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Floors for Farm Products*

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Commodity loans and price floors
for farm products

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ARM *and* FOOD POLICY

Pamphlet No. **6** in the Series

COMMODITY LOANS AND PRICE
FLOORS FOR FARM PRODUCTS

by

GEOFFREY SHEPHERD

Twenty Cents

THE IOWA STATE
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WARTIME FARM AND FOOD POLICY SERIES

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fair. To mobilize our nation's giant strength for war necessarily means a drastic readjustment in our ways of producing, distributing, and consuming everything we make. A few laggards, and people working at cross purposes, can slow down the whole nation if government authority is not used to bring them into line. But authority is not a substitute for public understanding and acceptance. As a matter of democratic principle and of efficiency, the citizens must know what has to be done in economic mobilization—and why and how. This series of pamphlets, prepared by members of the Department of Economics and Sociology at Iowa State College, deals with the what, why, and how of agricultural policy and food management.

Previous pamphlets have outlined the broad relations of food to the war effort and sketched techniques of dividing food supplies and getting maximum production. The use of farm prices to obtain the kinds and amounts of food production needed, the mobilization of necessary farm labor, a food rationing program to maintain a high level of morale, and changes needed to put dairying on a war footing have been examined in detail.

This pamphlet, "Commodity Loans and Price Floors for Farm Products," deals with the agricultural price controls that now rule the markets for farm products. The legislation under which these controls operate needs revision. It is basically peace-time depression legislation, not well adapted to war and postwar purposes. This pamphlet offers suggestions for bringing the legislation up to date.

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Ames, Iowa, April 12, 1943

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COMMODITY LOANS AND PRICE FLOORS FOR FARM PRODUCTS

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SUMMARY AND RECOMMENDATIONS*

The commodity loans of the U.S.D.A. are a powerful tool for controlling the prices, production, storage, and consumption of agricultural staples, but they have not been converted from a peacetime to a wartime basis. They are still being used as they were during the 1930's, (1) to stabilize market supplies and prices against fluctuations in production, (2) to stabilize prices against fluctuations in demand, and (3) to raise prices over a period of years higher than they otherwise would be. The first of these three uses is still appropriate, but the second is of doubtful merit, and the third is a misuse at any time; during war it contributes to inflation and interferes with the best use of agricultural resources.

The loan programs have not yet been put on a war footing, chiefly because the law under which they operate has remained essentially the same as it was in peacetime. That law was designed to meet conditions of depression. It does not serve a war economy.

The law providing price floors for "non-basic" products was initiated in 1941, but it is unsatisfactory for war purposes.

These two laws as they stand today are defective in several respects. These defects, and suggestions for overcoming them and harmonizing the two laws, are as follows:

* This pamphlet is based on research carried on under Project 818 of the Iowa Agricultural Experiment Station, Iowa State College, Ames, Iowa. The study also was aided by a grant from the division of the Social Sciences of the Rockefeller Foundation, New York.

Acknowledgements of the professional contributions made by individuals appear at the end.

1. The existing legislation specifies that price floors may be used only to encourage the expansion of production. This restriction should be removed, so that price floors can be used continuously, when necessary to reduce production, or hold it constant, as well as expand it. This would relieve farmers of price uncertainty, and overcome the lag in the response of production to change in prices. It would let farmers know what prices they can count on before they start producing, and encourage them to expand the production of those crops that were needed most and contract the production of those crops that were needed least.

2. The law provides that loans and price floors are to run at existing levels for the duration of the war and for two years after the first January 1 after the end of the war. This is too long a period for given floors to extend into the future. Price floors should be provided as a continuing feature of the agricultural production program through peacetime as well as war, but each price floor should be announced just before planting or breeding time and extend into the future only for one production and marketing period for the product concerned. Lower loans and floors should be used whenever necessary to help reduce production, just as higher ones have been used recently to help increase production.

3. The levels at which loan rates are set each year should be completely dissociated from 1909-14 parity. The uniform percentages of parity used now are too high for some products and too low for others; the relations between prices that are required for war needs are entirely different from those relations that existed in 1909-14. If parity is adhered to, overproduction of some products and underproduction of others are bound to result.

4. The existing law prohibits the CCC from selling more than 300,000 bales of cotton in any calendar month or 1,500,000 bales in any calendar year. This impediment to efficient stabilization operations obviously should be removed.

COMMODITY LOANS AND PRICE FLOORS
FOR FARM PRODUCTS

COMMODITY LOANS

The commodity loan programs of the United States Department of Agriculture have developed over the past ten years to the point where they have become the major factor in the markets for the great staple crops. The Commodity Credit Corporation makes non-recourse loans available to millions of growers on the so-called "basic" crops—cotton, wheat, corn, tobacco, rice, and peanuts. These loans, and the purchases and sales of the physical commodities that the CCC takes over, now practically dominate the markets.

The loan programs were originally designed to meet peacetime requirements. How well are they being converted to war purposes? And how well are they likely to serve post-war needs?

In the early 1930's, the loans were used primarily to smooth out fluctuations in market supplies resulting from fluctuations in yields caused by changes in the weather. That was the original ever-normal granary idea. The loans were also used to stabilize prices against changes in demand. In the late 1930's, the loans were put to a third use. They were employed to raise prices over a period of years.

These three objectives, divergent enough in peacetime, are still being followed. The war has changed the situation completely, but the loan programs are proceeding much the same as they did before war was declared. They have not been converted to war. Instead, they have become a considerable impediment to the attainment of war production goals.

Why is this? Has the Commodity Credit Corporation not been run properly? Have the administrators fallen down on the job?

The answer is: No. The administrators of the CCC have

been doing a very creditable job, but legislative restrictions have kept the CCC in its peacetime groove. The trouble lies with the legislation under which the CCC operates. That legislation is still vintage of 1930-40, set up to deal with fluctuating supplies, low prices, surplus production, and weak demand. It is entirely inappropriate for war.

Obsolete Legislation

The commodity loan legislation now on the statute books stems from the Agricultural Adjustment Act of 1938. It was amended once shortly before the United States entered the war, and again amended in 1942 shortly after war was declared. The existing commodity loan legislation is a 1938 peacetime model—patched up with 1941 and 1942 amendments, but still basically a 1938 model. Our military equipment is as up to date as we can make it, but our legislative equipment for fighting the battle for food is obsolete.

