparity and instability in some parts of agriculture are sharply separated from the major difficulties of commercial agriculture. The implicit objective here is to specify the market structure conditions which may preclude a profit-maximum equilibrium unless government intervenes on a broad or continuing scale.

In the past decade drastic changes have taken place in the food and fiber industries, with sharp repercussions on producers. These changes may also have affected the mission of the Extension Service and certainly should have affected its activities.

One method—among many alternatives—of summarizing the basic shifts in the food industries is to describe obvious changes in scale and method of food operations at retail. With changes in procurement by the new types of retailers, sales by processors or farmers in many cases have been reduced to a specification basis.

Retailers have been able to develop policies for pricing, branding, promotion, or other profit determinants long denied to the small retailers. They have either absorbed or replaced old-line wholesalers, or have become associated on a coordinated basis with them. These activities are not new. But as they have developed at the retailing level, multiple related changes have followed in the other functions and at other levels of the production and distribution process. Perhaps more important the coordination of functional levels, now so obvious in the food industry as a whole, is being reflected in particular industries and especially within particular enterprises.

Perhaps this pattern of coordination within the firm is the best example of the meaning of coordination or integration. In nearly all such firms, the old functional method of internal organization with separate profit centers and separate responsibility over separate functions is dying out. In its place is coming a single structure, generally

departmentalized along commodity lines, and with a vice president of marketing usually responsible for all of the functions of product development, product engineering, procurement, manufacturing, and merchandising in a single profit center.

This new organization and the new management devices are evidence of awareness that virtually all phases of the production process are so closely interrelated that effective over-all profit maximization requires unified decision in all segments of the process. A single authority is needed to enforce coordination and a single profit account is needed to induce it.

These changes are most dramatic at the retail level. However, shifts in retail structure and operations could not occur without simultaneous and perhaps equally dramatic shifts in other segments of the food industry. Likewise, shifts could not take place in the other segments without shifts at the retail level.

Scale and Method of Operation

Looking to the retail level as the segment in which the change is most striking, the average sale per store has increased tremendously in recent years, with a rapid decrease in the smaller operations. Some estimates in the food trade indicate that by 1970 some 70,000 outlets may control perhaps 85 percent of retail volume. Other estimates indicate that by 1970 perhaps 90 percent of the food retailers would be large enough to maintain their own pricing, product differentiation, and promotion policies—or at least be big enough to avail themselves of such policies developed by others. Major changes in method of physical operation, as well as in scale, are obvious at all levels of the system.

The typical store at retail carried some 800 products in 1930, while today it carries about 5,000 on the average, and general projections indicate that it will carry some 6,000 items in 1960. Nonfood items in such outlets represent some 14 percent of their volume. A shift toward convenience and prefabricated items has been evident at the retail level. The battery of products and the layout of store is associated with one-stop shopping dependent upon consumer automobiles and upon facilities for home storage. More than 40 percent of the items in the grocery departments are now less than five years old. These changes reflect the new importance of the product development manager.

Major changes have also occurred in inventories, turnover, organization, and methods of mechanization. Concentration has been mainly in terms of store size, but the merger movement has also accelerated.

Procurement

Opportunities in procurement have been equally great. As a function of size and consequent full-scale merchandising policy, retailers have been able to extend their specification procurement. Frequently, they can require adjustment by their suppliers to retailer specifications. Some people allege that the bases of price determination have also shifted. With relatively few procurement agencies dominating large percentages of sales outlets in many markets, the price of failure to meet such specifications could be significant loss of potential in the market, although thus far this is not supported by evidence. The small number of procuring agencies controlling large volumes of sales in some markets is also said to result in price failing to represent effectively the specification demands of the buyers.

The buying process now largely involves specification of the physical attributes, the minimum units of volume, and the delivery terms of the products desired. In effect, price offers are then received and the transactions are completed without old-line selling. This development, insofar as it has been successful, has deprived others at the processing or wholesaling level of the merchandising devices they once commanded. Thus, the private label versus the processor's label battle is an index of the nature of this shift in merchandising policy. Its impact affects production at all levels.

Merchandising

The newer forms of merchandising reflect the new product mix—emphasizing convenience, prefabrication, and one-stop shopping. Few of these are focal points for promotion. Nonfood items appear to be increasing and probably contribute substantially to retailer profit. Most important, the battle of brands or the battle for more shelf space indicates the intensity of the conflict among different segments of the industry.

Some retailers state that they have taken the private label route because the retailer's name has greater drawing power than the processor's; because they prefer to use their own cases, shelves, or bins for their own products; because they offer better margins; and in some cases because they eliminate direct price competition.

