ESSAYS IN INTERNATIONAL FINANCE

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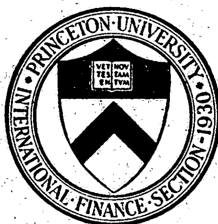

INTERNATIONAL FINANCE SECTION

DEPARTMENT OF ECONOMICS AND SOCIAL INSTITUTIONS

PRINCETON UNIVERSITY

Princeton, New Jersey

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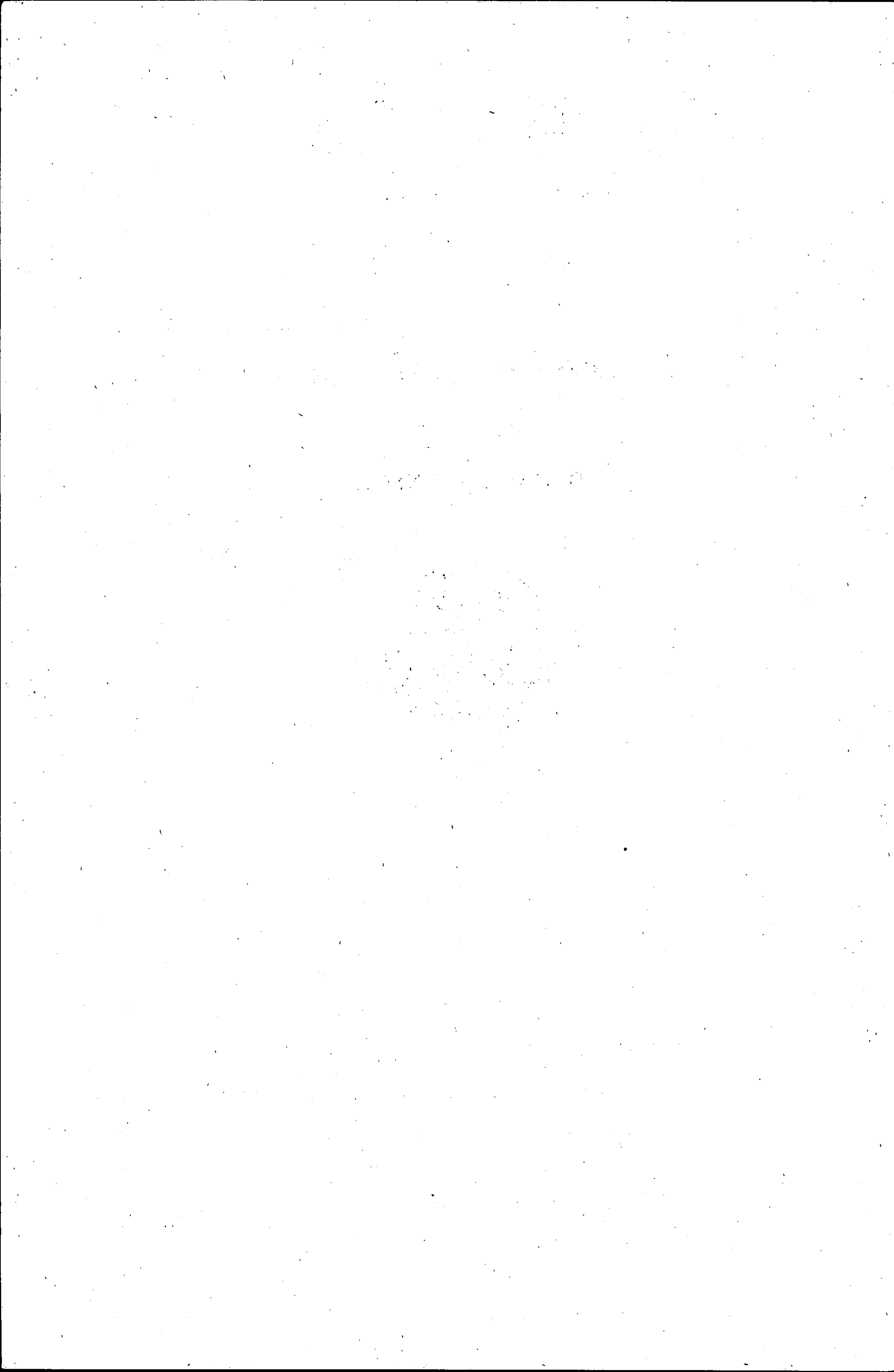

AGRICULTURAL PRICE POLICY AND INTERNATIONAL TRADE

D. GALE JOHNSON
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AN appraisal of the interrelations and inconsistencies between international trade policy and agricultural price policy in the United States appropriately may begin with a description and analysis of the farm price programs. Such a beginning is justified because the major steps to eliminate some of the inconsistencies between farm price and international trade programs must start with the farm price programs. This position does not rest upon the presumption that nothing can be done through international economic measures to heal the breach between trade and agricultural policies. Instead, two other premises are uppermost. First, the present farm price policies are basically inimical to the long run interests of American farm people, as well as to the general level of productivity in the United States. Second, the price and other policies that can be designed to meet the most important economic objectives of American farm people would not require a significant interference with the expansion of international trade as a means of gaining the advantages of international specialization.

But before examining agricultural price policy and international trade policy, it is pertinent to consider the linkage that exists between domestic and international markets for agricultural products. If the United States were neither an important exporter nor importer of agricultural products, its actions in the farm price field would have little significance to international trade policies.

I. UNITED STATES TRADE IN AGRICULTURAL PRODUCTS

The United States is in the rather unique position of being a major exporter of both manufactured and agricultural products and a major importer of agricultural products and raw materials. As a result, our farm programs as well as our trade policies can and do have a significant influence on the total world movement and prices of agricultural products.

