AgEcon SEARCH
RESEARCH IN AGRICULTURAL & APPLIED ECONOMICS

The World's Largest Open Access Agricultural & Applied Economics Digital Library

This document is discoverable and free to researchers across the globe due to the work of AgEcon Search.

Help ensure our sustainability.

Give to AgEcon Search

AgEcon Search
http://ageconsearch.umn.edu
aesearch@umn.edu

*Papers downloaded from **AgEcon Search** may be used for non-commercial purposes and personal study only. No other use, including posting to another Internet site, is permitted without permission from the copyright owner (not AgEcon Search), or as allowed under the provisions of Fair Use, U.S. Copyright Act, Title 17 U.S.C.*

No endorsement of AgEcon Search or its fundraising activities by the author(s) of the following work or their employer(s) is intended or implied.

EDITORIAL

PRICES, COSTS AND PRODUCTION.

In recent years agricultural price policy, both in Australia and overseas, has commonly had a dual objective—stability, and a "fair" return to the producer. Various means have been used to achieve these aims, including price guarantees based on cost, price supports based on "parity", and stabilization schemes to which the farmer has contributed by way of export tax. While the objective of securing a fair share of the national income for the rural producer is an admirable one, and its achievement is essential if the rural industries are to prosper, the means of achievement require most careful consideration. Many price schemes have proved relatively unsuccessful, primarily because the price formulae were too restricted in scope, and so factors which should have been allowed to influence prices have been ignored.

The recent accumulation in the United States of large surpluses of wheat, dairy produce, cotton, maize and other commodities points emphatically to the dangers inherent in a controlled price mechanism, which takes little or no account of changes in the level of demand or in relative productive efficiency.

The United States' price support programme relates both the price paid by the consumer and the return to the producer to the "parity" price, which in turn is based on commodity prices and the general level of prices paid by farmers in the base period, 1910-1914. The parity concept and its concomitant price support programme may have succeeded in providing agriculture with a fairer share of the national income, as well as a degree of price stability which would not otherwise have been apparent. It is generally agreed, however, that it has introduced an undesirable rigidity into the pricing of American farm products. The price support for a particular commodity is not affected either by changes in the demand for the commodity or by changes in relative productive efficiency as between that particular commodity and other commodities. The resultant danger of burdensome surpluses was recognized by the framers of the 1938 Agricultural Adjustment Act, and provision was made in that legislation for the implementation of acreage allotments and marketing quotas under certain circumstances. It has been necessary in recent years to implement this section of the legislation on many occasions. Wheat acreages in the United States were reduced in 1954 by 16 per cent. under this legislation, and there may well be a further reduction in areas and marketing quotas in the coming season. Physical production controls are an almost inescapable corollary to a rigid agricultural price mechanism. Despite the implementation of production controls, stocks of some commodities have risen to such an extent that a modification of the whole price support programme in the United States is now being considered. The new proposals aim "to allow American agriculture to operate on a flexible, rather than a rigid basis".

In contrast to the United States' system of providing price supports based on parity, there has been a tendency in Australia in recent years to attempt to secure price stability, coupled with a "fair return" to the producer, by guaranteeing farmers "cost of production". There are dangers inherent in this system, too, particularly if the guarantee is too rigid or is for a protracted period. Quite apart from the difficulties,

both practical and theoretical, associated with the determination of the "average" cost of production—and these difficulties are by no means inconsiderable—a price which is based on cost of production alone is likely to result in over-production accompanied by the accumulation of excessive stocks under some circumstances (unless compulsory production controls are imposed), and severe under-production in other circumstances.

It may be argued that price stability for agriculture is, in itself, a desirable policy objective. Supporters of this viewpoint would claim that stability enables farmers to plan ahead with safety and with some degree of certainty. For this reason, and because it results in the more ready availability of finance, they would claim that price stability tends to encourage sound farm developmental programmes.

However, the extent to which stability facilitates farm development is doubtful. It may be that periodical high incomes provide a greater over-all stimulus to investment than does long term price stability at moderate levels. It is almost certain, though, that a stabilized price which is related solely to the cost of production—whether it is fixed at the cost of production or in some definite and rigid relationship to that cost—will, eventually, result in production or disposal problems.

It is undoubtedly reasonable that, in the long run, the efficient producer should obtain cost of production, or better, for the goods he produces, but if prices are to be regulated, for one reason or another, other factors besides cost must be taken into account; chief of these are the demand for the commodity and for its substitutes and the prices ruling for commodities which compete with it for productive resources. For instance, although the general price level, production costs, and the price of wheat remain unchanged, the volume of wheat production may conceivably vary quite considerably, due solely to variations in the price of either wool, fat lambs, barley or linseed, any or all of which are competitive with wheat for land and other resources. Again, the demand for wheat may vary significantly, due solely to a change in the price of rice or rye on world markets, or of coarse grains on the local market. A price mechanism which does not take account of such possibilities can never be entirely satisfactory. Despite these arguments, producers' organizations continue to press from time to time for price schemes based solely on cost of production (but not necessarily at the ascertained cost).

In the long term, profitability determines the volume of production. If the profitability of wheatgrowing, as an example, is low relative to other commodities competing with it for land and other resources, wheat production will fall, and this will hold even though the price of wheat is substantially in excess of the average cost of production; if profitability is high relative to other commodities, production will increase, and this will hold in the short and medium terms (although not in the long term) even though the price is less than the average cost of production.

Cost of production is a factor to be considered if prices are to be regulated—whether the objective is to ensure primary producers a fair return, to obtain price stability, or to protect consumers—but is not the only factor warranting attention, and perhaps not even the most important.