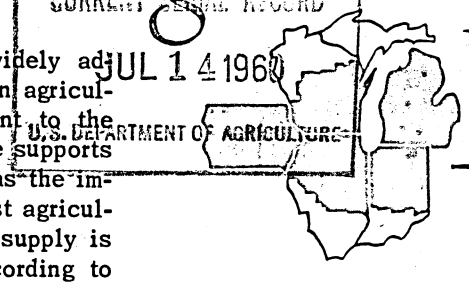
Federal Reserve Bank of Chicago - -

# Agricultural Letter





July 1, 1960

Number 565

PRODUCTION CONTROLS have been widely advocated as a solution to the surplus problem in agriculture. The proponents of this approach point to the elimination of Government expenditures on price supports and the end of surplus accumulation as well as the improvement of farm prices and incomes. For most agricultural commodities, only a small reduction in supply is necessary to boost prices substantially, according to this argument, because the nature of consumer demand is such that the quantity of food purchased is largely unresponsive to changes in prices.

However, to achieve higher prices without Government purchases, the production controls must be effective in reducing supplies. Present agricultural programs include acreage restrictions and marketing quotas for such commodities as wheat, cotton, rice, peanuts and tobacco. However, acreage controls have not effectively limited production of these commodities with the possible exception of tobacco. Furthermore, land which is taken out of production of controlled crops can be shifted to production of uncontrolled commodities. Yet, attempts to restrict use of the diverted acres have been politically unacceptable.

Even if the difficulties of farmers' acceptance and Government administration of a rigid control program were overcome, other defects of such a program would remain: capitalization of the value of production rights, possibly undesirable distribution of benefits and inefficient use of resources. Since the tobacco program has come closest to effectively restricting production to the quantity demanded at the support price, it is appropriate to examine the experience of tobacco controls.

In recent years, the Secretary of Agriculture has supported tobacco prices at 90 per cent of parity after national marketing quotas and acreage allotments were approved by more than two-thirds of the growers voting in referendums. Under the tobacco program, an allotment is a legal right to grow tobacco on a specified acreage of land--the acreage being determined each year on the basis of the national marketing quota and the historical production on each farm. If the land in a farm is sold, the right to the allotment is transferred along with the ownership of the land. Thus the two criteria for capitalizing the value of a production right have been met: (1) there is a specific right to produce which can be evaluated and (2) this right can be legally transferred to other owners.

The market value of an acre of flue-cured tobacco allotment alone (without any associated land or buildings) was determined by a recent study to be nearly $1,700 in an area of Virginia and $2,500 in an area of North Carolina in 1957. Furthermore, the per acre value of these allotments rose 75 to 90 per cent from 1954 to 1957 as a result of a one-third reduction in the size of tobacco allotments together with increased yields and net income per acre of tobacco grown.

The benefits of a production control program, therefore, go in large part to those people--farmers or landlords--who first receive the production rights. In the study on tobacco allotments, those persons who owned tobacco farms obtained a substantial capital gain once the value of the allotments was capitalized into farm land values. Furthermore, those farmers entering production after the program was established had to pay in advance to the old owners a part of the future benefits expected from the program. Thus the original owners benefit both from higher returns on their crops and from capital gains on sale of the production rights while the purchase price of the production rights merely becomes another cost to future owners.

Finally, the study notes: "Higher incomes and land values stemming from the tobacco program have become firmly embedded in the economy of the tobacco-producing areas. Any change in the tobacco program to reduce farm incomes and the value of tobacco allotments would result in a considerable reorganization of tobacco operations and an appreciable reallocation of resources in tobacco production. Declining farm land values would reduce owners' equities in tobacco farms and impair the value of creditors' security behind loans to farmers." Thus, once started along the road to production control it becomes very difficult to reverse direction because of the adverse effects on farmers with production rights and on agriculturally related businesses.

While this study was limited to the value of tobacco allotments, it provides an example of the problems of assessing the results of monopoly restrictions on agricultural output. If the purpose of agricultural programs is to aid farmers with low incomes, this approach leaves much to be desired. If the goal is to maintain relatively high and stable prices for farm commodities, then this gain must be weighed against the effects of the program on the distribution of benefits between landlord and tenant or among different income groups, and against the effects of controls on production efficiency and resource use in the economy. Once again there seem to be no "easy" solutions to the "hard" problems of farm policy.

Research Department

## FARM BUSINESS CONDITIONS

MAY 1960, WITH COMPARISONS

| ITEMS | 1960 | | 1959 |
|---|---|---|---|
| | May | April | May |
| PRICES: | | | |
| Received by farmers (1947 - 49 = 100) | 89 | 89 | 90 |
| Paid by farmers (1947 - 49 = 100) | 120 | 121 | 119 |
| Parity price ratio (1910 - 14 = 100) | 80 | 80 | 82 |
| Wholesale, all commodities (1947 - 49 = 100) | 120 | 120 | 120 |
| Paid by consumers (1947 - 49 = 100) | 126 | 126 | 124 |
| Wheat, No. 2 red winter, Chicago (dol. per bu.) | 2.07 | 2.11 | 1.89 |
| Corn, No. 2 yellow, Chicago (dol. per bu.) | 1.23 | 1.22 | 1.30 |
| Oats, No. 2 white, Chicago (dol. per bu.) | .78 | .78 | .71 |
| Soybeans, No. 1 yellow, Chicago (dol. per bu.) | 2.19 | 2.19 | 2.34 |
| Hogs, barrows and gilts, Chicago (dol. per cwt.) | 16.09 | 16.11 | 16.32 |
| Beef steers, choice grade, Chicago (dol. per cwt.) | 27.43 | 27.76 | 29.34 |
| Milk, wholesale, U.S. (dol. per cwt.) | 3.83 | 3.96 | 3.76 |
| Butterfat, local markets, U.S. (dol. per lb.) | .59 | .59 | .58 |
| Chickens, local markets, U.S. (dol. per lb.) | .17 | .17 | .15 |
| Eggs, local markets, U.S. (dol. per doz.) | .33 | .36 | .25 |
| Milk cows, U.S. (dol. per head) | 224 | 226 | 238 |
| Farm labor, U.S. (dol. per week without board) | -- | 45.75 | 44.25[a] |
| Factory labor, U.S. (dol. earned per week) | 90.74 | 89.83 | 90.32 |
| PRODUCTION: | | | |
| Industrial, physical volume (1947 - 49 = 100) | 166 | 165 | 166 |
| Farm marketings, physical volume (1947 - 49 = 100) | 103 | 98 | 99 |
| INCOME PAYMENTS: | | | |
| Total personal income, U.S. (annual rate, bil. of dol.) | 399 | 398 | 381 |
| Cash farm income, U.S. [1] (annual rate, bil. of dol.) | -- | 34 | 33 |
| EMPLOYMENT: | | | |
| Farm (millions) | 5.8 | 5.4 | 6.4 |
| Nonagricultural (millions) | 61.4 | 60.8 | 59.6 |
| FINANCIAL (District member banks): | | | |
| Demand deposits: | | | |
| Agricultural banks (1955 monthly average = 100) | -- | 99.2 | 105.0 |
| Nonagricultural banks (1955 monthly average = 100) | -- | 102.1 | 104.2 |
| Time deposits: | | | |
| Agricultural banks (1955 monthly average = 100) | -- | 131.7 | 127.4 |
| Nonagricultural banks (1955 monthly average = 100) | -- | 127.3 | 124.6 |

[1] *Based on estimated monthly income.*

[a] April

*Compiled from official sources by the Research Department, Federal Reserve Bank of Chicago*