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THE MACHINERY OF FORWARD PRICE-FIXING IN BRITISH AGRICULTURE

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THE basic assumption underlying this paper is that any discussion of a return to the free operation of demand and supply as the determining factor in the fixing of agricultural prices is largely academic.

During the last quarter of a century price control of one kind or another has gradually become the general rule in agriculture. There is now probably no country—at any rate in western Europe, the British Commonwealth, and the Western Hemisphere—in which price-fixing or control measures do not operate over the greater part of the agricultural sector of the economy. Moreover, under the large-scale maladjustments which obtain to-day it is difficult to see any prospect of any general departure from price-control in the foreseeable future. Indeed, there are reasons for believing that the drift away from the free-price mechanism is not a passing but a fundamental phase in economic evolution.

The initial impetus for this development can undoubtedly be traced to a determination to overcome some of the more glaring shortcomings of the free market, especially since these shortcomings appeared to weigh particularly heavily against primary producers the world over. We all think we know what was wrong with the old system, but none of us would care to say dogmatically that in the processes of eliminating some of the things which are wrong we are not incurring any risk of retarding other things which we believe to be right. That is why in the present stage of experimenting with the new system it is of the greatest advantage to be able to pool experiences. This paper is submitted for that purpose only. Its object is to describe briefly the development and the present working of forward pricing in British agriculture. Some indication is also given of the more important problems which arise.

At the outset it may be well to point out that the British method of price control has been improvised from the beginning more or less piecemeal to meet a series of specific 'emergencies'. In 1947 these improvisations were systematized in a truly British way in the Agriculture Act of that year.

Apart from the price control practised during the period of the First World War, the first step in the process was the decision taken in 1924 to subsidize the new sugar-beet industry. This was for the specific purpose of enabling the farmers in the eastern counties of England to substitute a profitable cash crop for fodder crops in the rotation, thus sheltering them from the intense overseas competition in the supply of their staple products, cereals and meat.

But it was the depression of the early thirties which really stimulated what may be regarded as a movement away from freedom of prices towards a managed economy in agriculture. Although the process of development up to 1939 was not consistent or uniform on the lines of a managed economy there was, nevertheless, a pronounced effort to support farm prices and to establish a measure of control in agriculture. This effort took three main forms, viz. control by legally constituted producers' monopolies, control by independent commissions, and control by measures of 'protection'.

Action by producers' monopolies—the so-called Agricultural Marketing Boards—using the statutory powers conferred on them under the Agricultural Marketing Acts of 1931 and 1933, resulted in sellers' prices being fixed for milk, for pigs and bacon, and for hops. The Potato Marketing Board did not fix prices, but endeavoured to reduce price fluctuations by regulating the supplies coming on the market. Apart from the farmers, few people were really happy about a system which made the industry itself the statutory price-fixing agency for its products.

This was not so with the price-support schemes administered by the Commodity Commissions, for these Commissions were appointed not by the industry but by the Government. Under these schemes, while free market conditions continued to operate, the producers' income was supplemented by Government subsidies. The variable deficiency payment for wheat, the fixed subsidy for fat cattle, and the acreage payments for oats and barley were examples of this kind of action. For sugar, the injection of a State subsidy enabled the independently appointed Sugar Commission to authorize the statutory monopoly which owned all the sugar-beet factories to pay fixed contract prices to farmers for sugar-beet.

The prices of British farm products before 1939 were also buttressed to some extent by the protectionist policy obtaining from 1931 onwards. For reasons which need not be discussed here, however, the protectionist measures adopted did not exert any marked effect on the general level of agricultural prices in the United Kingdom.

The outbreak of war in 1939 put a sudden end to what was left of the free-price system in agriculture. Farm products were rapidly brought within a general system of controlled prices which embraced the whole of our economy. The primary objective of this price control, coupled with rationing, was, of course, to shelter consumers from the price inflation and maldistribution which would otherwise have accompanied war-time scarcities.

