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Cereal foods - Marketing



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# Price and Marketing Prospects for UK Cereal Growers within the EEC

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Summary of a Study sponsored by the Home-Grown Cereals Authority  
Agricultural Adjustment Unit University of Newcastle upon Tyne

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WITHIN THE EEC

Summary of a study sponsored by  
the Home-Grown Cereals Authority

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The full report of this study can be obtained  
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# PRICE AND MARKETING PROSPECTS FOR UK CEREAL GROWERS

## WITHIN THE EEC

### SUMMARY

#### 1. Introduction

The Agricultural Adjustment Unit at the University of Newcastle upon Tyne is undertaking a five-year research programme on the effects of the EEC Common Agricultural Policy on the UK Cereals Market. It is sponsored by the Home-Grown Cereals Authority, and has had support from the Agricultural Market Development Executive Committee.

The first report on 'The Potential Market for British Cereals' by I.M. Sturgess and R. Reeves, was published in 1972.

This report on 'Price and Marketing Prospects for UK Cereal Growers Within the EEC' by I.M. Sturgess, examines the effects of the EEC Common Agricultural Policy on UK cereal farmers.

A third report on the effects of EEC entry on UK cereal traders, merchants, millers, compounders and maltsters will be published during 1974.

#### 2. The EEC Cereals Market

By comparison with the world cereals economy, and even that of just the industrialized world, the cereals economies of the Six and the UK are very similar. There are however important differences. In the Six wheat rather than barley is the dominant cereal and small-scale production of cereals by mixed farmers is of greater relative importance. The Six are more nearly self sufficient in cereals, France indeed being a major exporter. A higher proportion of grain is retained on farms than in the UK. That which does leave the farm is sold earlier, is more often stored centrally and is more likely to be handled by co-operatives.

During the transition period to full application of the CAP on cereals, the cereal grower will increasingly derive his total return from the market price paid and not from government payments. The market price received will be bolstered by minimum prices for both imported cereals and cereals produced within the Community. Minimum import prices will be at a higher level than those used in the past in the UK. To maintain prices at the desired level in a market close to self-sufficiency however, the volume of Community production that is marketed internally is also restricted by diversion into support stocks and subsidized exports, by means of respectively intervention prices and export restitutions. In addition, an artificial differential between the price of milling wheat and the price of feeding wheat is maintained by the payment of a denaturing premium to those who make wheat unfit for human consumption.

The effect of these measures will be to make the prices of cereals higher, in relation to both the general price level and the prices of most livestock products, than they were in the UK before entry into the EEC.

UK prices will move up to Community levels in stages but to enable intra-Community trade to take place as if prices had been harmonized immediately on entry, accession compensatory amounts are paid by the EEC to exporters of cereals from the partner countries to the UK and paid by importers of cereals from the UK into the partner countries. In the transition period to date accession compensatory amounts<sup>1</sup> applying to a particular cereal and pair of countries have been subject to frequent modification to offset excesses of world prices over derived UK threshold prices. Also, levies and subsidies on trade have been further adjusted by the application of monetary compensatory amounts. In principle however the accession compensatory amount applying to trade between the UK and the Six in a cereal at any point in time is simply the difference between the common Community threshold price and the transitional derived threshold price in the UK.

### 3. Future Annual Prices of Cereals

The projection of future national ex-farm prices of wheat and barley is done in a series of stages. The items projected at each stage are

- 
1. Accession compensatory amounts are to be distinguished from monetary compensatory amounts. The latter are used to offset deviations in market rates of conversion of national currencies to the Community unit of account from established rates of conversion.

- (i) EEC Threshold and basic intervention prices in units of account in 1978/79.
- (ii) UK Transitional threshold and basic intervention prices in sterling 1973/74 - 1978/79.
- (iii) Maximum and minimum wholesale prices at West Coast UK ports.
- (iv) Ceiling and floor wholesale prices at West Coast UK ports.
- (v) Ranges of national average ex-farm prices for standard qualities.
- (vi) Points within ranges of national average ex-farm prices for standard qualities and
- (vii) National average ex-farm prices for average qualities.

