

Methods of Stabilizing Commodity Prices

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Producers must have some assurance of price stability if the increased production of the cereals called for in the production goals for most developing countries are to be achieved.

Wide fluctuations in cereal prices are neither in the interests of producers or consumers. Most governments have recognized this. The United States recognized this need back in the late 1920's when it embarked upon an effort at commodity stabilization.

All too often in these efforts, the primary motive behind the so-called stabilization programs in reality has been enhancement of prices, however. There is a basic difference between stabilization and price enhancement.

Programs for the enhancement of incomes attempt to raise the level of farm prices beyond that which would otherwise prevail, either through affecting the supply of the product coming to market or stimulating the demand for the product. Other approaches are to reduce costs for the producer, or to transfer income to the producers through direct payments from the public treasury.

NOTE: This text is the basis of Mr. Kutish's oral remarks. It should be used with the understanding that some material may be omitted or added during presentation.

The word "stabilize" means to contain variations within reasonable limits. Variations in commodity prices are caused mainly by fluctuations in available market supplies and by changes in domestic or foreign demand. Stabilization programs operate to reduce these variations for both producers and consumers through more orderly marketing, by maintaining reserve stocks in line with the risks and uncertainties, and by protection against undue declines in demand and through crop insurance programs.

Surplus removal during short-term periods of supply-glut has both income raising and stabilization features. The United States has used surplus removal to help stabilize the price of perishable products. The motive is both to stabilize prices in the short-run and to prevent too sharp an output reduction in response to abnormally low prices resulting from short-term surpluses.

United States Experience

Theoretically, the question of the "best" amount of reserve grain stocks to carry in the United States should be based on weather variability one year to the next, and its interrelationship with the variability in the demand one year to the next -- coupled with the degree of price variability the nation is willing to tolerate.

A study of farm program history over the past several decades, indicates that the size of grain stocks in the United States in fact has resulted from decisions made primarily with other objectives in mind. In most cases, the stocks were accumulated as a by-product of farm programs designed to assist farmers by raising prices.

The first active public stabilization program in the United States was begun in 1929 when the government established the Federal Farm Board. The approach was to attempt to stabilize available market supplies. Loans were made to cooperatives to engage in merchandising programs, in which commodities were withheld from the market in an effort to practice "orderly marketing." The collapse in demand from the 1932 Depression proved too much, however, and brought the Farm Board's death.

The next move by Congress was to establish in 1933 the Agricultural Adjustment Administration, through which the government undertook to control farm production and make limited direct payments to help support income. The objective here was clearly income enhancement -- to raise farm prices. Secretary Wallace proposed an "ever-normal granary" with a comparison to the biblical parable of storing during the 7 years of plenty for the years of lean. His idea was to use loans and crop insurance in kind, as a stabilizing mechanism. But the serious financial conditions of the cotton and corn producers led the Congress to set non-recourse loans at a higher level than Secretary Wallace envisioned. The loans were begun as temporary measures to give the farmers in advance some of the benefits to be derived from controlled production and to stimulate farm purchasing power as part of the recovery.

The Department of Agriculture attempted to reduce hog production and raise the income of hog farmers by buying pregnant sows and little pigs. But the public reaction to "killing those little pigs" was so great that the program was stopped immediately.

The efforts at crop production control were not very successful, however, and government stocks began to accumulate.

The Agricultural Act of 1938 attempted to add marketing controls to production controls. The new features provided for mandatory non-recourse loans for corn, wheat, and cotton if marketing quotas^{1/} were voted by the producers. It also provided for loans at the option of the Secretary for other commodities -- with supplemental income payments to the producers of corn, cotton, rice, tobacco, and wheat.

Although crop allotments were in effect for corn -- and allotments and marketing quotas for cotton, tobacco, and wheat -- output did not decline proportionately with the cut in acreage. Yields per harvested acre began an upward trend. Then World War II broke out providing new demands for farm production as well as using the accumulated stocks in storage.

The large stocks of wheat, cotton, and corn resulting from price support loans which had caused criticism of the "ever-normal granary," became a military reserve of crucial importance after the United States entered World War II. Concern over the need to reduce the buildup in government stocks changed to concern about producing enough to meet war and postwar needs. Congress passed legislation to raise the loan rates as an incentive to wartime production.

^{1/} A marketing quota constituted the total amount of a crop which could be marketed during the year. The national quota was then divided up into individual quotas for each producer, who then was subject to penalty if he sold more than his quota for that year.

The War, followed by early post-war reconstruction in Europe, provided enough demand to absorb all farm production as well as the stocks which had accumulated during the 1930's.

With the end of the post-war reconstruction era in the late 1940's, surplus grain stocks in government hands again began to mount. National farm output once again expanded faster than the market would absorb at prevailing support prices. Carryover stocks grew. One of the important forces that helped expand farm output in the post-war years was the fairly high level of government price supports. To protect farmers from a repetition of the 1920-21 collapse of farm prices which followed World War I -- and to reward farmers for their production expansion during World War II -- Congress extended the wartime price support provisions for 2 years beyond the war's end. These wartime price supports were scheduled to expire at the end of 1948, but Congress continued the high price support loans.