But, parallel with this, there was the need to provide farmers with both the incentive and the additional capital required for the large expansion in the output of home-grown food which the emergency made imperative. The level of the fixed prices paid to the farmers thus, at an early stage, became divorced from the prices paid by the consumers, and has remained so ever since. The gap between the two price levels was met out of public funds, and its extent is to be measured by the large dimensions to which subsidies on home-produced foods have grown.

The need for the control of farm prices did not disappear with the ending of the War. At first the artificial scarcity of food, brought about by shipping shortage during the War, was replaced by the real world food shortage of the immediate post-war years. This, in turn, has given way to the acute shortage of overseas currency wherewith to buy imported food which is one of our main problems to-day.

In the earlier years of the War it is difficult to trace any deliberate plan governing the fixing of farm prices except that the fixed prices were designed to lever resources into the production of priority products such as milk, wheat, potatoes, and sugar-beet. In November 1940 the Minister of Agriculture gave a pledge that the system of fixed prices and assured markets would be maintained for the duration of the War and at least one year thereafter. The general principle was also laid down that prices would be 'subject to adjustment to the extent of any substantial changes in cost of production'.

Towards the end of the War, however, a system of regular periodical price reviews was introduced and this has now become established as a permanent procedure under the Agricultural Act of 1947.

The purpose of price-fixing under the 1947 Act is to establish stability of net income for British agriculture as a whole. Nothing is said in the Act about the level at which this net income is to be stabilized. But the Government's policy is stated to be the promotion of 'a stable and efficient agricultural industry capable of producing such part of the nation's food and other agricultural produce as in the national interest it is desirable to produce in the United Kingdom, and of producing it at minimum prices consistent with proper remuneration and living conditions for farmers and workers in agriculture and on adequate return on capital invested in the industry'.

The Act perpetuates the system of annual reviews of prices each February, which developed in the last year of the War. As a result of these annual reviews the Government fixes the prices for stated periods ahead for all the main farm products, i.e. fat cattle, fat sheep, fat pigs, milk, eggs, wheat, barley, oats, rye, potatoes, and sugar-beet. These eleven commodities, which cannot be reduced in number but can be added to, together account for 70 per cent. by value of the agricultural production of the country. It is also possible to hold special price reviews in between two February reviews if this is warranted by circumstances involving a substantial change in the economic position of the industry.

For crop products the prices fixed each February relate to the crops harvested in the year following that in which the review is held. For livestock and livestock products the prices fixed cover the twelve months period immediately following the review. But in view of the long-term character of livestock production provision is also made for the fixing in alternate years of *minimum* prices for such products four years in advance. When the time comes for fixing the actual prices for livestock products, such actual prices may be higher but not lower than the long-term minima previously announced. This forward-pricing system thus eliminates price fluctuations during any one 'production period' for both crops and livestock.

Before fixing the annual price schedules the Government is under an obligation to consider, *in consultation with representatives of the farmers*, 'the general economic conditions and prospects of the agricultural industry'. This obligation to consult means that, in a sense, the prices are negotiated prices. But it is not essential that the conversations should result in agreed prices; the ultimate price schedule is the responsibility of the Government alone.

It is clear, however, that the consultations between the Government and the farmers which take place each February are of the greatest significance. At these consultations the two sides will have before them a wide range of financial and economic data. For example, they will scrutinize calculations as to the trend of the net income of the 'national farm', data on the financial position of farms of different types and sizes, cost-structures of the various farm commodities, index numbers comparing farm profits with the incomes of the non-farming sector of the rural population, &c. Many of these statistics are accepted without question by both sides, since they are collected in an impartial way by Provincial Agricultural Economists attached to the Universities. It is to be regretted, however, that the calculations which are made about farming costs and incomes have never been made available for public discussion.

The statistical material is, of course, only one aspect of the information which is examined and discussed at these consultations. If prices are to be reviewed against the background of the country's food supply position as a whole, other factors 'not readily reducible to statistical form' must also be considered. For example, it is necessary to consider consumer requirements in relation to import policy, the amount of price incentive necessary to call forth the required outputs, the technical needs of a proper balance in farming, &c.

