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PRICES AND AGRICULTURAL POLICY

by

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What should be the goal of an agricultural price policy? Most agricultural economists who have written on the subject agree that the goal of a price policy for agriculture and the national economy should be the same. This goal is an effective utilization of the nation's resources and distribution of products from these resources in such a way as to satisfy as many wants of the citizens as possible. Stated in another way the goal of our agricultural price policy should be to promote the highest production and income per person possible with present population, present resources and technological knowledge. The "per person" part of this goal should be emphasized. The effective utilization of our human resources, high production per person, is the most important test of a price policy.

A second criterion of a desirable price policy listed by some is high income per person for as large a modal group in the population as possible rather than just a high average income per person. A high average income might be present in an economy where the distribution of individual incomes is highly skewed to the right because of some very large incomes. Most people feel that such a distribution is socially undesirable. Some think it is also economically unsound because it decreases productive incentive and may decrease productive capacity.

A third test of a price policy in a democracy should be: Will it eliminate the wide swings from year to year in income and production per person? In my opinion it must eliminate declines in income and production which approach in magnitude the 1929-32 decline; otherwise we will have extensive economic and political changes in this country.

A high long-time average income is an important part of a price policy, but because people live in the short-run it is unacceptable as a complete goal, especially in a democracy. Quoting long-time averages did not satisfy the unemployed worker or the depression-ridden farmer in 1931-32 and it will not in the next depression. Moreover, comparison with other groups or nations chronically less prosperous has not been an effective argument with the ordinary voter for retaining an economic system of relatively free enterprise and extensive ownership of productive capital by private individuals and corporations probably would not withstand another severe depression of the 1929-32 variety.

Our free market price policy worked fairly well until the depression following World War I. In fact the period from about 1896 until 1915 has been called a "golden era" for American agriculture. Even today, I think it could be successfully argued that in comparison with other types of economy our system has met the first test of a price policy, a high average productivity and income per person. Our past system might even meet the second criterion of a good price policy, a large number of average incomes in the distribution of all incomes. The support on this point for our system would be less than on the first goal and far from unanimous. It is when applying the third test, variability in income and production from year to year, that we find our past price policies falling short.

Some criticisms of our price policies have been voiced by farmers and others during all general price declines, especially the long and severe decline following the Civil War. Various solutions were suggested during this latter price decline, among them remonetization of silver. In the late 1890's, however, prices in the United States and in the world rose and the criticism of our price system subsided until the sharp decline in 1920-21. Since that time there has been a great deal of criticism and many different price policies have been suggested. Several have been tried.

Out of the experience we have had with price policies in this country and in other countries, we must look for the solution to the problem of variability in income per person from year to year. How can wide swings in income per person and in industrial activity be lessened?

Important Characteristics of Past Price Fluctuations

In analyzing this question, let me first call your attention to some characteristics of prices and production which will serve as background material. First, most of the variations in individual farm prices are associated with the general level of prices (compare figs. 1 and 1a). In the past 35 years most Washington farm prices have fluctuated from an index as low as 60 to an index as high as 240 when 1910-14 equals 100. This is a range of 180 points. When the variations that were associated with the United States farm price level were statistically eliminated, however, almost all of the fluctuations in individual prices fall within a range of 70 to 130, a gross range of 60 points (fig. 1a).

Second, basic commodity prices tend to have similar price movements, within the same state, within the same country and between countries. Fig. 1 illustrates the tendency for Washington farm prices to move together. Figs. 2 and 3 are illustrations of farm commodities within the United States that had similar price movements. Numerous other examples could be given both within agricultural commodities and between agricultural commodities and other basic commodities. Fig. 4 is an illustration of how closely wheat prices have moved with basic commodity prices in the world. Figs. 5 and 6 illustrate how basic commodities in the United States have moved in a pattern similar to basic commodity prices in the "rest of the world."

Basic commodities (raw materials) account for most of the world's trade. Human beings on a world basis have established long-time value relationships between basic commodities that tend to persist. Within countries value relationships like the hog-corn ratio or a wheat-corn ratio become established and move within rather narrow ranges. If any of a country's basic commodities move into world trade, it necessarily follows that there will be value relationships between it, not only the internationally traded commodities, but also value relationships between basic commodities that are traded only internally and basic commodities throughout the world.