The Korean Conflict gave a brief relief to mounting surplus farm stocks, but by 1953 the expansion in stocks again was on its way. Wheat marketing quotas were restored in 1954. Then in 1956, in an effort to restrain production, the Congress passed the Soil Bank Act, encouraging farmers to retire productive land in return for payments. However, this type of program did not become large enough to greatly restrain output and this program was largely abandoned in 1959.

By 1961, feed grain carryover stocks had built up to nearly 85 million tons and wheat stocks to more than 1.4 billion bushels. It became apparent that something more had to be done. It was costing the Department of Agriculture over a million dollars a day just to store and maintain the surplus farm stocks in its hands.

So the U.S. governmental farm policy again shifted to stronger attempts to control grain production while at the same time the Congress directed the Department of Agriculture to reduce its holdings. Supply control programs for grains and cotton were put into effect. But the loan rates were maintained relatively high.

Then in the mid-1960's another shift in United States farm policy took place. A definite effort was made to partially separate the level of income objective from the stabilization objective. Commodity loans were lowered to near or below market prices. The loss in income to farmers through the lower support price was offset by direct commodity payments. Meanwhile, acreage adjustment efforts were stepped up in an effort to restrain production in line with demand to maintain a competitive market price.

Present U.S. government policy takes the position that it would be unwise to again accumulate a large government stockpile to hang over the market. Experience has shown that once heavy government-owned stocks are built up, an opportune time to sell off the surplus never seems to come.

Prices that are supported too high complicate the voluntary acreage adjustment programs for the next year. Farmers then are inclined to want to produce more of the product and less inclined to participate in the voluntary adjustment programs -- or else the payments for participation have to be increased in line with the market supported at the higher level. Too-high prices also restrain the utilization of the product as well as encourage production by other Nations producing that product.

The United States Department of Agriculture does not have programs limiting production of fruits and vegetables. However, there are programs available which can affect prices and supplies, namely Federal-state marketing orders, various purchase programs, and promotional efforts both in the United States, and in a more limited way, foreign outlets.

Federal-state marketing orders for fruits and vegetables have been authorized since 1937. They can regulate the handling of these commodities by standardizing packs and grades which can have the effect of regulating the market and supply. A marketing order, upon approval by two-thirds of the growers voting, becomes effective, requiring that the product meet certain size and quality standards in order to be marketed. More than forty are currently in force.

Fresh and processed fruits and vegetables are purchased for the National School Lunch Program and for distribution to needy persons. Funds come from customs-house receipts. Often these purchases are made when certain items are in especially heavy supply.

Under the Plentiful Foods Program, the Department of Agriculture works with producers and marketing groups to inform the public of items in heavy supply in order to stimulate consumption.

International Experiences

Most of the early international commodity price stabilization schemes also dealt with price alone. They set up certain target sale prices for the commodities. The exporting countries were not to sell at below these prices. In some cases, export quotas were assigned to the different exporting countries. In some of the agreements importing countries were to maintain certain minimum purchase prices.

No serious efforts at restricting the production at these levels were made. If the price was high enough to be profitable, producers expanded production -- and stocks piled up. The smaller export producing countries usually managed to get an increasing share of the international market at the expense of the market share of the larger producers. The reason: The larger producing countries had the biggest stake in maintaining prices. So they found it more in their short-run interest to restrain marketings to offset the increased supply from the small exporters than to continue to fight for their entire share of the market and drive down prices. But excessive stocks eventually accumulated in the major exporting countries, however, and price-cutting resulted.

Latin American Experiences

Most Latin American governments have established some kind of governmental agency to stabilize the price of cereals and charge it with the responsibility for supporting the price of cereals to the producer and at the same time giving the consumer protection against unreasonably high prices later in the season.

The typical method by which most Latin American grain stabilization agencies have attempted to perform this first function -- that of stabilizing the price to the producer -- is to set a floor price to the producer. It is carried out by offering to purchase grains from producers at the support price in the harvest period. Often this offer has been restricted to those producers who signed contracts with the government stabilization agency.

The stabilization agencies typically have attempted to stabilize prices to the consumer by subsequently selling the cereals which they purchased at harvest. The sales may be made at retail through governmental agency distributors, or wholesale, or through both methods. In addition, government agencies have imported cereals where needed to maintain adequate supplies and to avoid unnecessarily high prices for consumers.

In most countries where these operations have been carried on, little attention has been paid to specific measures designed to reduce seasonal producer price variations. Nevertheless, there has been some reduction

in the seasonal variation in the price of the basic cereals -- corn, grain sorghum, rice and beans -- over the past two decades. This is probably due to a combination of two forces: The increasing volume of trade in these basic cereals and the effects of the stabilization agencies in various countries. The price effects of the increasing movements of trade have been especially great in deficit producing countries where this has made more cereals available in the latter part of the marketing year -- just before the new harvest.

Despite this, in many cases these stabilization agencies have not been successful in containing the seasonal consumer price variations of those grains within the limits of the maximum and minimum prices the agency has set for their overall targets. Furthermore, not all producers have been getting the benefits of the price floor purchases by the stabilization agencies. Many of the small producers have sold their grain below the minimum support price.