In the text, an attempt is made to project prices in each year of the projection period. To make the summary more easily understandable, however, prices at the end of the period are first considered in isolation. This allows the price projections at each stage together with the key assumptions which lead to them to be encapsulated in one table. The justification of the various assumptions is to be found in the text. It may however be helpful to explain the ceiling and floor prices. The ceiling price of wheat is assumed to be the price at which French wheat can be profitably landed in volume in UK. The ceiling price of barley is then derived from this by the value net of costs of the denaturing premium, on the assumption the market price for barley of standard quality will not exceed the price of denatured wheat. The floor price of barley is the intervention price less the discount for inconvenience of selling into intervention. The floor price of wheat is derived therefrom by the assumption that livestock feeders will never value wheat eligible for denaturing at less than the price of barley plus the net value of the denaturing premium.

For a number of reasons the increase in UK official prices over the transition period will be irregular; also values of some of the key determinants of prices, notably the denaturing premium and land and water transport costs are projected to change over the transition period. The projected path of prices over the transition period is as shown in Table 2. Since it now seems clear that prices of cereals in 1973/74 will be determined by world market forces and not the influence of the CAP, the projections begin at 1974/75.

Table 1

Summary of Sequence of Projections of Prices of Wheat and Barley in 1978/79<sup>(a)</sup>

Basis	Quality	Region	Wheat Price		Barley Price		Key Assumptions					
W H O L E S A L E	S T A N D A R D	EEC	<u>UA per tonne</u>				(i)	Role threshold & intervention prices in EEC unchanged before 1980.				
			<u>Threshold</u>	<u>Intervention</u>	<u>Threshold</u>	<u>Intervention</u>						
			124	117	115	108						
									(ii)	Average increase 1972/73 - 1978/79, wheat + 1% p.a., barley + 1½% p.a.		
				UK West Coast	<u>£ per ton</u>				(i)	cif to alongside-mill cost = £1 ton,		
					<u>Threshold</u>	<u>Intervention</u>	<u>Threshold</u>	<u>Intervention</u>				
					58½	55	54	51				
											(ii)	UK port "inefficiency" loading cf. Rotterdam = £1 ton,
		<u>Max.</u>	<u>Min.</u>	<u>Max.</u>	<u>Min.</u>	(iii)	Max. "inconvenience" discount on intervention price = £1 ton.					
		60½	54	56	50							

continued.....



Table 1 - continued

Basis	Quality	Region	Wheat Price		Barley Price		Key Assumption
			<u>Ceiling</u>	<u>Floor</u>	<u>Ceiling</u>	<u>Floor</u>	
W H O L E S A L E	S T A N D A R D	UK West Coast	58	55½	52½	50	(i) Denaturing premium = £6.0 a ton, (ii) Denaturing costs = £1.5 a ton, (iii) S.Q. wheat - denaturing wheat = £1.0 a ton, (iv) Max. excess over Rouen intervention paid by French exporters = £1.0 a ton, (v) Threshold-Rouen inter- vention = £5.5 a ton, (vi) Freight rate Rouen - Liverpool = £3.0 a ton, (vii) Handling charges = £1.0 a ton.
		UK	<u>Ceiling</u> 57½	<u>Floor</u> 55	<u>Ceiling</u> 52	<u>Floor</u> 49½	(i) West Coast - National Price = £0.5 ton.

continued.....

Table 1 - continued

Basis	Quality	Region	Wheat Price		Barley Price		Key Assumptions
			<u>Ceiling</u>	<u>Floor</u>	<u>Ceiling</u>	<u>Floor</u>	
E X - F A R M	S T A N D A R D	UK	55	52½	49½	47	Transport and Marketing costs ex-farm to wholesaler = £2.5 ton.
			<u>Likely</u> 53½		<u>Likely</u> 48		Pressure increasing production and competition cereal substitutes keeps prices nearer floor than ceiling.
E X - F A R M	A V E R A G E	UK	<u>Likely</u> 53		<u>Likely</u> 48		Market differentials similar intervention.