This tendency for prices to move in the same direction, up or down, leads to this conclusion: the most important factors causing changes in farm prices are common to all of the individual products. Because of this tendency toward a similar pattern in price movements, farmers can avoid only a small part of the financial difficulties which accompany a general fall in farm prices by shifting from the production of one commodity to another.

Some of the past crop and livestock shifts encouraged by government programs during periods of a general fall in price level have resulted in farmers changing to the production of crops or livestock which were less adapted to their area.

These shifts resulted in decreased efficiency of production, and therefore, in a loss to the nation as a whole.

If the price of an individual basic commodity is low because of a falling price level, other basic commodities also must be low in price. A shift from the production of one commodity to another usually has only a small effect on net returns to the producer. Sometimes the shift results in a greater loss.

Professor T. W. Schultz emphasizes in the following quotation the importance of the general price level on individual farm commodites:

> "Any price policy for agriculture worthy of consideration must start with the general level of prices. It is the movement of the price level that either makes or breaks farmers. There isn't much point in laboring for an enlightened policy covering the relationships among farm prices when the center of gravity of all prices is constantly moving either up or down.....
> "Stability in the general level of prices should therefore stand first among objectives in a nation's price policy. Agriculture may have a larger stake in this goal than any other major group in our society, since farmers are peculiarly vulnerable to price movements. The techniques appropriate to this objective call for major fiscal-monetary reforms." 1/

As previously shown, most of the variation in farm prices would be eliminated if the fluctuations in the general level of prices could be eliminated. The question arises as to what should be done about the remaining fluctuations in farm prices. It is in this realm of farm price fluctuation that such proposals as a two-price system for wheat or forward pricing should be considered. It is here also that production control programs, an ever normal granary and international wheat agreements would have to wield their influence on individual commodity prices. Personally I would prefer to allow the prices of individual commodities to fluctuate around a stable price level. I believe we will get better distribution of resources and a more equitable distribution of consumers' goods by allowing individual commodity prices to fluctuate around a relatively stable price level. At least it is important to recognize that price programs which attempt to eliminate price fluctuation by changing the supply and demand for individual commodities are limited to the fluctuation of these prices around the general price level. It also seems reasonable to assume that such programs will require extensive controls to make them effective.

The third characteristic of prices that can be well established by statistical data is a difference in flexibility between basic commodity prices (including agricultural prices) and the prices of finished goods. Perhaps the most important item in finished goods prices which contributes to their inflexibility is the inflexibility of wage rates. Interest payments, freight rates and taxes, are even less flexible than wage rates, although less important in total costs.

Fig. 7 shows the difference in flexibility of factory wage rates and United States farm prices. Associated with this difference in price flexibility between agriculture and industry is the stability in production from year to year for agriculture and the instability in production in industry. The disparity created by these differences in flexibility of prices is greatest in countries that are highly industrialized. The problem has also become more serious with passing years as specialization in labor has increased.

1/ Schultz, T. W., Agriculture in an Unstable Economy, McGraw-Hill Book Company, Inc., New York 1945, pp. 260-261.

Trade between groups can be carried on at any price level but it is the difference in flexibility of various prices and price groups as they move from one level to another that upsets the exchange of products. Examples of the slowness of wage rates to decline when farm prices fall are to be found in the periods 1920-21, 1930-32, and 1937-38. In 1920-21, United States farm prices fell from an index of 230 to 115, a decline of 50 percent (fig. 7). Wage rates fell less, from about 60 cents per hour to around 48 cents, a decrease of 20 per cent. Business activity declined about 35 percent. From 1930-1932, farm prices fell 60 percent while wage rates declined 25 percent. Business activity was cut in half. From early 1937 until early 1938, farm prices fell more than 25 percent and wage rates increased about 12 percent. Business activity declined about 30 percent.

Examples of how farm prices rise faster than wage rates in periods of rising price levels occurred in the periods 1933-37 and 1939-46. From March 1933 until April 1937, farm prices rose from an index of 60 to 130, an increase of over 100 percent. Wage rates rose less, from 45 cents per hour to about 64 cents. This is an increase of around 44 percent. Industrial activity increased over 100 percent. Wage rates would not be expected to rise as much as farm prices because they had not fallen as much from 1929 to 1933. All that wage earners needed was increased business activity that would bring them a full-time job. The greater rise in the farm price level relative to wage rates during 1933-37 and 1939-46 removed some of the disparity in price relationships between farmers and wage earners. As a result, trade and industrial production increased.