Part of the problem faced by these price stabilization efforts grows out of the fact that they also are trying to maintain farm prices at a level sufficiently high to raise farm income. Thus, domestically desirable and politically acceptable floor prices have been used by the stabilization agencies in addition to the criteria related to price stabilization in setting minimum price supports.

Everyone will agree that efforts to raise farm income, especially for the small farmer, are worthy. But in a market setting with ample trade opportunities, efforts to raise farm income usually run into trouble when minimum price supports are set above the level of neighboring country prices plus the cost of transportation. The governmental stabilization agency soon finds itself burdened with purchasing locally produced grain for price support, while grain from the neighboring countries flows in to keep the local farm price below the support level.

As a result, a substantially increased share of the local crop must be taken over by the stabilization agency in order to maintain its minimum price support. The agency soon runs out of sufficient storage capacity. The Agency finds that a program to finance the purchase and storage of a major share of the nation's harvest can turn out to be tremendously expensive -- to say nothing of the need for obtaining the long term capital to build the needed grain storage facilities. What's more, in many of the developing countries, local grain prices already are high relative to world prices. Higher grain prices are not in the interest of their consumers and only of short-run benefit to their producers when they stimulate imports and create excessive local production.

It is clear that the agricultural policy of a country must have some method of raising income to small producers other than governmental stabilization agencies purchasing grain at harvest time for a floor price

which attracts grain from neighboring countries. Most developing countries have had considerable difficulties in implementing stabilization programs in a way to reach the great mass of small producers. Thus, there is need to examine the objectives and methods used by governmental stabilization agencies for price stabilization purposes.

As pointed out, the typical stabilization method consists of a harvest-time purchase program. Sometimes, in order to be eligible, a producer must sign an agreement offering to deliver a stated quantity of grain to the governmental stabilization agency.

The stabilization agency agrees to buy this agreed quantity of grain from that producer during the stated post-harvest period -- or sometimes a smaller proportion of that offered by each producer if the total amount offered by all producers exceeds the finances of the Agency. However, the grain must be delivered by the producer to the governmental silo or warehouse and during the stated period.

This method has several shortcomings: It results in a hardship for small producers who must assemble and transport small quantities of grain a long distance to be eligible for the price support purchase. In practice, many don't participate and as a result sell at substantially lower prices to intermediaries.

One alternative would be a governmental loan guarantee or purchase agreement for grain with an advancing seasonal price support level. The grain support level could increase enough per month from harvest through the post-harvest period to cover monthly interest and storage costs. The producer who signed up for such a program would agree to store the grain and be responsible for maintaining its quality. He could either get a loan backed up by the government guarantee of the support price from a bank or a governmental credit agency, or carry the grain himself without a loan. The grain could be stored on the farm or in a private commercial warehouse.

In some of these countries, farmers don't have the means to fight rats and insects in their own storage, and local commercial warehouses probably are very much lacking. Here, maybe the answer would be cooperative storage warehouses.

At the end of the loan period, the producer would be obligated to either deliver the grain to the stabilization agency, who then would pay the lending agency on the quantity and quality of grain delivered -- or, if the market price had risen above the guaranteed support, the producer could sell the grain himself on the market at the market price. Then he would pay off the loan and interest to the lending agency. If the producer had not taken out a loan but only signed a purchase agreement, he could deliver the grain and get the full support price from the stabilization agency -- or if the market price were higher than the support price, he could sell the grain on the market without having to pay the interest on the loan.

In any case, the government would not have its funds tied up through the actual ownership of this grain nor would it have the cost of providing physical storage and handling of this grain during this period. The advance in the support rate probably would appeal mostly to those larger producers who could finance the holding of the grain on their own farms or in commercial warehouses.

Thus, the government's use of funds for outright purchase of grain during the early months after harvest could be directed mainly at making such support purchases available more easily to the small producers not able to obtain storage and storage financing for their own on-the-farm storage. These producers, for the most part, now are not able to take advantage of the stabilization program. Instead, they must sell at harvest time to speculators and traders at a lower price. Thus, the availability of the minimum price support by the stabilization agency would be a significant economic advantage to a low income group of small producers. It would also help to reduce the seasonal variation in the price of grain by raising the farm price at harvest.

By the time the loans expired, the agency would have resold part of its earlier purchased grain for consumption -- freeing space for the takeover of such purchases as would be necessary from its loan guarantee and purchase agreement activities as described heretofore.

Such a program of loan guarantee by the governmental stabilization agency also could form the basis for a government licensed and bonded public warehouse industry owned and operated by private commercial interests.

Producers could store their grain there for a fee, with the price protected by the government loan and purchase guarantee.

It is evident that a vigorous, effective program to encourage investment capital for the construction and use of both private commercial grain storage and on-farm storage will be needed, to implement such a program. Training and technical assistance programs in the management of this commercial grain warehousing industry likewise will be needed. However, it is apparent, also, that to the extent such program succeed in expanding both commercial and cooperative private storage and on-farm storage facilities, the burden of providing storage facilities by the government itself for price stabilization will be lessened.