The original Agricultural Adjustment Act of 1933 was very broad and general with respect to commodity loans. It left the Secretary of Agriculture free to set the loan rates where he thought they should be set. In the Agricultural Adjustment Act of 1938, Congress began to circumscribe the Secretary's powers; it specified that CCC loans on wheat, cotton, and corn must be made at rates ranging between 52 and 75 per cent of parity. This still left the Secretary some latitude. But on May 20, 1941, Congress went further, and tied the Secretary's hands completely; it directed the CCC to make loans on the 1941 crops of wheat, cotton, corn, tobacco, rice, and peanuts at a single figure—85 per cent of parity.

On December 26, 1941, this loan rate of 85 per cent of parity was extended to the crops from 1942 to 1946 inclusive. On October 2, 1942, the rate was raised from 85 per cent to 90 per cent, except where that would adversely affect livestock feeding, in which case the rate was to remain at 85 per cent. These loan rates were to extend to "the expiration

of the two-year period beginning with the first day of January" after the end of the war.

That is the legislative strait-jacket in which the CCC has been operating the loan program. These restrictions have reduced the CCC step by step to making loans on the basic crops at rates that are set by a backward-looking mechanical formula dictated by Congress. The CCC is legally powerless to affect these rates, no matter how much the formula gets out of line with the needs of the times, and no matter how completely conditions change from peace to war and back to peace again.

Peacetime Difficulties

The CCC had trouble under this legislation, even in peacetime. The loans were put to three uses. The first use was to smooth out fluctuations in market supplies. This was a straightforward physical storage and "unstorage" operation, and lay well within the powers of a loan and storage agency like the CCC. The loans were also used to stabilize prices against fluctuations in demand. This course was open to some question. The third use to which the loans were put—raising prices over a period of years—was clearly beyond the powers of the CCC, and the course of events soon proved it.

The Federal Farm Board had gone on the rocks trying to stabilize wheat and cotton prices against the decline in demand that took place from 1929 to 1932. The CCC was more fortunate in starting at the bottom of the depression in 1933, and for the first four years of its life appeared to be pursuing all three of its objectives successfully. Severe drouths in 1934 and 1936, and a rising general price level, enabled it to dispose of all of its stocks of corn and most of its cotton without substantial losses—in some cases, actually at a profit. But from 1937 to 1940, crops were good, price levels ceased to rise, and storage stocks began to accumulate in excessive quantities. By the fall of 1941, the equivalent of a full crop of cotton, half

a crop of wheat, and a quarter of a crop of corn had accumulated in storage. Taking care of these stocks became a major problem. Some of the cotton was seven years old; grain storage facilities were overburdened, and embargoes had to be applied at several terminal markets to prevent grain being shipped in. The loan rates that were used each year, and the size of the stocks that piled up under the influence of those rates, are shown in Figures 1 and 2.

The operation of a stabilization program, of course, requires substantially larger stocks than were carried before; if carry-over stocks previously were not large enough to stabilize prices, the only way to stabilize supplies is to carry over larger stocks from big crops than before. The stocks of wheat and corn that were accumulated by 1941 were not unduly large for stabilization purposes. Only in the case of cotton were the stocks clearly excessive—perhaps two or three times larger than required for stabilization purposes. It was not so much the size of the stocks that mattered; the trouble was that they had been built up over a period when the crops were about average or only slightly larger than average in size. The stocks had accumulated, not as the result of a conscious policy of withholding the excess over average production, but as an incidental result of attempts to raise agricultural prices over a period of time in defiance of the supply and demand situation. This price-raising pressure showed no sign of relaxing, and there was no indication that the stocks would be kept from growing larger. It was evident in 1941 that if a really big crop came along, the stabilization program would have great difficulty in taking care of it, since stocks were already large enough for stabilization purposes, and too large for existing storage and transportation facilities.

Furthermore, the loan programs were all being conducted as purely domestic programs. This was all right in the case of corn, for ordinarily less than 1 per cent of the corn crop is exported or imported. But wheat and cotton are obviously