From August 1939 until January 1947, farm prices rose about 200 percent. Wage rates increased from about 70 cents per hour to about $1.25 per hour, an increase of about 80 percent. The smaller increase in wage rates does not necessarily mean that farm prices and wage rates are out of balance in 1947. This is because wage rates were very high relative to farm prices in 1939.

In periods of rising prices like the period from 1939 to date, increases in industrial wage rates occur rather rapdily, even though they lag behind farm prices. Comparisons between farm prices and wage rates using 1939 as a base of 100, are unfair to farmers because at that date farm prices were relatively low compared to wage rates. If 1925-29 is used as 100, farm prices are now about double what they were at that time and wage rates are a little more than double. Using this period for comparison, industrial wage rates and farm prices in 1946-47 appear to be in fairly good adjustment at a high level. If anything, wage rates appear to be a little high relative to farm prices.

Although it may be possible, there are no instances known to the writer in which United States farm prices rose rapidly enough to unbalance the relationship between earnings of industrial workers and farmers and cause a decline in business activity. This may be true because during periods of rising prices it pays to risk and invest capital; as a result, employment tends to be high. It is true that for some portions of the population a rising price level seriously decreases purchasing power. Among this group are mortgage holders and investors in government bonds. The share of the total income represented by these investments is small when compared to the incomes affected by a falling price level.

When the price level falls, it becomes extremely difficult to maintain trade between city workers and farmers because farm prices fall much more than do industrial wage rates. Farm incomes are low and some unemployed city workers are practically without earned income. Falling prices mean losses in inventories; they discourage risk taking; and they are accompanied by decreasing business activity

and an increase in unemployment. The unbalance in exchange rates between farmers and city workers is extremely serious because such a large percentage of the population is involved.

After reading from different schools of thought on the subject of business activity and the general price level, I have concluded that most writers agree that there is a close association between changes in industrial activity and changes in the general price level. The area of disagreement lies in determining which factors are causal. This becomes an important question because the price policies which should be adopted to cure the disequilibrium would vary depending upon which factor is determined as causal. Dr. Schultz, in his recent book, from which I have previously quoted, writes:

> "The general level of prices is identified with the value of money. The ever-changing value of money has brought many difficulties to American farmers. The history of our agrarian movements expresses the concern of farm people about money values.....To counteract the declining price level after the Civil War, the agrarian movements turned to greenbacks, to monetization of silver, and to many variants of a commodity dollar.
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> "In modern terminology, this concern about the value of money would be expressed as concern about fiscal-monetary policy. The appropriate aim of fiscal-monetary policy is a stable price level at full employment." 2/

Many economists view the problem of a changing price level for agricultural commodities as being basically one of changes in business activity and in the income of industrial wage earners. They reason that the line of cause to result goes from high business activity to high purchasing power of industrial workers to high demand and finally to high prices for agricultural commodities. On the basis of this reasoning it has been argued recently by some people, most of them not professional economists, that the most important thing necessary to maintain demand for farm commodities and farm income is an increase in wage rates so that earnings of industrial workers will remain high.

The important question is: Do serious depressions arise mainly from factors independent of business activity that cause changes in the value of the monetary unit; or do factors within the business activity cycle itself cause first, variation in business activity, then unemployment and lower purchasing power for consumers, and finally a lower price level? Personally I have concluded that the basic causes are those which change the value of the monetary unit. I would include as possible causes of a depression all factors that might influence the value of the monetary unit.

Let me hasten to add that I recognize the existence of production cycles in business. These, however, I believe to be largely independent of monetary and fiscal factors that influence business activity.

For example, you are all familiar with the various cycles in livestock production. In addition it can be statistically demonstrated that there is a building production cycle, a textile cycle, an automobile cycle and many other cycles too numerous to mention. Fortunately these cycles are of varying lengths and seldom combine to cause serious overproduction in several lines at the same time. This factor of over and underproduction and its influence on business activity, however, has not been, in my opinion, the cause for the most serious

2/ Schultz, T. W. Op. cit., p. 253.

periods of business inactivity or falling farm prices. In order to cause a serious fall in basic commodity prices these factors would have to have world-wide influence because as previously shown basic commodity prices move together on a world basis in a depression. These over and underproduction cycles tend to influence the value of a particular commodity or the employment in a particular industry much more than they influence the general basic commodity price level or over-all business activity.