*Table 2*  
*Projected Ex-Farm Prices of Wheat and Barley,*  
*UK, 1974/75 - 1978/79*

	Wheat			Barley		
	Ceiling	Floor	Likely	Ceiling	Floor	Likely
1974/75	38	36	37½	32½	30½	32
1975/76	42	40	41	36½	34½	34
1976/77	47	44½	46	42	39½	41
1977/78	52½	50	51	47½	45	46
1978/79	54½	52	53	49½	47	48

If the price projected for 1974/75 eventuates then a deficiency payment will be made on barley in 1974/75. It is supposed, however, that from 1975/76 onwards producer returns will derive entirely from end-prices.

In projecting the price of maize it has been assumed that, in spite of US opposition, the EEC will try to reduce some of the more visible pressures of disposals of surpluses of wheat and barley by restricting imports of maize more severely in relation to other cereals. Hence the threshold price is projected to rise by an average rate of 2 per cent a year over the transition period (compared to 1½ per cent for barley and 1 per cent for wheat). A substantial part of the imports of maize into the UK are expected to continue to come from outside the Community. Hence the wholesale price of maize is projected to follow closely the course of the threshold price and to reach £56 a ton by 1978/79.

The projection of the price of oats is derived from the projection of the price of barley. Without the stimulus of a high deficiency payment the production of oats as a proportion of that of barley is likely to decline markedly and it is accordingly assumed the ex-farm price of oats will rise as a proportion of the price of barley will rise somewhat over the transition period. The ex-farm price of oats is accordingly projected to be £44½ a ton in 1978/79.

Largely because of the denaturing premium the ratio of the ex-farm price of wheat to that of barley will in 1978/79 be some 10 per cent higher than the parity of recent seasons. The price of barley will, however, rise in relation to that of feeding maize, since the gap between barley and maize import prices will decline over the transition period.

The ratio of total producer returns per ton of wheat to barley in 1978/79 will not be much different from the level of 1967/68 - 1971/72 but there will be a significant drop in the relative return from oats production.

#### 4. Price Patterns within Seasons

The stepped pattern of threshold prices and the tendency of French supply prices to follow the rise of intervention prices over most of the season will make prices of imported wheat follow a more regular upward path over the season. This effect will be reinforced by a change in the pattern of off-farm marketing. A detailed comparison of the storage incentives operating under the CDP scheme for wheat in the past decade with the likely price expectations of producers under EEC conditions suggests the pattern of off-farm marketing is likely to change such as to reduce the price of wheat seasonally in August and September and December/February and to increase it in October and March/May. Marketings by farmers are also likely to be more sensitive to changes in market prices. This should reduce the variability of market prices from month to month within the season and thereby make the pattern of prices more stable from season to season.

The combined effect of the change in the pattern of import prices and off-farm marketings is likely to prevent a concentration of intervention purchases in the period between February (when UK prices have tended to peak) and May (before intervention prices drop at the end of the season). A combination of an abated end-of-season stock compensation and the increase in prices between seasons, resulting from the transitional process, is likely to have the same effect as the full end-of-season stock compensation in the Six in preventing prices slumping with intervention prices at the end of the season.

The seasonal pattern of the price of barley will be affected similarly to that of wheat by an increased seasonality in prices of imported cereals. The increased use of cereal substitutes will also tend to reduce demand pressure on the price of barley in the January/March period. Prior to EEC entry, government interference distorted the seasonal pattern of marketings of barley less than that of wheat. Even so, the EEC system of cereal support, compared to the CDP system, will be less of a deterrent to marketing barley soon after harvest and will provide less of an incentive to carry barley into the second half of the season. The effect of the rise between seasons in official prices over the transition period and the reaction of storers to the known pattern of intervention prices is likely to step up the ratio of June and July prices to the May price. Therefore all the forces affecting the seasonality of prices are likely to be working toward making the seasonal pattern of barley prices follow a more regular upward path than hitherto. The effect of the CAP in making growers more responsive to market prices in their selling will, however, be weaker in the case of barley than wheat, because the CDP scheme insulated growers of barley from the effects of seasonal changes in market prices less strongly than growers of wheat.