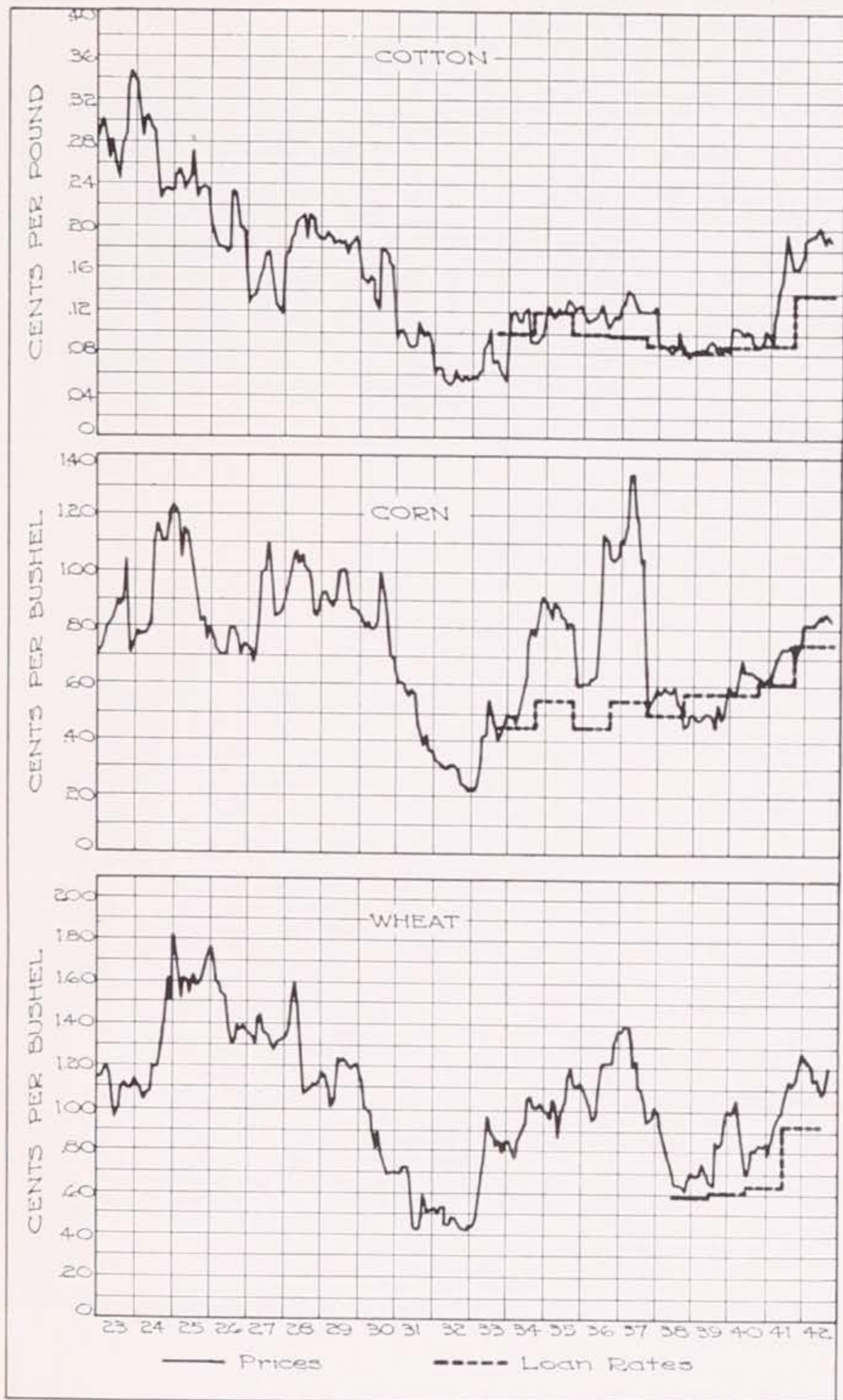


FIG. 1. Prices and loan rates for cotton, corn and wheat, 1923 to 1942. Cotton prices for middling 7/8 inch (15/16 inch after August 1941) spot cotton at 10 markets; corn prices for No. 3 yellow at Chicago; wheat prices for No. 2 hard winter at Kansas City. These prices are used rather than prices received by farmers, because the latter include unredeemed commodities at their average loan values.

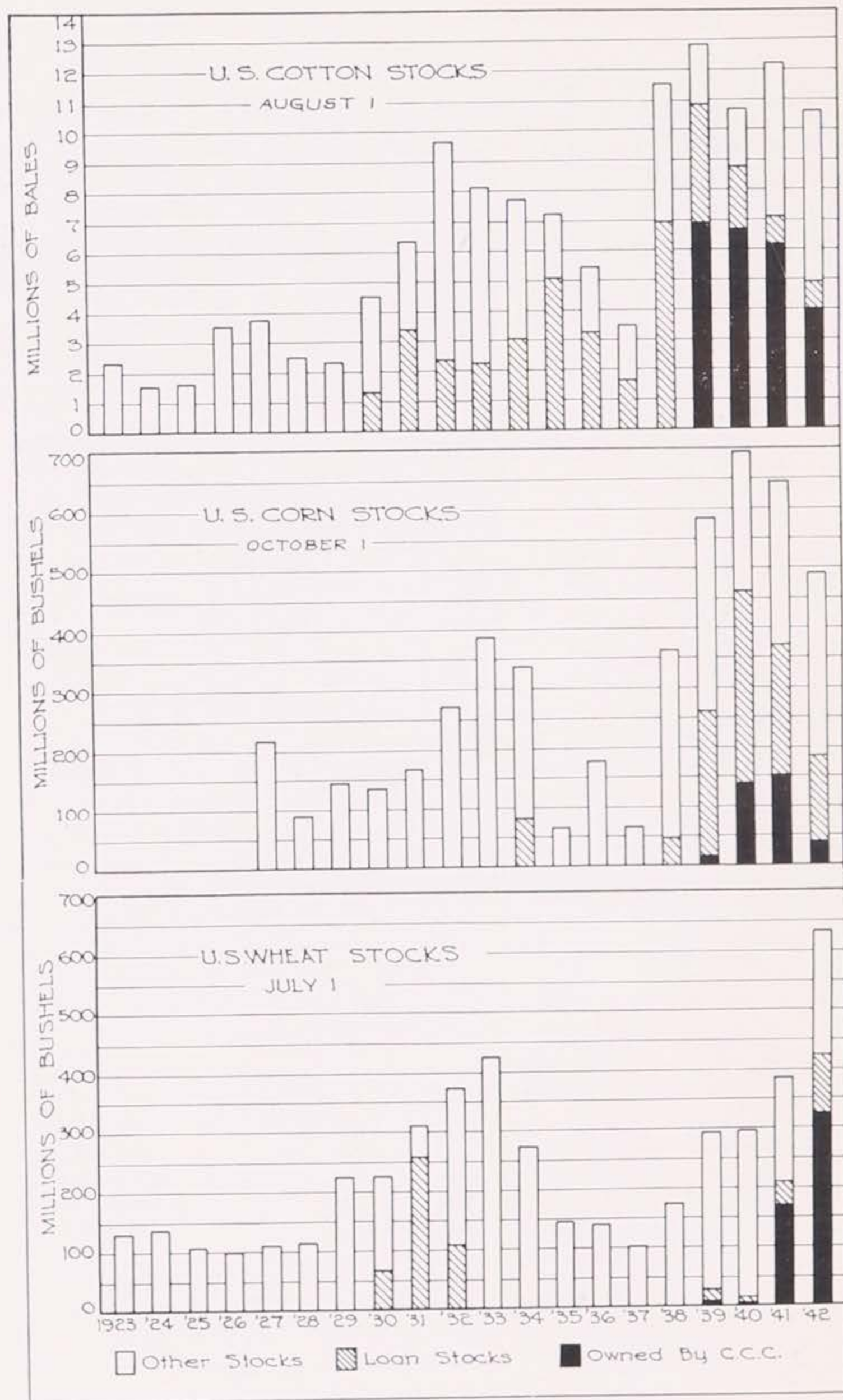


FIG. 2. Quantities of cotton, corn and wheat owned by the CCC, under loan, and "other," at the end of each marketing year, 1933 to 1942. No data for corn before 1927. The quantities shown as under loan before 1933 are those that were held by the Federal Farm Board.

international commodities. In normal times, two-thirds of the cotton crop and one-fourth of the wheat crop was exported. Unless their production is to be shrunk to a domestic basis, their prices have to be kept in line with world prices, and their ever-normal granary programs have to be conducted as parts of international ever-normal granary programs. Corn can be handled on a domestic basis, but cotton and wheat cannot. Yet they were all being handled as domestic programs, ignoring the rest of the world.

War Bailed Out the CCC

The advent of war converted the large stocks accumulated by 1941 from a liability into an asset, but did not change the basic fact that the CCC had been trying to do things that were beyond its powers and would have become involved in major difficulties if the war had not bailed it out. Even the tremendous expansion in demand resulting from the war has only partly overcome these difficulties. The stocks of cotton have decreased to some extent, but they are still too large; and the stocks of wheat have further increased, until now they are about 50 per cent larger than they were in 1941. If the CCC continues to operate as it has been operating, it may bog down completely, buried under unmanageable surplus stocks, when demand declines after the war is over.

