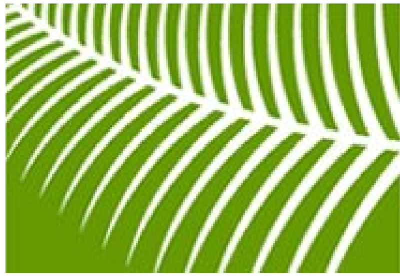

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SOME ECONOMIC ASPECTS OF MARKETING AGREEMENTS FOR FRUITS AND VEGETABLES

by

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SOME ECONOMIC ASPECTS OF MARKETING AGREEMENTS FOR FRUITS AND VEGETABLES

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The title of this paper might appropriately be "some economic aspects of an experiment in controlled marketing with special reference to fruits and vegetables produced in California." Marketing agreements are still in an experimental stage as far as the economic and operating aspects are concerned, and the Supreme Court of the United States has not yet passed upon the constitutionality of the enforcing instrument, the license.[1] The short time in which this experiment in controlled marketing has been under way does not afford sufficient experience to justify hard and fast conclusions. If my statements seem dogmatic, it is only because I am attempting to cover a complex subject in a brief period.

Farmers have long sought methods for insuring the orderly marketing of their crops and for avoiding the losses from glutted markets, and they will continue to do so as long as these problems remain unsolved. The marketing agreement and related sections of the Agricultural Adjustment Act may be viewed as a phase in the development which has been under way for many years. That it is the final phase can scarcely be assumed. It attempts to fill two important gaps that have hampered the use of strictly voluntary programs. First, it provides exemption from the anti-trust laws, and secondly, it seeks to force compliance on those who refuse to abide by the program voluntarily.

Numerous voluntary programs designed to increase returns to growers through limitation of the supply marketed have at various times been undertaken in California. All were started with high hopes; all were accompanied by a temporary increase in returns to growers; but only one[2] still remains in operation. While many causes contributed to the abandonment of these control programs, two are outstanding: (1) lack of participation on the part of the entire industry, and (2) high prices.

The programs were usually started with 80 per cent or more of the crop included. The increase in returns to those participating, while not quite as large as they would have been if all had joined in the plan, was in most cases substantial. Usually, however, the increased returns accruing to the man on the "outside" were even larger, since he obtained

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[1] Licenses are replaced by "order" in the proposed amendments to the Agricultural Adjustment Act.

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[2] The lemon program of the California Fruit Growers Exchange.

most of the benefits of the program without bearing any of the costs. After the enthusiasm of the sign-up campaign had subsided and as the relative monetary advantages of being on the "outside" became more apparent, an increasing number decided that they would prefer to trade the title of "a good cooperator" for additional income, and so they proceeded, by one means or another, to "get out." Before long there weren't enough "loyal souls" left to maintain the "umbrella" over the rest, and thus it collapsed.

Lack of participation on the part of the entire industry has also been partly responsible for the difficulties encountered in maintaining marketing agreements under the Agricultural Adjustment Act. Chiefly because of the uncertainty of the constitutionality of the licensing section of the Act, all non-signatories have not been forced to abide by the provisions of the license. While violators of the licenses for fruits and vegetables produced in California have handled only a small fraction of the total crop, they have by reason of their violations been able to obtain an advantage over the large majority who have lived up to the agreements and licenses. This situation has caused an increasing number of handlers and growers to question the advisability of continuing the programs until such time as full compliance on the part of all can be reasonably assured. The amendments to the Act recently passed by Congress are designed to meet the constitutional requirements, but whether they will or not can be determined finally by only the Supreme Court of the United States, and until that body has acted, at least some uncertainty is bound to exist.

Another factor which hastened the early demise of some of the voluntary control schemes was the high prices established under it. It is becoming increasingly apparent that when any group has the power to control the price of the commodity it sells, it tends to raise the price too high. On the one hand, high prices tend to retard consumption and, on the other hand, they tend to increase production, and the higher the price in relation to the prices of competing products, the more pronounced are these tendencies. This danger is not confined to voluntary programs, but may be equally serious, if not more serious, under marketing agreements and licenses, since the degree of control is greater. An offsetting factor in marketing agreements and licenses, however, is the power of veto invested in the Secretary of Agriculture, who, if he can withstand the pressure of producer groups, may not only protect the consumers but also the producers against unwise price increases.

Since the enactment of the Agricultural Adjustment Act, fourteen marketing agreements and licenses on fruits and vegetables produced in California have been put into effect. In order of their effective date these are cling peaches 1933, Tokay grapes, deciduous tree fruits except apples, walnuts, ripe olives, oranges and grapefruit, fresh asparagus, canning asparagus 1934,[3] raisins, dates, cling peaches 1934, prunes,

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[3] License only.

Gravenstein apples, and canning asparagus 1935.