The greater incentive to store wheat than barley under EEC conditions introduces no essentially new feature to the market. Indeed the discrimination in favour of wheat could be argued to have been greater under the CDP scheme.

The stability of the seasonal increments to threshold and intervention prices over the transition period, despite the rise in cereal prices, and therefore in financing costs, is a phenomenon less readily dismissed. At first sight, it would appear to provide an incentive to speculative storage by importers and potential sellers into intervention in the earlier part of the transition period. In practice this may not be the case because of higher interest charges in the UK than in the countries of the Six.

#### 5. Regional Price Patterns

The regional differentials in intervention prices established are likely to diverge from "natural" price differentials not only at particular times of the season or in abnormal seasons but even on average in normal seasons. Work by Colman on past regional patterns, in spite of some criticism, is argued to give a reasonably representative picture of typical differentials. Comparison of these with those established by intervention prices was not a feature of past market prices. Market prices in the Northern part of the East Coast of Great Britain have generally been lower than in the Southern part. On the West Coast also, prices in the Southern part have been higher than in the Northern part.

Even in times of considerable intervention buying it is not to be expected that the intervention price pattern will completely replace the natural pattern. The concentration of intervention support of a falling market at particular intervention points will cause grain to be diverted from other areas to these points (although not necessarily into intervention). As a result prices will be raised in these other areas where intervention is not taking place. Regionally selective intervention may therefore well produce a regional pattern of price differentials not greatly different from what would have otherwise held. "Errors" in the regional pattern of intervention prices will affect the pattern of grain flows more than the pattern of grain prices. Some correction of "errors" may occur in the light of experience but the past tendency in the Six has been to hold regional differentials relatively constant.

Other evidence presented by Colman is consistent with the assumption used in the projections of annual prices that national average prices of both wheat and barley will, as a rule, average only about £0.50 a ton below prices in West Coast deficit areas.

## 6. Profitability of Cereal Growing

Despite projected average annual rises in input costs ranging from 4 per cent for sprays to 8 per cent for seeds, marked rises in prices combined with a modest rise in yields are likely almost to double the gross margins per acre of both wheat and barley between 1970/71 and 1978/79. This rise must, however, be set against an expected average rate of inflation of 6 per cent a year which makes the rise in gross margins in terms of purchasing power a more modest 20 per cent. It is suggested that errors in assumptions will tend to offset one another. If the rate of inflation turns out to be higher than here projected the projection of the rate of increase in cereal prices is likely also to be too low. Either the value of sterling in terms of units of account will be lower or else the increase in Community cereal price will be steeper than projected.

## 7. Uncertainty in Cereal Growing

The forces of inertia in policy making are particularly strong when agreement has to be reached between several sovereign governments. Hence one may suppose year-to-year changes in official prices in the future as in the past, will be small, even at the regional level. On the other hand changes in intervention prices will be a poorer indicator of changes in average producer returns than guaranteed prices. This uncertainty about changes in unit returns between years may well be increased by delays in the announcement of prices.

Within seasons, however, a crude comparison suggests the price of barley will be more certain than hitherto. Though also constrained within quite a narrow tunnel, the producer price of wheat will be more uncertain than under the CDP scheme. Up till 1971/72 the only uncertainty of producer price of wheat within seasons was the relation of price received to the average price paid during each (relatively short) accounting period.

Price differentials for quality are likely to be more certain under EEC conditions. To a lesser degree price differentials according to location, will also be made more stable and certain.

## 8. Cereal Production

Between 1968/69 - 1972/73 and 1978/79 yields of both barley and wheat are projected to rise by only 7 per cent, since no dramatic solution to the problems of intensive cereal growing is foreseen.