There has been no official account of the exact procedure adopted at these annual consultations. But it is generally understood that after disposing of points of disagreement, discussion centres around a sum called the 'global total' which is taken to represent the industry's net earnings over a period of twelve months. This forms the basis for achieving the primary objective of maintaining stability of net income for farmers *as a whole*. This 'global total' is then broken down for the individual farm products. It is at this stage that the Government reserves its right to give price incentives to stimulate the production of those commodities considered to be desirable in the national interest.

It remains to state that the British system gives the producer not merely a guaranteed price but also an assured market for his output at that price. Thus it is coupled, so far as all the main products are concerned, with a system of central purchase by the Government either directly—as for livestock—or through accredited agents—as for cereals, sugar-beet, milk, and eggs. Under the 1947 Act, however, the Government retains the right to fix quantitative limits to the total amount of any product for which the guaranteed price will be paid. So far this right has not been used. If and when limitation of supply becomes necessary, it is laid down that it 'shall only be imposed as nearly as may be at the same time as determinations are made regarding prices. This gives effect to the general principle that a guaranteed price is of little value to a farmer unless he knows at the time what volume of produce is covered by that guarantee of price.'

It is too soon to attempt any assessment of the system just described, for so far it has operated almost entirely in a crisis situation. There is no evidence yet on which to form any judgement about its ability to perform the more fundamental functions which any adequate price system must perform in a progressing economy. It may be permissible, however, to touch briefly on some of the main questions which must inevitably arise.

It has already been stated that the aim of the British system is the maintenance of stability of net incomes for farmers. Assuming for the moment that this is a legitimate aim, let us consider how far a system of forward pricing is likely to achieve it. Two fairly obvious shortcomings will immediately come to mind.

The first is that forward prices are more likely to accentuate than to correct variations in income resulting from those variations in yield which are so prominent a feature of agricultural production. In the free market these variations in yields were often compensated by differences in prices—low yields in particular being offset by higher prices. Here it must be admitted that the forward-pricing system only gives stability on the assumption of normal yields. But no price system is ever likely to prove adequate for correcting variations in income resulting from the uncontrollable character of the physical output of farming. It may be suggested that some system of insurance is much more appropriate for protecting farmers against income instability resulting from the hazards of nature.

The second obvious shortcoming is that stability in terms of money prices does not necessarily mean stability in real prices, in view of changes in the value of money. Here, however, the British system, which aims at stabilizing net income rather than prices, takes account of changes in costs such as would accompany changes in the purchasing power of money in so far as such changes may fall within a production cycle.

In considering stability of net income, however, the most important consideration is the distinction which must be made between its short-term and its long-term features. The British system of forward pricing forms part of a policy designed to give a measure of long-term stability to agriculture, but the specific measures concerned are confined to price-fixing in the comparatively short run only.

The maintenance of a reasonable measure of income stability in the short run can be regarded as a substantial merit in the British system. And it is a substantial merit because it is both socially desirable and in the economic interest of the community to protect farmers from those sudden and violent short-term fluctuations of prices and incomes which in the past have so bedevilled their industry.

The problem of long-term income stability is very much more complex in principle. Before considering it, it may be well to touch on some possible effects of the forward-pricing system on the technical and on the economic efficiency of the farming industry.

The system of forward pricing should make it easier for the farmer to adhere to a settled policy in the choice of the number and type of enterprises to include in his farming plan, since he can reasonably assume that price changes when they are made are fairly reliable guides to future conditions. Under the free-price system it was often difficult for farmers to distinguish between those changes in prices which were of fleeting significance only, and other price changes which were really significant for the future. Furthermore, owing to the extreme sensitivity of the free-price mechanism, fluctuations in prices often occurred which were too rapid for the productive organization to follow. Indeed, a change in prices might set in motion a change in the organization of production which was out of date by the time it had come into effect. Apart from causing real hardship to the farming sector, short-term fluctuations of this kind caused so much confusion and uncertainty in the minds of farmers that their effect was to make it more difficult for them to adjust their farming to the genuine long-term requirements of the situation.