One of the results for holding the view that monetary factors are largely responsible for changes in the general price level is that basic commodities maintain a close value relationship to each other both on a national and international basis. Therefore, important price level factors must be world-wide or the value of a national monetary unit must be changed relative to other monetary units in the world in order to change the internal basic commodity price level. 3/ If industrial activity were the dominant factor in farm price levels important regional and national difference should be found in farm prices associated with local and national differences in business activity. Otherwise one must argue that business activity on an international basis caused the decline in basic commodity prices in 1929-32. It seems more logical to me to reason that the value of money in gold standard countries increased because gold increased in value.

The basic commodity price decline in 1929-32 occurred only in countries on the gold standard. According to Dr. A. B. Lewis 4/ basic commodity prices rose in China from 1929-31 because silver was falling in value and China was on a silver standard.

There is also considerable evidence to show that those countries like Sweden, Australia, and Canada who devalued their currencies early following the general world price decline in 1929 had increased business activity relative to the countries that did not manage their currencies.

If the main problem of agriculture and industry is in the instability of the general price level--for agriculture because prices fall more than costs of finished goods and for industry because the unbalance in the price structure causes unemployment, then it would seem logical to attack the problem as a monetary and fiscal problem.

Although Professor Schultz may arrive at his conclusion by a different route than I have, he indicates a similar conclusion when he writes:

> "There is a growing consensus among economists that fiscal-monetary measures are the appropriate remedy for what we have referred to throughout this chapter as business fluctuations. Fiscal-monetary measures, broadly defined, are the actions of the government entailed in the issue and retirement of money, the spending as well as the raising of money, through taxation and public expenditures and through public borrowings and repayments, including government loans to individuals and corporations. Fiscal-monetary measures have this outstanding advantage: they are a means of attaining essential stability at a high level of employment and production within the framework of an enterprise economy." 5/

3/ If value relationships of basic commodities are world-wide, price changes will be world-wide unless a country changes its monetary exchange rate.

4/ Dr. Lewis was at Nanking University from 1933 to 1936 making extensive studies on Chinese prices. During the war Dr. Lewis was associated with the Division of Foreign Agriculture.

5/ Schultz, T. W., Op. cit., p. 219.

The last sentence in this quotation is especially important because most of us are interested in "attaining essential stability at a high level of employment and production within the framework of an enterprise economy."

The Committee on Agricultural Policy of the Association of Land Grant Colleges published a statement in April 1947. 6/ This report states:

> "Continuous high-level production and employment throughout the economy can be fostered by appropriate fiscal, credit, and monetary policies."

If a stable price level can be established, it seems probable to me that we might eliminate some of the other serious problems that confront our economy and agriculture. I am inclined to think that restrictive trade policies of groups are fostered by a declining price level and inactivity in business. Basically I see no difference between the conditions under which trade restrictions grow nationally and internationally. When a price decline occurs and the prices of basic commodities fall relative to the prices of finished goods, trade between areas within countries and between countries becomes difficult. As a result labor unions adopt policies of restricting movement of workers into their kind of employment. Farmers adopt polices aimed at restricting production and maintaining prices for their individual commodities. Businessmen argue for "buy at home" policies. Nations erect numerous trade barriers. The mechanism by which these restrictive polices can be accomplished are different on a national and international basis but the cause appears to me to be highly associated with severe declines in the general level of prices.

Present Agricultural Price Polices. A paper on price policy would be incomplete if it did not recognize the present laws on our statute books which are tied back to a parity price base, usually 1910-14. These laws apparently have the support of farmers and most farm organizations. It would be unrealistic to assume that farmers will give up the economic gains which they believe these laws have brought to them unless they are pursuaded that a substitute policy will bring them more benefits.