Increased returns to growers, which is the primary objective of marketing agreements, is sought to be achieved mainly through the manipulation of the supplies marketed, although in some agreements reliance has also been placed upon manipulation of the quality of the product marketed and upon the direct fixing of prices.

Provisions relating to the control of the supply marketed are found in all of the marketing agreements on fruits and vegetables in California with the single exception of dates. In the agreements relating to canned and dried fruits the principal form of supply control is the limitation of the total volume to be marketed for the entire season to a predetermined total. The 1934 cling peach agreement, for example, provides that "the Control Committee shall determine and announce the number of tons of cling peaches which may be canned by all canners in California collectively in the year 1934." Determination of a fixed volume which may be handled by all handlers collectively is also found in the 1933 cling peach agreement, in the 1934 and 1935 canning asparagus agreements, and in the Gravenstein apple agreement. A somewhat different type of limitation of the total season's supply is contained in the marketing agreements relating to raisins, prunes, walnuts, and ripe olives. In these latter agreements provision is made for a fixed percentage of the crop rather than for a fixed volume. The marketing agreements for Gravenstein apples, raisins, prunes, walnuts, and ripe olives provide that the total volume initially determined may be increased but not decreased, whereas those relating to cling peaches and canning asparagus permit no change.

A reduction in the total supply marketed during the season from that available for market is based upon the premise that growers would not only receive a higher price per unit but also a larger total return for the supply permitted to be marketed than for a larger supply. It is a well established principle in economics that at any given time the larger the supply of a commodity offered for sale, the lower will be the price at which it all can find buyers, whereas the smaller the supply offered for sale, the higher will be the price obtained. Growers' primary interest, however, should not be in a high price per unit but in a large total return, and the price per unit should be of significance to them only as it affects the total return. Total returns to growers are determined not only by the price received per unit but also by the number of units marketed.

Whether growers as a whole will receive a larger total return for a smaller supply of a given product at a higher price than for a larger supply at a lower price depends primarily upon two factors: (1) the elasticity of demand for the product, and (2) the cost of marketing. With the exception of raisins, the present available evidence indicates that the consumer demand schedule for all of the California fruits and vegetables under marketing agreements tends to be elastic; that is, other things being equal, an increase in the supply moved into consumption does not result in a corresponding decrease in prices paid by consumers, and a decrease in the supply

moved into consumption does not result in a corresponding increase in the prices paid by consumers. Even though consumers do spend a larger total amount of money for a larger supply than for a smaller supply, it does not necessarily follow that returns to growers follow suit. Costs, which must necessarily be incurred in getting California fruits and vegetables to the principal consuming markets, are relatively high and tend to be fixed at least for short periods. For example, in the case of canned peaches, it is probable that canners would have received about 7 per cent more money gross in 1934-35 if shipment had been 3 million cases larger, but the total cost of canning and selling the larger supply, exclusive of the cost of the raw peaches, would probably have increased about 28 per cent, resulting in a reduction of about 53 per cent in the amount of money available to pay growers.

An analogous situation prevails with respect to fresh fruits and vegetables. It costs, for example, approximately $1.20 to transfer a box of Gravenstein apples from the trees in California to the wholesaler in New York. Within a wide range in the volume of shipments the costs per box of picking, hauling, packing, and transporting, which make up the bulk of the $1.20, remain virtually constant. This season, with a prospective crop double the record crop of 1928 and with demand conditions materially lower than in 1928, it would not be surprising if prices and total returns to growers fell to distressingly low levels unless a portion of the crop is withheld from market.

While limitation of the total supply of a given fruit or vegetable marketed in years of large crops relative to consumers' incomes may result in a material increase in returns to producers temporarily, it does not follow that a continuing program of limitation would prove beneficial to producers in the long run. The maintenance of prices to consumers on a particular product at a relatively higher level than prevails on competing products will cause consumers to turn away from that product, and, if the higher prices are long continued, some consumers may abandon it entirely. Thus it might be expected that, even though limitation of shipments in a particular year resulted in a material increase in total returns to producers that year, a continued program of reduction would produce steadily smaller total returns to growers and before many years the market for the product would be permanently restricted. It should also be kept in mind that an abundant supply of low-priced fruit and vegetables available to consumers in some years may result in an increased demand in the years immediately following by reason of the fact that more people become accustomed to using them.

Another important consideration from the longer time point of view is the effect of the temporary increase in returns to growers upon plantings. If returns to growers from the particular crop under control are not increased above the returns that can be obtained from alternative crops, such control is not likely to stimulate plantings,[4] but if returns

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[4] It must be recognized that if growers, as the result of controlled shipments when the crop is large, received returns in those years equal to the returns which can be obtained from alternative crops and in years when the crop is small receive higher returns, then the average return over a period of years is likely to stimulate plantings.

to growers from the crop under control are much above returns from alternative crops, plantings tend to increase. In the case of perennial crops, which do not come into production until some years after being planted, the effects of increased supplies upon prices are postponed for several years. Thus, one might expect that at the end of several years of a continued program of radical reduction in the market supplies of some commodities, consumer demand would be lower and available supplies larger than at the beginning, and that the net effect of the program would be to aggravate the situation it was designed to relieve.