The basic function of the loans is to withhold excess supplies (the excess over average production) in good crop years, and release them in short crop years. This converts a series of fluctuating crops into a series of constant quantities released each year upon the market. But if the loans are also used to raise prices or hold them up over a period of years to unrealistic price goals, regardless of supply and demand conditions for the particular crops concerned, trouble is bound to follow. That misuse of the loan technique wrecked the Federal Farm Board a little over a decade ago, and by 1941 brought the CCC close to serious difficulties that would have become acute

but for the great expansion in demand that resulted from the war.

The extent of the difficulties is indicated not only by the size of the stocks accumulated, as shown in Figure 2, but also by the financial losses involved. From 1935 to 1940, inclusive, the general price level, as measured by the Bureau of Labor Statistics index of wholesale prices, was practically constant (except for 1937 when the index was about 10 points higher than in the other years). Data concerning CCC deficits and surpluses are not available before March 31, 1938; but those from 1938 on are given in Table 1. The deficits averaged about \$100 million per year while the price level was constant. Surpluses occurred as the price level rose. It is estimated that losses would have continued at about \$100 million per annum (10 per cent of the original loans) if the price level had continued constant.¹ These deficits would have been much greater if the price level had fallen.

TABLE 1

DEFICITS AND SURPLUSES OF THE CCC

(Appropriations From and Payments to the Treasury as Result of Appraisals)

| | Appropriations from the Treasury to the CCC | Payments from the CCC to the Treasury |
|--|---|---------------------------------------|
| March 31, 1938..... | \$ 94,285,404.73 | |
| March 31, 1939..... | 119,599,918.05 | |
| March 31, 1940..... | | \$ 43,756,731.01 |
| March 31, 1941..... | 1,637,445.31 | |
| March 31, 1942..... | | 27,815,513.68 |
| Total..... | \$215,522,768.29 | \$ 71,572,244.69 |
| Accumulative deficit as of March 31, 1942..... | | \$143,950,523.60 |

Wheat for Feed

In peacetime, the accumulation of larger and larger stocks of farm products, clearly beyond the size needed for stabiliza-

¹J. B. Hutson, President, Commodity Credit Corporation, Address, "Looking Ahead at Our Financial Problems," U.S.D.A. Mimeo., Nov. 6, 1941.

tion purposes, arouses concern chiefly because of the financial losses which they are likely to bring upon the lending agency. But in war, the withholding of products that should move into consumption becomes a more important defect than any financial loss. Accordingly, in the summer of 1942, Congress took a step in the direction of breaching the dam of high prices that was holding up the feeding of wheat. It directed the CCC to make 125 million bushels of wheat available for feeding purposes at 85 per cent of corn parity (83 cents a bushel). The loan rate for wheat at 85 per cent of wheat parity was \$1.14. This action, therefore, amounted to a subsidy of 31 cents per bushel plus freight. The 125 million bushels are all gone now. Except that the CCC presumably had a fortuitous profit in some of this wheat, which had been acquired in earlier years at lower prices, the cost to the Federal government of this subsidy would be \$38,750,000 plus the freight charges for moving the wheat to the feeding area.

This subsidy has been a considerable and unnecessary drain on CCC funds. It is a waste of public money, for the quantity of wheat required for war purposes would be produced in response to a much lower loan rate than the present rate—perhaps one as low as feed prices. This rate would induce "all out" production of wheat for food and feed, and might well serve the interests of wheat producers better than the old policy of AAA restriction coupled with very high loan rates.

The cost of the high loan rate for wheat is greater than is indicated by the figures for wheat alone. In areas where wheat is directly competitive with other crops, the high loan rate is drawing productive resources away from those other crops and into wheat. Higher loan rates or subsidies therefore have to be used for those other crops in order to offset the pull of the high loan rate for wheat. Flaxseed is a good example of a crop for which higher rates will have to be used than if the wheat loan rate were down to a more reasonable

level. Barley is another. In the Dakotas there are many counties in which barley produces much more feed per acre than wheat, and where barley should be grown this year, because we need all the feed we can get. Yet many farmers in this area are cutting down on barley in order to make room for more wheat, simply because the extremely high price of wheat caused by CCC loans makes it profitable for them to do so.

It is impossible to reduce the loan rate for the 1943 crop, for the existing rate has been promised to producers many of whom now have sown wheat in response to that promise. But immediate steps should be taken to lower the loan rate for the 1944 crop. Meanwhile, only the second best alternative can be followed—continuation of the subsidy for wheat feeding. The need for livestock feed is so great that several hundred million bushels more wheat should be fed.²

We need to carry enough wheat in storage to fill up the Old World's empty bread basket for a year after the end of the war, but Europe will get back into production to meet most of its own needs for the second year. A quantitative estimate of the European need during the first year is difficult to make, because of the number of conflicting factors involved—shipping space, the urgency of needs for other products, etc. But after World War I our total exports were only between 200 and 300 million bushels per year, for several years. At present, only 50 million bushels are earmarked as our contribution to post-war relief. The conclusion seems inescapable that we are carrying a larger stock of wheat than we need, withholding it from consumption at a time when we should

² There is plenty of wheat on hand for this purpose. On July 1, 1942, the stocks of old crop wheat in the United States were 627 million bushels. On July 1, 1943, they are expected to be as large or larger. Stocks of wheat in Canada are expected to be 673 million bushels then. Thus the total stocks of wheat in the two countries on July 1, 1943, will be over 1,300 million bushels, with a new crop coming on. Thus even if yields in the United States in 1943 were the lowest they have ever been (11.2 bushels per acre, as they were in 1933) and 56 to 57 million acres of wheat are sown, as expected, supplies would still be abundant.

be converting it into livestock and livestock products. An overly high loan rate for wheat has been the chief cause of this condition; a lower rate would correct it.