One phase of an educational program on price policy is to point out the weaknesses of the present policy. The main weakness in our present farm price program, as I see it, is that it deals with individual commodities rather than the over-all general price level and business situation. There are other weaknesses in the parity concept. Some of these have been pointed out by Professor Jesness of Minnesota:

> "A formula to measure parity which depends on relationships of the past is basically unsound. It rests on the assumption that there is a fixed relationship among prices to be preserved indefinitely. It assumes no change in efficiency or that changes are equal in all lines. It assumes no changes in demand. It over-looks the longer-run effects on both agricultural and general welfare. Its supporters do not seem to recognize that adherence to the parity dogma leads in the direction of accepting arbitrary price maintenance and the controls which that involves." 7/

The continued use of a parity formula could prove to be detrimental to agricultural workers in relation to workers in other industries because agricultural prices must rise over a period of time to keep income relationships between

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6/ Committee on Agricultural Policy, Association of Land Grant Colleges and Universities, Long-Run Effects of Price-Maintenance Policy for Agricultural Products, April 1947.

7/ Jesness, A. B., "Post War Agricultural Policy," Journal of Farm Economics, Vol. XXVIII, February 1946, p. 10.

industrial workers and farmers in balance. This is because changes in rates of production per person require some offsetting price changes to maintain this balance. If workers in industry have increased their net production per person faster than workers in agriculture, the price of agricultural products should increase relative to the price of non-agricultural prices in order to retain a past income per person relationship. This they have done (fig. 8). Likewise, if the bushels of wheat per man hour have risen more than the pounds of milk per man hour, it seems likely that the price of milk should increase relative to the price of wheat if any historical balance in income per hour is to be maintained. 8/

Price as a distributor of resources and income is handicapped, therefore, by parity formulas that remain rigid and do not reflect changes in efficiency of production.

Some supporters of the 1910-14 base period do not realize that agricultural prices have risen relative to non-agricultural prices over a long period of time. This is due to the fact that the declining price periods in the 1920 to 1940 era temporarily obscured this relationship. Nevertheless, it seems likely that over a period of years agricultural prices should rise relative to non-agricultural prices in order to maintain a balance in income per person of each group. Any price policy or program which attempts to maintain a static relationship between agricultural prices and non-agricultural prices eventually will be unfavorable to agriculture.

Related Agricultural Income Problems. Not all income problems in agriculture are direct results of fluctuations in the price level or fluctuations in prices between commodities. One such income problem that influences agricultural price policy is the excess population that is continually piling up in rural areas. This has been more fully discussed by several agricultural economists than space in this paper will allow. 9/ Suffice it to say that the greater birth rate on farms than in industrial areas together with increasing agricultural production per worker and a more elastic demand for industrial products has made it necessary to continually shift population from rural areas to industrial areas. In a price economy like ours the shifting of resources, including labor has been done by price. This has required and will continue to require a higher income per person in industrial centers compared to rural areas in order to shift population. A price policy that does not recognize the relative overpopulation in rural areas might waste resources by assuming that differences in incomes should be equalized between rural and industrial centers. This probably would stop the flow of population from surplus population areas to industrial centers.

The fact that rural areas produce population for industrial centers poses important questions of price policy regarding education, health, and public services. To what extent should these be subsidized out of public money and considered a general welfare problem? What proportion of the subsides should come from local, state, or federal tax revenues? It should be recognized that lack of education, doctors, hospitals, electricity, all weather roads, and the like are economic factors that encourage population movement from rural to industrial areas. To delay this movement is economic waste. On the other hand it is also a waste of economic resources to limit the education and health of future citizens just because they were born in a rural area.

8/ In the above comparisons changes in capital required per person should be measured before arriving at a final conclusion, but the principle involved, the need to change relative prices between groups and between commodities in order to maintain income, holds as long as productivity varies per hour or per person.

9/ Schultz, T. W., Op. cit., Chapters III and IV.
Jesness, A. B., Op. cit., pp. 7 and 8.

Most people agree that education and some health needs should be met by public subsidies because they so definitely affect the future productivity of the citizen. The agreement is not nearly as complete regarding subsidies for facilties like electricity.

I would like to stress two principles regarding income subsidies to rural areas. First, the taxation from which the subsidies are to come should in my opinion be paid partially from local and state sources. It has been altogether too easy in a democracy to vote federal taxes supposedly out of the other fellow's pocket.