In the above statement I do not wish to imply that such an unfortunate situation is the inevitable outcome of marketing agreements containing provisions relating to the limitation of the total supply marketed during the season. What I do wish to point out is that it is an ever present possibility and may become an actuality unless great caution is exercised by both the industry and the Administration. It seems to me that this provision is essentially a palliative and should be treated as such. It should be used only in acute emergency situations; that is, when prices and returns to growers would otherwise be at distressingly low levels. Its use should be confined to raising returns to producers up to the returns obtained from alternative crops. To go beyond that is to court disaster. On the other hand, if limitations of the total supply marketed during the entire season are applied only in years of excessive surplus arising out of unusually high yields or of unusually low demand conditions, and if a quantity no larger than the surplus is withheld from the market, it will be a permanent as well as a temporary benefit to growers.[5] However, if the surplus is the result of excessive acreage under average yields and normal demand conditions, withholding a portion of the crop from the market will merely delay the necessary adjustment. Under such conditions acreage reduction and not market control is the solution.

Regulation of the shipments of fresh fruits and vegetables from day to day or from week to week for the purpose of stabilizing the market throughout the season rather than for the purpose of limiting the total supply marketed during the entire season, has much to commend it. Such a provision is found in all of the agreements relating to fresh fruits and vegetables produced in California.

Alternate periods of short-time market gluts and shortages, arising from unregulated shipments from the areas of production, have been characteristic in the marketing of many fresh fruits and vegetables. It not infrequently happens that as a result of excessive supplies in consuming markets, prices fall sufficiently so that the grower not only receives no return for his product but is out additional expense for packing and transportation charges.

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[5] Space does not permit a discussion of the effects of reduction in the supplies of fruits and vegetables marketed upon the returns to laborers, railroads, and marketing agencies.

SOME ECONOMIC ASPECTS OF MARKETING AGREEMENTS FOR FRUITS AND VEGETABLES

Careful regulation of shipments in accordance with the demand in consuming markets does not necessarily result in a reduction in the total supply marketed. The evidence to date indicated that a larger supply of fruits and vegetables can be moved into consumption on a stabilized market than on a demoralized market. The presence of excessive supplies in wholesale markets generally results in drastic price declines. Once started, price declines tend to become cumulative. Each drop in price discourages sales for the time being and necessitates further price concessions in order to move the product. While a reduction in prices to consumers generally results in a prompt increase in consumption, a reduction in prices to the trade may, if a further decline is in prospect, result in a decrease rather than an increase in sales. Price declines in wholesale markets occasioned by competition between shippers are seldom passed on to consumers immediately and therefore seldom result in a prompt increase in consumption. In fact, as long as the market is weak, consumption may even be retarded because of the failure of the trade to promote and display the commodity adequately. With the prospect of returns for handling a commodity uncertain, jobbers and retailers turn their attention to other products. Instead of being active merchandizers of the particular commodity, they become merely passive order takers.

Provisions designed to prohibit the marketing of the lower quality produce in regular commercial channels are found in the following marketing agreements and licenses: cling peaches 1933 and 1934, canning asparagus 1934 and 1935, prunes, and the recently amended agreement for deciduous tree fruits. In the cling peach and canning asparagus agreements only No. 1 grade is permitted to be canned; the prune agreement provides that all off-grade prunes obtained by packers must be turned over to the Control Committee for disposal into by-products; and the deciduous tree fruit agreement provides that the commodity committee may order that only specified grades and/or sizes or a certain proportion of such grades and/or sizes of the designated varieties of fruit may be shipped during a given period.

The chief way in which quality regulations of this type influence total returns to growers is through the reductions in the total volume marketed. The argument is usually advanced by the proponents of this type of regulation that removal of the poorer quality portion of the crop would, through the resulting improvement in the average quality offered on the market, result in increased prices and returns. While there are some grounds for this contention, I am of the opinion that most of the increased returns would be the result of the reduction in the quantity and not of the improvement in average quality. Nevertheless when conditions are such that it is deemed necessary to withhold a portion of the available supply from the market, it is generally preferable from the standpoint of the growers as a whole to withhold the least valuable portion.[6] An excep-

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[6] The effect of quality restrictions upon the income of individual growers whose crop runs heavily to the grades and/or sizes being limited and the methods of minimizing the resulting hardship on those growers are not discussed in this paper.

tion to this situation would be where the supplies of the various qualities available are in axact proportion to the consumers' demands for those qualities and where consumers would not readily substitute higher quality products for lower quality ones. Under such conditions it appears that an equal percentage reduction in the supply of each quality would be more advantageous to producers than a reduction of the same volume applied entirely to the lowest quality. Thus far little study has been given to problems of stratification of the market for agricultural products, and consequently our surmises as to what might happen in particular cases may be far from correct.