Too Much Short Staple Cotton

For some staple lengths and grades, the cotton situation is similar to the wheat situation. The structure of the loan rates for the different staple lengths and grades in relation to the demand has been such that excessive quantities of short staple and low grade cotton have accumulated in store. "The present large supply of short staple cotton makes it desirable that farmers formerly producing cotton shorter than one inch either shift to longer staple varieties in 1943, or shift to other crops, particularly peanuts, soybeans, or feed crops, for which the war need is greater."³

The Department of Agriculture has taken some steps to check the accumulation of short staple and low grade cotton. The loan rates for the 1943 cotton crop show a much greater discount for staple lengths below $\frac{15}{16}$ inch than the 1942 rates, and the discounts for the lower grades have also been increased. But the premiums for the longer staple cotton are increased very little (not at all from $1\frac{1}{8}$ inches up), and the discounts for the low grades in the loan rate are not so great as the December, 1942, market price discounts. The loan rate for the basic grade of cotton ($\frac{7}{8}$ inch) is kept at 90 per cent of parity, the price of cotton is about 20.5 cents per pound,⁴ and the returns per acre for the 1942 crop were \$67, the highest returns on record except for 1919. These prices and returns plus the recent announcement that producers can exceed their 1943 cotton acreage allotment as much as 10 per cent without penalty will retard rather than promote the shift to other crops. The high loan rates for cotton specified in the existing legislation are also increasing the price that

³ Summary legend on the front page of the United States Department of Agriculture Cotton Situation for December, 1942.

⁴ The average price of $\frac{5}{8}$ -inch spot cotton for January, 1943, was 20.44 cents.

must be paid in order to induce farmers to grow the peanuts that are needed. Furthermore, the attempts on the part of Congress to raise parity have been encouraging much speculative holding of cotton.

In addition, two further provisions in the law have made it difficult for the CCC to dispose of its stocks to private buyers. Section 381 of the AAA of 1938 as amended prohibits the CCC from selling any cotton "unless the proceeds of such sale are at least sufficient to reimburse the United States for all amounts (including any price-adjustment payment) paid out by any of its agencies with respect to the cotton so sold. After July 31, 1939, the CCC shall not sell more than 300,000 bales of cotton in any calendar month, or more than 1,500,000 bales in any calendar year."

This is enough to ruin any storage program. If the first provision means that the CCC cannot sell any cotton at less than it paid for it, what is going to happen when the demand and price for cotton declines after the war? Will the CCC have to hold the cotton indefinitely? And even when a favorable time arrives, how can a stabilization corporation that has held nearly 7 million bales of cotton (in 1939) operate effectively if it can sell only 1,500,000 bales a year? The CCC cannot operate successfully with cotton until these provisions are removed.

PRICE FLOORS FOR "NON-BASIC" PRODUCTS

Loans in the "basic" crops are only part of the price-control picture. The prices of the so-called "non-basic" products have also been brought under some degree of control.

Administrative action with respect to "non-basic" products preceded legislation. Early in 1941, it had become evident that a great expansion in the production of certain commodities would be needed to meet lend-lease and domestic needs. In order to bring about this expansion, the Secretary of Agriculture announced in April, 1941, guaranteed minimum

prices for several farm products, to be implemented by government purchases in the open market. The price floor for hogs was \$9 per 100 pounds at Chicago; for butter, 31 cents per pound; for chickens, 15 cents per pound; and for eggs, 22 cents per dozen.

Legislation soon followed which gave the Secretary specific authority to use price floors to increase production. In July, 1941, Congress enacted Public Law 147, commonly referred to as the Steagall Amendment. This amendment directed the Secretary, whenever during the present emergency he found it necessary to encourage the expansion of production of any nonbasic commodity, to support its price "through a commodity loan, purchase, or other operation" at not less than 85 per cent of parity or comparable price.

Up to that time, guaranteed minimum prices (or price floors, as they were called) for perishable products had been used only in times of rapidly expanding demand, for the purpose of encouraging farmers to expand production. In the latter part of 1942, however, the emphasis was shifted from raising the prices of certain crops in order to stimulate their production, to supporting prices or at least retarding their rate of fall after the war is over. On October 2, 1942, Congress enacted Public Law 729. This law retained the proviso that price floors for nonbasic crops were to be used only when necessary to encourage an expansion of their production, and raised the 85 per cent minimum to 90 per cent of parity. In the same law the commodity loan rates on basic crops were also raised by 85 to 90 per cent (except where that would adversely affect livestock feeding). In addition, the floors and loan rates were both extended for two full calendar years after the end of the war.

Under this legislation, the Secretary of Agriculture set the floors for several nonbasic products higher than the minimum levels prescribed by law for those products, for in most cases a floor at 90 per cent of parity would have been too low to

induce the desired expansion in production. The floor for hog prices, for example, is \$13.75 per 100 pounds at Chicago, which is about 30 per cent higher than the minimum 90 per cent of parity prescribed. But these floors that are above the prescribed minimum extend for less than two full calendar years after the end of the war. For example, the floor announced for hog prices extends only to September 30, 1944, not to December, 1945 (the time indicated in the legislation if the war were to end in 1943). The floors announced for most of the other products extend only to June 30, 1944. These periods are shorter than those specified in the law.

DEFECTS IN EXISTING LEGISLATION

The two-fold legislation outlined above, providing commodity loans for basic products and price floors for nonbasic products, gives the Department of Agriculture powers to do certain essential things; but it is defective in three major respects.

Defect No. 1. Price Floors Are Provided Only When Necessary to Expand Production

The legislation provides for forward price floors under nonbasic products only where necessary to encourage expansion of their production. This apparently means that no floor for these products can be legally maintained after the need for expanding production has passed.⁵ This is all the more disconcerting since the loan rates (corresponding somewhat to floors) for the basic crops are not subject to this restriction. They are to be continued whether expansion

⁵ There is some question as to just what the law does mean. Some groups claim that once the Secretary has called for an increase in the production of a crop and proclaimed a price floor for it, even though in a later year he calls for a reduction in production, the floor must still be maintained for two full calendar years after the war. The wording of the law certainly requires clarification. Our suggestion is to knock out the clause restricting the use of floors to conditions of increasing production.

of the production of the basic crops is needed or not. Thus the prices of the basic crops may be supported even though the prices of the nonbasic products are not being supported. This could lead to a serious unbalanced condition; the price of corn, for instance, may be pegged at a high level while the price of hogs may have fallen to a low level, thus lowering the hog-corn ratio and having the effect of reducing hog production at the same time that the high loan rate on corn would be encouraging high corn production.

This defect would disappear if price floors for nonbasic products could be used in periods when production is to be contracted. The prices of the nonbasic products would then stand on the same footing as the prices of the basic crops. Price floors could then be used when demand is declining as well as now when demand is increasing. The price floors would be used to reflect the expected decrease in demand, just as they have been used up to the present time to reflect the expected increase in demand. There is no need to discontinue price floors when the strong wartime demand has passed. They should be retained, but adjusted up or down each year in line with expected changes in demand or changes in cost of production.