Despite the steep rise in profitability of cereal production expected, rotational constraints and the relative attractiveness of grass-using livestock enterprises are expected to constrain the rise in acreage under cereals to 1 million acres (11 per cent). The resulting projection of production in 1978/79 is 16.5 million tons, 2.6 million tons (20 per cent) higher than in the base period.

## 9. Physical Movement of Cereals Off Farms

The abandonment of the seasonal incentive scheme for barley and the forward contract bonus scheme remove two earlier disincentives to the retention of barley on farms. This influence is, however, likely to be outweighed by a checking of the swing to home-mixing of feeds through the advantageous access of compounders to cereal substitutes.

The proportion of wheat retained on farms in the past has been negligible because farmers (till 1971/72) had to sell their wheat to obtain the deficiency payment. Feeding of wheat without denaturing now incurs a similar opportunity cost but there is the possibility of denaturing on the farm perhaps by use of mobile plant. This has the attraction of avoiding the costs of double handling provided the farm has livestock and has cleaning equipment capable of bringing wheat to denaturing standard. Many farms do not satisfy these criteria. Moreover wheat is a difficult grain to mill and mix and has to be used cautiously in many rations. Hence the proportion of wheat retained on farms is likely to continue to be rather small.

The effects of changes in rating and fiscal policy made shortly before and shortly after entry into the EEC make the estimated cost of storing cereals in a 10-thousand ton group-owned store only about £0.50 a ton more than in a 500-ton farm store (Merchant owned stores are however still put at a substantial disadvantage by government policies).

Replacement demand and the need to store expanded production could create a demand for perhaps 3 million tons more storage over the next 5 years or so. Since a large part of expanded production will take place in areas that

have traditionally grown little cereals, central stores may have an unusual chance to get in on the ground floor. This chance, however, is unlikely to be translated into actuality if the CAP does not enhance the marketing advantages of central stores. The transport advantages of central stores will increase but in the main independently of the adoption of the CAP. The CAP is however likely to lead to more precise quality differentials in prices and to a greater need to assemble large amounts of cereals for export; the advantage of the central store in respect of presentation will therefore be enhanced. The chances of central stores obtaining bonuses for regular supply are viewed more sceptically.

Farmers, for their part, may be increasingly eager to surrender their selling discretion because the opportunities for speculative gain will be limited and available only to those with excellent information. The need to reserve storage for intervention is also likely to favour central rather than farm stores, given the difficulties of on-farm storage of intervention stocks.

In general then substantial further investment in centralized storage is to be expected. However, given the tremendous amount of only partly depreciated farm storage now in being there is no prospect of central storage replacing farm storage as the dominant form of storage of cereals in the UK within the projection period.

#### 10. Off-Farm Selling Methods

Marketing co-operatives, narrowly defined, are unlikely to be much more strongly supported by public policy as a result of EEC entry. The complexity of trading under EEC conditions may well encourage more cereal farmers to surrender their selling initiative and also reduce the number of merchanting firms. The freeing of trade within the Community and the introduction of the intervention agency as an alternative buyer however mean the scope for co-operative bargaining is on balance not likely to be much increased. New opportunities for co-operatives in the bulking and standardisation of grain will emerge but these will also be open to corporate merchants. Greater uncertainty of returns to wheat growers leaves open a role for co-operative stabilisation but it is a role that may be difficult to fill.

Likely Community legislation on producer groups will provide an incentive for growers to commit their selling discretion to particular intermediaries but, notwithstanding this, it is believed many farmers will still make their selling decisions as individuals.



Because of the abandonment of the Forward Contract Bonus Scheme and the introduction of floors to market prices, producers (or groups of producers) alone are unlikely to initiate an extension of selling on contract. It is believed, however, that on balance, the greater certainty of market prices will encourage end-users to buy more domestic grain contractually because the main incentive to contract is security of supply or quality rather than security of price.