A second type of quality regulation is found in the date agreement which provides that all dates must be graded in accordance with standards established by the Control Committee. This provision has a two-fold purpose: (1) to provide a basis for the minimum price schedule, and (2) to facilitate the marketing of dates through the establishment of definite standards of quality.

Provisions relating to the direct fixing of prices are contained in five of the marketing agreements which are now or have been in operation in California. The most elaborate scheme of price fixing was in the 1933 cling peach agreement, which contained minimum prices to growers and maximum and minimum resale prices. The walnut agreement contains maximum and minimum resale prices but not prices to growers. The ripe olive agreement contains minimum prices to growers and minimum resale prices. The price provisions in the date agreements relate only to minimum resale prices, while those in the raisin agreement relate only to minimum prices to growers.

Of all the various provisions contained in the marketing agreements and licenses for fruits and vegetables produced in California it seems to me that price fixing has the least merit. Unless the prices so fixed are fixed at approximately the same levels that would prevail in the absence of such fixation, they cannot be maintained; and if they are fixed at that level nothing has been accomplished except to burden the industry with a lot of rules and regulations.

If prices are fixed at a higher level than is justified by the existing demand and supply conditions, and this is an ever present temptation, the entire supply cannot be moved into consumption. Some sellers cannot dispose of their entire supply at the fixed prices, so they proceed by one means or another to dispose of it at lower prices. It is surprising how many ways minimum price provisions can be violated with little danger that such violation can be established in court.

In addition to the proper level of prices and the problems relating to enforcement, many other complexing questions arise, once price fixing is undertaken. Are differences in prices to be permitted for variations in quality, for variations in location with respect to the principal markets, for variations in the types of services performed, and if so how are they to be equitably determined? If both prices to growers

and resale prices are fixed, there is an automatic fixing of handlers' margins. Should such a margin be wide enough to cover the cost of all handlers, the average cost, or only the cost of the most efficient? When several products are handled in the same organization, how are you going to determine the overhead cost of handling a particular product? These questions give some indication of the problems facing the price fixer.

The time allotted me does not permit the discussion of numerous other economic aspects of marketing agreements nor does it permit a discussion of the complex problems relating to operation and enforcement. Suffice it to say that a marketing program under the Agricultural Adjustment Act may be both economically sound and legally enforceable, but may fail miserably because it is incapable of practical operation. Likewise, a program which is both economically sound and capable of being operated may be legally unenforceable. Also a program which is both capable of being operated and legally enforceable may generate economic consequences of such a serious nature that at the end of several years the industry is in a worse position than it occupied before the program went into effect. In addition to a marketing agreement containing provisions which in the judgment of qualified experts are economically sound, legally enforceable, and capable of practical operation, at least two other elements are essential, namely, cooperation on the part of the large majority of both growers and handlers, and wise management. All of these five elements are difficult of attainment under the most favorable circumstances and in many industries are impossible of attainment at the present time.

Based upon the experience to date, I am inclined toward the opinion that marketing agreements under the Agricultural Adjustment Act have a useful although limited field, as far as fruits and vegetables produced in California are concerned. The canning peach[7] and asparagus agreements have demonstrated their ability to control a temporary surplus of these commodities, but it is also apparent that agreements of this type should not be used except in years of real surpluses. In the case of fresh fruits and vegetables, agreements designed primarily to provide for regulation of shipments from day to day or from week to week, with the view of providing an abundant supply at all times and of avoiding alternate periods of gluts and famines, offer considerable promise. Because of the greater inelasticity of the demand for raisins than of the demand for prunes, the removal of a portion of the supply from regular trade channels in years of large crops is not only more feasible but also more necessary in the case of raisins than in the case of prunes.

Taking the marketing agreements for fruits and vegetables produced in California as a whole, my tentative conclusion is that they have been worth while.

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[7] Canning peaches are not included in the commodities subject to "orders" in the proposed amendments to the Agricultural Adjustment Act.

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Growers have benefited from them, while prices to consumers have not been unduly enhanced, and in only one case, asparagus, have plantings been greatly stimulated, although it is probable that peach plantings would have been substantially increased if ample nursery stock had been available. Mistakes in procedure and policy have been made by both the Administration and the industries, but many more mistakes which chould easily have been made have been avoided. The time is now ripe for a careful reexamination of all of the agreements outstanding, with the view of improving those that should be continued and of terminating those that have outlived their usefulness.