Forward price floors have an important place in an agricultural production program. They should not, therefore, be discontinued a few years after the end of the war. Farmers need to know when the price of hogs is going to drop from \$13.75 to \$10.00 just as much as when it is going to rise from \$10.00 to \$13.75. The weather man does not hesitate to warn us of an approaching storm; his warning, as a matter of fact, is more valuable than his forecast that fair weather is coming. It would be a poor sort of weather-reporting system that would merely issue forecasts of good weather and remain silent at other times. Forward price floors will not reach their greatest value until they are used continuously, through per-

iods of stable and declining demand as well as rising demand, and through peacetime as well as war.

Defect No. 2. Loans and Floors Extend Too Far Into the Future

The price floor system should be made a continuing feature of the agricultural production program, but each price floor should extend for a shorter period of time into the future than is provided for in the existing legislation.

The present legislation provides that the loan rates at 90 per cent of parity (85 per cent in the case of corn and wheat) and floors at not less than 90 per cent of parity, shall extend "during the continuance of the present war and until the expiration of the two-year period beginning with the 1st day of January immediately following the date upon which the President by proclamation or the Congress by concurrent resolution declares that hostilities in the present war have terminated."⁶ An earlier amendment still specifies that loans shall be made at 85 per cent of parity on the basic crops up to and including the 1946 crop. This means that the floors must be maintained at least as high as the minimum levels of parity specified now, anywhere from two to three years after the end of the war (depending upon whether the war ends late or early in a calendar year). It also means that loans at the percentages of parity specified now must continue to the 1946 crops.

Is this provision well adapted to post-war needs? The answer depends upon two things: Whether there is a severe post-war depression, as there was beginning a year and a half after the last war; and whether the war ends on all fronts at once, all over the globe, at the same time.

Severity of post-war depression. The post-war depression may not be as severe after this war as it was after World War I. There may be no depression at all, for we now know more

⁶ Public Law 729—77th Congress, Chap. 578—2nd Session, H. R. 7565, p. 4, Sec. 9. (1)

about how to deal with depressions than we did then, and have better controls. Yet our knowledge was not sufficient to enable us to prevent a considerable "recession" in 1937, and the problem of demobilization after this war will be greater than it was after World War I. The army to be demobilized will be much larger, and the job of reconversion of our industrial set-up will be more difficult to handle, because the conversion to total war purposes has been far more complete. Legislation should at least be ready to meet a severe reduction in demand in case it happens after World War II.

The fact that the minimum loan rates are expressed in terms of parity provides some flexibility in loan rates and floors. If there is a severe depression, that lowers the prices of things that farmers buy, which lowers the level of parity to the same extent. But the amount of this flexibility is small. The change in the prices of the things that farmers buy will be only a fraction of the change in the prices of the products that they sell, and it will lag a year or so behind. After World War I, the prices of hogs and corn fell to 30 or 40 per cent of their 1919 levels by the end of 1920—two years after the end of the war. Wheat fell to similar levels by the end of 1921. But the prices of the things that farmers buy, which determine the level of parity, *rose* from 1919 to 1920, and by 1921 fell only moderately, to 80 per cent of their 1919 levels. Thus the decline in parity was only about one-third as great as the decline in the market prices of these products.

In the present war, the prices of cotton, corn, and wheat are running at about the same level as the loan rates. Even so, these products are over priced. If there is a substantial decline in demand after the war, accompanied by a decline in loan rates only about one-third as great as the decline that would take place in prices were they not held up by loans, the CCC is likely to be swamped with larger stocks of cotton, corn, and wheat than any seen yet.

Will the war end all at once? This war may not end all at once. It is likely to continue in the Pacific for some time after it has ended in Europe and Russia. Because the size of the area and the intensity of the devastation is greater now than it was in World War I, the demand for food, feed, and livestock for rehabilitating Europe and Russia will probably continue strong for somewhat longer after the end of the war there than after the end of World War I—probably for a full two years this time.

But if the war with Japan continues one year, two years, or more after it has ended in Europe and Russia, what then? Are the price floors going to be maintained for two full calendar years after the end of the war with Japan? By the time the war with Japan comes to an end, the strong demand for food for rehabilitating Europe and Russia may already have passed. Yet the United States government would be committed to maintaining loans and price floors at present levels for two or three years more—levels that would be far too high for normal conditions of demand.

Tie floors to production periods. In view of these considerations, it seems decidedly unwise to commit the Federal government, as the present legislation does, to loans and price floors that are to be maintained at percentages of parity that are specified now for a length of time somewhere between two and three years after the war. Loans and price floors should be used continuously, not merely during the war and post-war period; but no loan or floor should be set for as long as two to three years in advance. When a floor is to extend for two to three years after the end of the war (or to the end of the 1946-47 crop year in the case of loans), a level that is the right height for the first year is likely to be considerably higher than necessary or advisable for the second, third, or fourth year. It would be better all round to have the loans and floors extended at existing levels for only one year after the war. That would

permit lower loans and floors during the second and third year as a more gradual return to normal, rather than constant loans and floors (constant in terms of parity, as the legislation now stands) for two or three years, and a sudden break, or no floors at all, at the end of that time. If it is necessary to reduce the production of some farm products, that can better be accompanied by a reduction in the price floor at the rate of one step per year rather than all at once at the end of the second or third year.

The calendar year is in any case an arbitrary unit of time. Perhaps it was chosen because the growing season for many crops begins and ends within a calendar year. But actually the production and marketing period for most crops does not fit into a calendar year. The floor for spring pigs needs to be announced early in November, to give farmers time to lay their plans for breeding in December, and needs to extend until all the spring pigs have been marketed, say until May or June, 18 months later. (The existing hog price floor was announced rather late in November, 1942, but extends to September, 1944). The floor for fall pigs needs to start and end about 6 months later. Neither of these periods coincides with a calendar year. The growing season for corn begins after the first quarter of the calendar year has elapsed, and the marketing season extends three quarters of the way into the second year. The same thing is true for spring wheat, except that the marketing season for most of the crop is shorter than for corn. The growing season for winter wheat extends from the latter part of one calendar year to the first half of the next. And so it goes. It would be highly desirable to change the arbitrary period of two full calendar years for all products specified in the present legislation to "the production and marketing period for each product," beginning and ending at the proper time for each product regardless of the beginning or end of the calendar year.