Under a system of assured markets at guaranteed prices success in farming is likely to depend less and less on the luck of buying and selling and more and more on technical skill and managerial efficiency. In effect, the new system offers the farmer the opportunity, hitherto the exception rather than the rule in agriculture, of *producing to contract*. From the farmers' point of view production to contract has many advantages. In particular, the farmer who has an order to sell before he starts to produce his crops and his livestock is free to devote most of his energies to the domestic problems of organization and management of his farm.

It would be foolish to argue that even on the technical level the system of forward pricing is entirely beneficial in its effects. On the contrary, any system of fixed prices will have two inherent drawbacks which may react detrimentally on the standards of technical efficiency.

The first danger is that too much security and stability may endanger enterprise and lead to sloth and stagnation. In particular, if prices are over-generous they may retard rather than encourage farming output. Thus some farmers may be disposed to work less hard once they realize the possibility of earning enough to maintain their accustomed standard of living by a more leisurely tempo of farming.

But more serious is the danger that the British system, which so far has recouped farmers for increases in costs, must tend to remove from producers the incentive to improve their general level of efficiency. The free-price system, on the contrary, provides every incentive for increasing efficiency as costs rise, and especially for economizing in the use of those particular production-factors whose costs are rising most steeply. To take an important example. With free prices, rising wages will cause farmers to use labour more carefully and will tend to encourage mechanization. But if rising wages are fully reflected in increased prices the incentive to mechanization is weakened. As a result of this passivity to costs the pattern of costs will tend to be distorted, and maladjustments and inefficiency must result.

To some extent this criticism is met in the United Kingdom by linking the price-fixing system to an act of Parliament which also provides for the application of efficiency measures. Indeed, it has been widely proclaimed that guaranteed prices are only given as a *quid pro quo* for efficiency in British farming. Actually the 1947 Act makes provision for the application of severe sanctions against those farmers who fail to farm according to 'the rules of good husbandry'. It has yet to be seen how effective these sanctions will be. But, in any case, they can only be effective in the narrowest technical sense since 'the rules of good husbandry' can only have a farming interpretation.

Economic efficiency cannot be entirely a matter of a *quid pro quo* by farmers as such, for it is also concerned with the wider problem of ensuring the optimum level and pattern of agriculture in the national interest. The real task facing any government operating a forward-pricing system for agriculture is, in fact, that of deciding how big its agriculture shall be and how it shall divide its activities between the production of different commodities. This means avoiding fixing prices at a level which will, over the long period, result in (*a*) the production of too much high-cost food at home which could be bought at lower prices from abroad, and (*b*) diverting into agriculture resources which could be used to better effect elsewhere. The British system has hitherto only operated in conditions of emergency, when it has been comparatively simple for the Government to decide the relative priorities to be given to particular farm products. For example, in war-time priorities had clearly to be given to those products which saved most shipping; at present those products which save most dollars must equally clearly come first. The return of more normal conditions will make this task much more difficult.

But there may be a case for maintaining agricultural activity at a long-term level different from that to which a free-price system would tend. For example, political considerations might call for a higher proportion of food to be grown at home than would be in free-market conditions; or nutritional standards might call for a higher consumption of food than, with the existing distribution of incomes, might be brought about by the operation of the free-market forces. In principle the chief problem involved here is that of deciding how much it is worth while to pay for a given degree of this or that non-economic effect, and then to adjust the level of agricultural activity aimed at, so as to ensure that not more than a worthwhile price is in fact paid.

Apart from such non-economic considerations, however, there still remains a case for some measure of interference with the free-price system, even though the superiority of that system as a means for attaining the optimum long-term level of economic activity be conceded. While there should be a constant effort to move towards the 'free' level, there is need, nevertheless, to retard or soften the process of adjustment so as to minimize the hardship to the farming sector. In other words, there must be some compromise between long-term and short-term interests, for, as Marshall was careful to point out, 'there is no hard and sharp line of division' between the two.