These policies have in some cases eliminated promotion or differentiation policies on items which have become specification products. They have thus, also, deprived some other segments of the food system of effective merchandising or pricing policy. Merchandising policies seem to be effective only for really differentiated products.

Many retailers can now use all demand manipulation devices. A concomitant decrease in power over these devices has taken place at

other levels. Competition now revolves around retail brands as well as others. Even presold processor or producer brands must conform now to the distributive requirements of the retail trade. Some processors cannot, and should not, sell on a cordwood or a specification basis.

Some Apparent Effects

These changes in market structure do not represent the development of chains so much as they do an increase in the size of individual operations now able to command most of the advantages of large-scale operation. In some areas a system of price leadership or dominant enterprise is claimed to have appeared. Producers of many types of crops must now produce in accordance with the rate of movement through retail and certainly in accordance with specifications physically essential to retail programming.

The results implied in standard price theory do not appear in many cases to be substantiated in fact. The major internal changes of these enterprises depend on the interrelationship of all the processing and distributing functions. The internal organization is accordingly adjusted on a commodity basis with no functional profit centers, no accounting centers, and no reporting centers or responsibility centers.

Product development has become probably the most important part of the internal management structure. Activities have generally become decentralized in the processing and handling of cordwood or specification items.

Marketing departments now include product development, product engineering, manufacturing, planning and control of inventory, promotion and advertising, administration, planning and management of sales, and market research.

Changes are most striking at the retail level, and other segments have by no means adjusted supinely to these changes. The present apparent dominance of retailers may not continue. Many processors have decided that some of their operations must be adjusted to the needs of their suppliers and their customers. They have, however, decided that complete adjustment to some of these requirements would mean their own effective elimination. Accordingly, in keeping with enterprise activity, they are looking for ways of imposing upon suppliers or customers changes necessary for their own health and survival.

Several major changes apparently are associated with this shift in structure. There is no longer an "open" market for many agricultural products in which anything produced and offered could be moved regardless of its specification and its adaptation to the programming requirements of other levels of the food system.

Production and processing now apparently need to meet certain specifications and attributes of final retail movement to consumers. In consequence, a large number of market organization forms called integration or coordination are now appearing. These differ vastly from the old terminal markets. A direct coordinated interrelationship—physically as well as economically—exists among virtually all levels of the food system.

Producers recognize that the nature and level of on-farm demand in many commodities depends explicitly upon levels of demand and physical necessities of programming and operation in other parts of the system. Specifically, the appearance, size, keeping quality, facility for mass display, self-service, or impulse buying, and ease of handling are qualities imposed upon producers.

Virtually all other segments of the system require continuous availability; uniformity, and minimum lots with regular terms of delivery for producers to get regular access into the markets. Thus, the apparent changes in the structure of the industries have affected mainly specifications of individual products and of mixes of products carried; the terms of distribution defined by minimum lots, rates of flow, containers, delivery or other terms, etc.; and the price-making policies.

POLICY IMPLICATIONS IN A PATTERN OF CHANGE

The “Problems”

The standard “problem” in other parts of the country is not involved in the difficulties outlined above. It is equally clear that any difficulty associated with this pattern of change could not effectively be handled through the monopoloid devices traditionally used to transfer income in agriculture.

In fact, many parts of the food trade have already made effective adjustments to this pattern of change and, in some cases, with little or no government support or control. In some areas price apparently has not proved adequate to control production and distribution to the complex specifications of some parts of the modern food industry.

In consequence, contract arrangements of a variety of types have developed. Financing or other devices have been used to achieve vertical integration of various stages of production both upward and downward. The bargaining cooperatives or associations are excellent examples of counter-actions operating effectively in this pattern of change. Relatively few marketing cooperatives or procurement cooperatives of the old type appear effectively to be adjusting their systems of operation to meet the newer requirements of the trade.

The West has a history of adjustment to these kinds of changes, especially in specialty industries. The cling peach industry—with an industry contract, supported by law, defining the methods of reaching a “reasonable” price—is an example. Quite different types of cooperative organizations have developed in the wine industry. In the rice industry parts of the diversion activity through exports have been placed in private hands.

Determinants and Limits

Two conclusions appear to be acceptable. First, effective organization for vertical integration requires horizontal integration. This appears to be necessary to defend the particular level against power developed in others. Second, it appears that some of the devices developed in relatively small crops might well be extended, or at least considered, for others.

The cost factors leading to integration appear to be that: (1) processing cost is a function of raw product characteristics and scheduling; (2) processing cost is also a function of the processor’s output; and (3) uncertainty might be reallocated by the processor’s assuming some measure of uncertainty if the producer meets certain conditions mainly with respect to requirements for uniformity and stability of production.