Defect No. 3. War-Time Loan Rates and Price Floors Are Tied to Peace-time Parity Price Goals

The most fundamental defect in the legislation is that it sets the loan rates at uniform percentages of parity prices—in this case, 90 per cent (with a 5 per cent concession in the case of corn and wheat, for feeding purposes). This is utterly unrealistic. Parity prices are merely the prices for each product that happened to exist in 1909–14 (or in the case of some products, at a later date) multiplied by the current index of the goods and services that farmers buy. Such prices ignore the fact that the costs of production per unit of product have changed, by different amounts for each product, since the base period, and the further fact that the relative demand for the different products has also changed and continues to change from year to year. For present conditions, parity prices are too high for most of the basic crops, and too low for many of the livestock products. Attempts are being made to redefine parity by including labor costs, ostensibly to make it more accurate; yet these attempts ignore the great changes in cost that have resulted from the introduction of new varieties, the mechanization of production, and the improvement of production practices. Agricultural productivity per man increased 40 per cent from 1909–14 to 1942, and the demand for some products has doubled, while for others it has decreased. To use such an obsolete yardstick as parity is to invite speedy disaster. The loan rates and price floors should be completely dissociated from parity.

The level of loan rates. What basis for loan rates and floors should be used instead of parity?

Commodity loans can be used for two concomitant purposes. Their primary purpose is to smooth out the effects of fluctuations in the production of storable crops from year to year. For those fluctuations are almost completely random in character, and occur about a fairly stable average which can be

projected into the future. The excess supplies from large crop years need to be carried only for a few years before short crops occur and necessitate using up the supplies. A series of fluctuating crops is thus converted into a series of constant supplies released upon the market. For this purpose, the loan rates should be set at the level at which an average crop⁷ would sell.

If demand remained constant, this loan rate would remain constant too. But demand changes from time to time. The price at which an average crop would sell, therefore, should be estimated ahead of time as accurately as possible, and the loan rate in line with that price should be announced before planting time. The loan rates for each crop could be published along with the production goals announced each year. The loan rates would thus fulfill their second purpose—of inducing the changes in production required to meet changes in demand.

In the case of livestock feeds such as corn, and wheat to be used for feed, the proper level for the loan rates can be determined objectively by consideration of the livestock-feed price ratios required to reach the production goals for livestock. This, in fact, has been an important factor in keeping the existing loan rates for corn and wheat down to 85 per cent of parity.

In the case of international commodities such as cotton and wheat, unless production is to be curtailed to a domestic basis, the loan rates have to be set at a level that will keep the commodity moving into international trade. If this is not done, stocks will continue to grow beyond manageable proportions. The ever-normal granary for these products has to be part of a world ever-normal granary, and loan rates have to be set with respect to world conditions. This conclusion is obvious, but the job is not simple, and the conclusion may not

⁷ This means the crop that would result from average yields (the yields that would result from average weather) on the acreage sown.

be accepted until stocks have piled up enough to force its acceptance. If so, a rather unsatisfactory but at least automatic method of bringing loan rates down to workable levels may have to be used. That method would involve, first, setting up a quantitative estimate of the maximum stocks required for stabilization purposes. This would be a sort of economic "high-water mark." Then legislative provision could be made that whenever stocks accumulated in larger amounts than this, the loan rate would automatically be reduced, by some such figure as 1 per cent for every 1 per cent by which the stocks exceeded the required size.

The level of price floors. Commodity loans are suited to durable products such as cotton, corn, and wheat. But loans cannot be used with perishable products, which cannot be stored. For those products, price floors have been used, to be implemented if necessary by outright purchases.

The purpose of these price floors is the same as the second purpose of commodity loans (which are a form of price floor). Price floors make clear to producers, before they lay their production plans, what prices they can count on for their products when they reach the market. The price floors reflect the demand and supply situation that is expected to prevail when the goods reach the market.

Price floors have generally been used only to encourage expansion of production, and that has created some impression that price floors raise prices, or at least "support prices" and keep them from falling. But that impression is misleading. Price floors in themselves do not amount to much. The existing price floor for hogs at \$13.75 is not the reason hog prices now are running between \$15.00 and \$16.00. The floor for hog prices was set at \$13.75, not because the Department wanted to raise the price of hogs or support the price of hogs, but because the Department estimated that the lend-lease plus domestic demand would be so strong that the price would

be \$13.75 or more. The Department merely wanted to convey this information to farmers in the most convincing terms—a guarantee of that minimum price—so that farmers would produce to the maximum, undeterred by any apprehension about low hog prices. In the late summer of 1942 many farmers were shaking their heads and viewing with skepticism the high hog prices then existing. "I'd just better count on \$11.00 or less for my hogs this winter" some of them were saying. The price floor of \$13.75 (originally \$13.25) was intended to remove skepticism of that sort.

The facts of the matter are that price floors for perishable products are only as good as the measures for controlling production and consumption that back them up. All that the United States Department of Agriculture can do is to look ahead, estimate what the private demand plus the government demand will be, forecast the supply, and announce the price that the prospective demand and supply permit it to guarantee.

If price floors are used to hold prices up during a post-war or other depression, they can be made to stick only if the Department is ready to purchase large quantities of the products concerned, and give them away free or sell them at reduced prices. In that case, the thing that supports the prices is these government purchases, not the price floor. The price floor is merely set in the first place in the light of the Department's intention and ability to purchase the product and sell or give it away.⁸

⁸ This I believe is an accurate statement of what price floors can and cannot do. It seems to me that "forward prices" is a more accurate term to use than "price floors," because it gets away from the implication that the floor itself does the holding up.

This is a different concept of price floors from that which is held by many people. The whole question as to the proper role of price floors needs much more discussion than it has been given so far. What may be in the cards is the gradual evolution of a system by which farmers would produce for prices agreed upon ahead of time, much as an arms manufacturer produces rifles or tanks or airplanes now. Most of agriculture, as a matter of fact, is already on this footing.
(Footnote continued on p. 26)

The level at which price floors can be set, therefore, depends upon the prospective situation for each product, including the Department's ability to purchase and distribute, not upon parity relationships. Accordingly, the way to promote satisfactory stability in the prices of farm products after the war is, first of all, to develop every possible means of stabilizing the whole economy at a high level. For this purpose, Federal fiscal policy, the rate of demobilization, the speed of industrial reconversion from war to peace, public works projects, and social security programs are the controlling elements. After all has been done that can be done along those lines, if some depression still materializes and employment decreases, nutritional considerations will require developing very large scale food stamp plans, and expanding school lunch programs and other nutritional projects. Progress along these lines will reduce the unstability of agricultural

⁸*Continued from p. 25.*

as a part of the war effort—the price however being not a single figure but a small range between a price floor and a price ceiling. The system applies to different grades of each product, not merely to different products. It provides the nation with the quantities of the products it needs when it needs them, not a production period behind the times, and enables farmers to produce without having to leave a margin to cover price uncertainty.