This problem may become particularly acute in Great Britain. For, as I have already indicated, current British price-fixing policy seems definitely to contain the intention to provide farmers with *long-term* as well as *short-term* stability. But in a progressing economy there can never be a *static* long-term optimum level for agriculture. It follows, therefore, that if the use of the price instrument to encourage this optimum long-term level is retained, then complete stability, so far as it is brought about by price control, can only be absolutely guaranteed in the relatively short term.

Some economists have suggested that this dilemma, which is a fundamental one confronting other countries besides Great Britain, can best be resolved by a skilful admixture of forward pricing and free markets. As I understand the suggestion, it is as follows: Let a sufficient measure of forward pricing be introduced to cope with the short-term problem. But apart from this let prices take care of themselves. Then let the social problem of minimizing the hardship to the farming sector accompanying a long-term downward adjustment be dealt with by means more appropriate than any pricing system. Provided satisfactory administrative details could be worked out this suggestion has much to commend it.

The advantages of short-term price stability to farmers have already been indicated. What, if any, are the direct benefits to consumers? It can be argued that the stability which forward pricing brings to the producer helps to ensure a more steady flow of supplies to the consumer and thus protects him from wide variations in the retail prices of food. This theory has yet to stand the test of experience. In the past the wide fluctuations in producers' prices were never fully reflected in retail prices. It would be difficult to prove that, even in times of the most extreme variations in world prices of agricultural produce, consumers (outside those regions where malnutrition is endemic) ever suffered any real hardship through scarcity of food resulting from the deterrent effect of price variations on output. Since the consumer is mainly concerned with the cost of food as a whole, or, indeed, with the general level of the cost of living, he is much more likely to be anxious to ensure that prices are not fixed at a level substantially higher than would obtain in the free market. But even to consumers the benefits are not to be measured simply in terms of a plentiful supply of cheap food. In times of depression there may be plenty of 'cheap' food available for sale in the shops, but many potential consumers will lack the money to buy it. It is arguable that an agriculture which is maintained reasonably stable through boom and slump would be a potent stabilizing factor in the economy as a whole and so confer a hidden benefit on the whole community by helping to avert depression.

In conclusion, it may be well to point out that this particular British method of price control has been used because, up to the present, it has proved a fairly simple and effective method of meeting the special situation in a food-importing country. In these circumstances price stabilization for the home producer is fairly easy so long as the political climate permits the difference between the fixed price and the world market price to be financed at the expense of the consumer or taxpayer. Even for an importing country, however, there is the problem of how long a really substantial margin above world prices can be maintained for the home product in the event of a severe depression in world prices. Not only might the United Kingdom find it difficult to maintain wide price-differentials in the face of the principles accepted under the I.T.O. Charter, it would also have to consider the adverse effects of such a policy on its exporting capacity.

It is not within the scope of this paper to deal with the even more difficult problems which arise in the international field. But two main difficulties which stand out prominently in the light of experience may be mentioned. They are (1) how to get a sufficient measure of agreement between major producing countries to operate a comprehensive scheme in the absence of any organization to apply sanctions, and (2) how to prevent any stabilization scheme on world markets from being defeated by the over-production which successful price-fixing is likely to stimulate.

No one will deny that price-fixing is fraught with difficulties and objections. But the crux of the matter is whether these objections are outweighed by the advantages from the *general* rather than from the *sectional* point of view; and whether, given all the objections, price-fixing does still solve more problems than it creates.

In reply to questions PROFESSOR THOMAS *said*:

The question has been asked if there is any relation between price-fixing and the apparent decline in the quality of production? In so far as there has been a decline in quality, it is probably the result of the emphasis on quantity made inevitable since 1939. I mentioned in my paper that if prices are over-generous then they may result in an actual decrease in output. But I did not touch on the relationship between price-fixing and faulty production. If I am right, however, in my contention that the system we are operating in Great Britain is a system of production to contract, and if it continues in more normal times and assumes the usual features of production to contract as this operates in industry, the system may become a means of improving the general efficiency of agricultural production. Indeed, it cannot help doing so if forward prices are associated with a contract to deliver goods of a stipulated grade and quality at stipulated times and in stipulated quantities.