Outright integration appears to be limited by management diseconomies, difficulties associated with numbers of products, and dispersion of the processing schedule. In some cases, some quasi-integrated units find that they can use their own production with greater flexibility than contracted materials.

The grower-processor contract is another example of integration. This normally involves an agreement before harvest of delivery of the full crop at a specified price—at least in vegetables. Such contracts involve substantial transfer of decision-making authority. Thus, in exchange for a minimization of the risks he normally faces, the producer frequently shifts to some contractor the right to buy or sell; the right to bargain for price; the right to control time of planting; the part of the farm used; the kind and amount of seed; the amount and type of fertilizer, weed, and pest control; the quality and maturity of the product; and the harvesting and delivery terms.

Some determinants of the degree of coordination or of processor integration appear to be identifiable. The recent development of the flow versus the old batch method in some areas has called for greater coordination of the processing that a raw product requires. As industry grows, knowledge obtained by producers may replace the present

contractual pattern of control which appears to be emerging. At present the necessity of processors financing small contractual growers is not fully explained in many industries. In some industries, the size of producer operations may eliminate the advantages associated with direct integration.

Some Suggestions

The word integration is unfortunate, and the word coordination is no better. There are many different types. In cling peaches we find a horizontal integration of growers buttressed by a marketing agreement and order. Sugar beets involve horizontal integration with strong support from a government program. In the processing tomato industry, a quasi-bargaining association faces some 50 canners in buying associations. Organization of producers in one area with no effective organization of similar producers in other areas greatly limits the possibilities for any form of coordination. It is generally being recognized that market-wide, horizontal integration of growers is necessary if they are to develop effective status in a system of increasingly close formal or informal vertical coordination.

An example of developments in the fruit and vegetable area has been very well described by one of the officials of the U.S. Department of Agriculture:

Acreage contracts for vegetables for processing are only one element in the field of canner-grower relations. The practice probably grew out of the desire of the processor for an assured supply of raw product of the desired quality and the equally strong desire of the grower for an assured market for his product. Certainly they have a mutual interest and common responsibility over the long term in an expanding market. At least some general understanding is required between the grower and processor as to varieties, cultural and spraying practices, timing of harvest, etc. In vegetables this has generally, with some notable exceptions, chiefly in the Tri-State (Maryland, Delaware, New Jersey) area, taken the form of written contracts although less formal arrangements do exist in some cases.

In the case of fruits there has been less resort to formal arrangements although this is apparently rapidly growing now. However, there have been many general understandings between growers and processors. For example, I understand that the production of a large pear orchard has gone to a certain processor every year for at least the last quarter of a century. Although there was no written contract involved there surely was a good working agreement in this case.

A major difference between fruits and vegetables is that in the case of fruits there is an open price contract or agreement and for vegetables the contract generally specifies the price.

In the case of vegetables the contract terms have varied widely among processors. They may range from a very simple understanding

that the processor will take the product produced by a certain grower at a stated price to contracts specifying in detail dates of planting, varieties, cultural and spraying practices, the rights of each party, schedules of prices by grades, sizes, and varieties, dates of payment, payment for passed acreage, etc. Generally, the processor controls vegetable varieties by furnishing plants or seed at stated prices. More and more processors are supplying many services to growers such as harvesting, spraying, etc., which they can do more cheaply on a large scale. The contracts may vary from State to State because of local legal requirements. Although a legal document exists generally there is little disposition on the part of the processor to insist on strict application of terms. Rather they recognize that they and the grower are partners over a long term rather than only for one year.

To summarize, through contracts growers of processing vegetables are able to assure themselves before planting of a market at a known price for the production from the contracted acreage. Processors, similarly, are able to assure themselves of a source of supply subject to variations in yield at a predetermined price and to exercise some measure of control over what is produced. This contractual relationship has, in my opinion, materially contributed to the stability of the vegetable processing industry in terms of producer prices, income, and acreage.

A study of this segment of agriculture, which has achieved a considerable measure of stability without Government programs, would be of interest and value to those concerning themselves with developing new approaches to agricultural program planning.

SOME CONCLUSIONS

Several conclusions are implicit in this discussion: (1) the so-called farm problem is quite a different thing from the basic difficulties affecting the commercial segments of agriculture; (2) in such segments support and control devices on an intermittent basis appear to be reasonable in terms of the characteristics of agriculture; (3) many agricultural people would like support but no limitation on production, sales, or diversion; (4) for local production areas, various types of marketing programs have proved successful as short-run devices for stabilization; (5) bargaining devices appear to be the most effective method of countering market structure changes which might be adverse to farmers; and (6) apparently, quite new types of industry organization must be developed in response to the basic changes occurring in the agricultural industries.