This is surely a subject which merits wide study and discussion. Is this system less suited to peace than to war? Should the range between floor and ceiling be narrowed, eventually to a single figure for each product, or should the range be retained because of the flexibility it provides? When the need for price ceilings has passed, should the government develop means for cashing in on a product when demand is stronger than it anticipated, to offset its losses when demand is weaker than it anticipated? (It does this in effect in the case of its commodity loans).

These questions indicate the nature of some of the problems involved. The literature on the subject so far is limited. The reader is referred to T. W. Schultz's "Economic Effects of Agricultural Programs," *Am. Ec. Review*, Vol. XXX, No. 3, February, 1941; "Redirecting Farm Policy," MacMillan, 1943; and Pamphlet No. 2, "Farm Prices for Food Production," in the present series. See also, by the present author, "Stabilization Operations of the Commodity Credit Corporation," *Journal of Farm Economics*, Vol. XXIV, No. 3, August, 1942; "Bases for Controlling Agricultural Prices," *Journal of Farm Economics*, Vol. XXIV, No. 4, November, 1942; "Controlling the Prices of the Basic Crops," to be published in the present series; and "Controlling the Prices of Perishable Farm Products," to be published in the present series. Parts of J. D. Black's "Parity, Parity, Parity," *The Harvard Committee on Research in the Social Sciences*, 1942; and J. S. Davis' "On Agricultural Policy, 1926-1938," *Food Research Institute*, 1939, also bear on the subject.

prices, and permit a program of price floors to proceed on a rational and lasting basis.

The quicker the price floors and loan rates are freed from parity, the more likely are they to remain in good repute. Revision of the legislation to that end cannot be deferred until the need for change is made obvious by a substantial reduction in demand after the war. The existing legislation providing loans and price floors commits the Department for several years in advance. The necessary changes in the legislation, therefore, should also be made several years in advance—that is, they should be made now.

☆ ☆ ☆

Acknowledgements: Professor T. W. Schultz made many useful comments, and with W. W. Wilcox, Margaret G. Reid, and A. G. Hart helped greatly in focusing the analysis upon current issues. R. Bowring and W. Bredo assembled some of the statistics.

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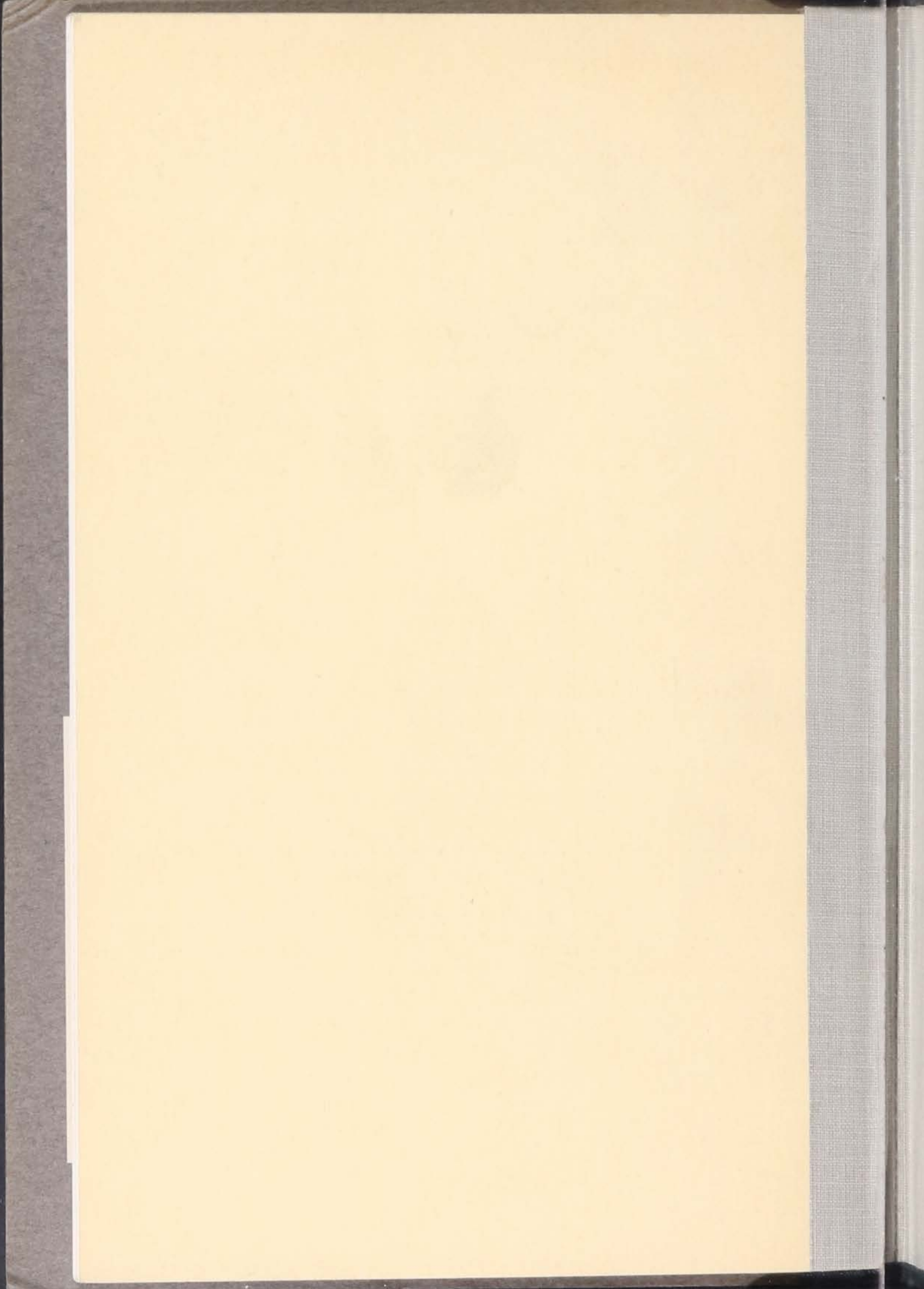
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