Dr. Skovgaard asked if any plans have been worked out to meet the danger of over-production in certain commodities? So far as I am aware there are no detailed plans. I take it, however, that when such a danger occurs, it will be taken into account at the February reviews and the prices of those products in over-supply will be reduced. We are really trying to work a system in which the forward prices are likely to be in line with the real supply-and-demand situation in the immediate future. Our system is in a sense a compromise between the free-price system and the so called fixed-price system. The point is that under the forward-pricing system the emphasis is on *forward* prices, not on *fixed* prices.

Professor Benedict has asked me to give some indication of the attitude of different groups of producers to the forward-pricing system. Do they like it better or not so well as the free-price system?

It is very difficult to answer that question on the basis of our experience to date. As I pointed out, so far the system has functioned in a crisis situation, and this crisis situation has determined the form of procedure as well as the reaction of producers. It has been entirely favourable to producers. What will happen when circumstances change one cannot say. Until the system is put to the test of functioning under more normal conditions it will be impossible to answer your question from experience. Any answer I should give now would be speculative only.

In answer to the query, if the system has worked to insulate the British farmer from the downward trend in world prices, I should say that so far the answer is certainly Yes.

Someone has asked if it is not necessary also to fix land prices and rents? That raises another problem. I suppose that once you start fixing prices you may be forced to go the whole way and fix prices at every level. So far, however, land values and rents have not been fixed. But rents are indirectly brought into the picture, for the 1947 Act also deals with the important question of land tenure. Thus, under our present system it is possible for both the tenant-farmer and the landlord to demand that the actual rent paid for a farm shall be submitted to independent arbitration every three years.

I should like to mention one other point here which I omitted from my paper: it is that in Britain minimum agricultural wages are also fixed by law. As a result there has been a marked and very welcome improvement in the wages of farm workers since 1939. Indeed, the improvement of the standard of living of the farm worker is an essential feature of our general agricultural policy.

The fixing of wages is left to a government-appointed body called the Agricultural Wages Board. This Board consists of an equal number of representatives of farmers and of farm workers, together with a number of independent members appointed by the Minister of Agriculture, one of whom acts as Chairman. The system might be aptly described as a system of legal collective bargaining. While the workers' representatives and the farmers' representatives will put forward the pleas for and against an increase in wages, the final decision must obviously be taken by the independent members. In this way, in practice it is a system which combines collective bargaining with independent arbitration. I think that most people are agreed that it is really a very good system.

Dr. Hanaü has suggested that if it is academic to discuss the free-price system at the present time, it is also academic to discuss the planned-price system if the prices deviate from supply and demand.

I am not sure that I understand the point of this question. My statement that a discussion of the free-price system is academic was prompted only by the fact that since the free-price system is no longer functioning it has no bearing on actual conditions. But if planned prices deviate from supply and demand, that is a practical situation, and a discussion of a practical situation can never be academic.

When Professor Norton asks me if the English system will work as well when our prices are above world prices as it has done when our prices were below world prices, as they have mostly been during the past two years, he has really repeated a question which I asked myself in the paper, but was careful not to answer. And I was careful not to answer it because at the moment any answer to that question must be entirely academic!

Mr. H. E. Garrett asks if, in view of the figures given in the recent White Paper on national incomes, it is not the case that the forward-price system tends to have an inflationary influence.

That is a very complex question. I am glad it has been raised, because it does underline what I said about the potential dangers of price-fixing. It would, however, take too long to attempt an adequate answer to the question.

Dr. Bean asks, what is the total cash value of the amount that the farmer receives from the market and the amount that he receives in subsidies from the Government. I am going to ask my colleague, Dr. Kirk of the Ministry of Agriculture, who is well informed on these matters, to answer that question.

J. H. Kirk: The total gross income of the farming industry in the United Kingdom is about £800 million. The total net income is about £250 million. The sums given directly to farmers by the Government, if by that one means subsidies paid to farmers in cash, are comparatively small. The greater part of Government assistance is given to farmers through the price system, and the amount cannot be separated from that part of the total subsidy which is also for the benefit of the consumers.