Secondly, subsidies should be avoided if they encourage settlement or retain population in areas in agriculture which even with the subsidy provide a low level of living. Many agricultural areas remain settled only because public and private money comes in from outside the area. The low income per person in such areas is often confused with the price problems of agriculture and even more often as a size of farm problem. The Department of Agricultural Economics at the State College of Washington had made extensive studies of these low income areas in the state of Washington. We are convinced from our studies that the basic problem is relatively low productivity per person associated with low productivity per acre. We doubt whether any agricultural use can be found for most of these areas that will produce a higher comparative advantage than the present land use pattern in such areas. Under the favorable agricultural price relationship of 1944 our records show very low returns per person in many areas in our state. Although returns per person in such areas were higher in terms of level of living than they were in less favorable price periods the spread in returns from agriculture widened between the most productive agricultural areas and the least productive. The spread in income per person between low income agricultural areas and a job in industry also widened. Thus the principal benefit of high prices and industrial activity to these areas came in the off-farm job opportunities. These increased greatly from 1940 to 1947.

Subsidies put into low income areas can result in poor utilization of resources. For example, some settlers in low income agricultural areas probably would seek better alternative opportunities in industry if it were not for the fact that society in general helped furnish electricity, roads and relief.

The problem of low income areas is second only to the price problem, but should not be confused with it. Agriculture in the state of Washington probably has at least an average income per farm for the United States, but our studies have indicated that as many as one-third of our farms are located in low income areas. The solution to this agricultural problem does not lie in subsidies to increase agricultural income. Rather the welfare of these rural people is dependent upon our ability to maintain an economic climate that provides balance in our economic structure and high industrial activity. If farm prices are in balance with non-farm prices and industrial activity is high, many of these people will move to industrial centers or commute to industrial jobs.

I have outlined three price goals. The goal of reasonable stability in productivity and income per person between years has not been met to date. I have contended that the cause of this difficulty lies in the fluctuating general price level, that is the variation in the value of the monetary unit. These fluctuations cause unbalance in price between important groups in our economy and disrupt trade. It is my belief that the cause of the difficulty lies in our monetary and fiscal policies. The cure for this problem, I believe, will be found by changing our past monetary fiscal policies.

Although I could not endorse the entire agricultural price policy program of the American Farm Bureau Federation I can heartily endorse the quotation that follows: I expect some restriction programs to be used in agriculture in the

next few years, but the extent and duration of these programs will be less if the following policy statement is adopted.

"A more stable price level is essential to the prosperity of agriculture and all other segments of the economy. When a material change in the general price level occurs, the prices of some products change more rapidly than others. This results in serious dislocations in the economy, particularly when the price level declines. Farmers, probably more than any other large group, are vitally affected by a change in the general level of prices. When prices in general decline, the prices of farm products, along with other raw material prices, decline more rapidly and further. Commodities used in farm production fall more slowly, resulting in a disparity for agriculture. If the price level continues on the lower plane, farm commodity prices and items used by the farmer in production are slow to come into adjustment. With farming, a business of slow turn-over and narrow margins, such price disparities place agriculture in a serious financial condition.

"We realize that greater stability of the general price level will not solve all our economic ills, but it is a prerequisite to developing workable agricultural programs. We likewise realize that many of the war-created inequities in the price structure will have to be corrected, and price relationships brought into a more normal balance before a program of greater stability can be made effective. However, we feel that now is the time for the nation to adopt such a program in order to avoid unreasonable price fluctuations in the future.

"Although the use of new governmental techniques are involved in the proposals for adding greater stability to the price level, it should be recognized that control of the monetary, credit, and fiscal policies should rest in the hands of the Federal Government, as is prescribed by the Constitution. Therefore, the problem is not one of delegating additional authority to the Federal Government in new areas, but rather one of reshaping and coordinating the policies in the fields in which government policy now largely prevails so that they will more definitely contribute to a stable price level. Unless some success is attained in adding greater stability to the price level and the general economy, the alternative is likely to be attempts to control many individual commodity prices through more detailed types of regulation and regimentation. Governmental controls in the monetary, credit and fiscal policy fields have the advantage of being less personal. They do not require special detailed programs that reach out and control the activities of individual farm businesses.

"The control of money, credit, and fiscal policies of the Federal Government should be coordinated under one authority. This should be an independent agency, the membership of which should be appointed by the President and confirmed by the Senate. The policies of this monetary authority should be regulated as far as feasible by formula, based upon some established index which would direct the authority to take action when the index reached certain levels in order to promote a dollar of constant purchasing power."