Although there are great variations in the year-to-year value and quantity of our agricultural imports and exports, United States trade in many farm goods is an important part of the world trade in such products. As an importer, the United States in recent years has been taking about one-fifth of the world's exports in sugar and from 15 to 30 per cent of the wool—the two major products for which we are an important producer and importer. As an exporter, this country plays an even greater role, having accounted during the period 1949-1952 for the following percentages of total world exports: wheat, 33-50 per cent; cotton, 30-45 per cent; tobacco, 35-40 per cent; rice, 10-13 per cent; lard, 75-90 per cent; tallow, 60-80 per cent; and all fats and oils, 17-19 per cent.

There are several different ways of depicting the importance to the United States farmer of his export markets and of the changes in their importance over time; perhaps the most significant for present purposes is the ratio of the value of exports to cash farm income. As Table 1 shows, this ratio in recent years has been well below that of the twenties, but exports still account for about 10 per cent of the farmer's total cash receipts.

Table 1

United States Agricultural Exports and Total Cash Farm Income, 1910-1953[a]

Period	*Exports as Percentage of Cash Farm Receipts*
1910-1914	17.5
1925-1929	17.3
1930-1934	12.9
1935-1939	9.4
1946	12.9
1947	13.1
1948	11.5
1949	12.8
1950	10.0
1951	12.2
1952	10.5
1953	9.1

[a] Sources: United States Department of Agriculture, *United States Farm Products in Foreign Trade*, Statistical Bulletin No. 112, Washington, D.C., 1953, p. 11. The data for 1951, 1952, and 1953 were taken from current press releases of the Department of Agriculture.

These overall statistics hide the even greater dependence of several farm commodities upon foreign markets. During 1949-1951, more than a third of all our wheat, cotton, and rice were exported; and approximately one quarter of our soybeans, tobacco, rye, grain sorghums, lard, tallow, field peas, and hops were sent abroad. Looked at in still another way, in recent years the value of agricultural exports has accounted for some 25 to 30 per cent of the total of United States commodity exports.

Imports of products of agricultural origin have bulked even larger in our total trade, constituting about 40 to 50 per cent of our total commodity imports. However, about half of these agricultural imports are not competitive with domestic agriculture, including as they do such commodities as coffee, crude rubber, copra, bananas, tea, spices, and wool for carpets.

Sketchy as these few data are, there can be no doubt that the United States has in the past and does at present play a significant role in international trade in agricultural products and that important linkages exist between the international and the domestic market for such goods.

II. A SHORT HISTORY OF FARM PRICE PROGRAMS, 1933-1953

Although the Federal Farm Board was engaged in certain price supporting operations as early as September, 1929, the beginning of the present farm price programs was in 1933 when the Agricultural Adjustment Act was passed and the Commodity Credit Corporation was created. The Corporation immediately offered non-recourse loans to producers of cotton and corn and they have been available every year since that time. The first cotton loan was at ten cents a pound, although the market price had just previously been around six cents. The first corn loan rate was set at 45 cents a bushel, only moderately above the market price at the time the loan was announced. The first wheat loans were not made until 1938—the small crops of 1933, 1934, 1935 and 1936 having resulted in relatively favorable wheat prices—but they too have since been continuously available. Tobacco producers have also enjoyed a price support loan program since the mid-thirties. In addition, many other commodities, such as rye, oats, barley, wool, flaxseed, dried milk, butter, soybeans, cheese, honey, and mohair, have had their prices supported through the use of non-recourse loans or direct government purchases.

The non-recourse feature of these loans means simply that the Commodity Credit Corporation cannot collect the amount of money borrowed by a farmer, unless the farmer wishes to repay. The farmer in

obtaining such a loan has two alternatives: (1) He may deliver the farm product which served as a security for the loan, or (2) he may pay the amount borrowed. Thus, if the market price exceeds the loan value the farmer will redeem the farm product used as a security for the loan by paying the Corporation the amount borrowed. However, if the market price is below the loan value, he will deliver the product to the Corporation. The non-recourse loan is only one, albeit the most important, of a number of methods used to influence the level of market prices. Efforts have been made to restrict supply through acreage allotments, marketing quotas, grade and quality regulation, and actual destruction of output. In addition, steps have been taken to increase demand through distribution of farm products at low cost, or free, to individuals on relief and to certain types of institutions such as schools and homes for the aged and the indigent. During the late thirties and early forties, the food stamp plan was tried as a means of expanding demand through a two price plan available to certain segments of the population, primarily persons on relief.

But efforts to control supply or to expand demand are relatively blunt instruments. The output of farm products is not entirely within the control of man—with no apparent change in acreage planted or seeded, the amount of fertilizer applied, or the production practices followed, output of an individual crop may vary by 20 to 50 per cent from one year to another. This is why direct methods of price influence have become an important and significant part of the farm program. The non-recourse loan and government storage programs represent direct means of assuring a given price, if sufficient storage space is available. Though other methods of direct price maintenance have been used, such as purchase operations, the loan and storage operations have been the mainstay of the farm price support program.

Formally, the objective of these programs is price parity. But the definition of parity and the extent of attainment of that objective has not remained unchanged over the past two decades. The concept of parity originally expressed in the Agricultural Adjustment Act of 1933 was a very simple notion (even though there is either one too many or one too few commas): ". . . prices to farmers at a level that will give agricultural commodities a purchasing power with respect to articles that farmers buy, equivalent to the purchasing power of agricultural commodities in the base period." The base period for all agricultural commodities except tobacco was August 1909-July 1914; that for tobacco was the ten years starting with August 1919.

In 1935 the sentence structure was straightened out, and, in addition, certain adjustments in the definition of parity were introduced. Prior to 1935 purchasing power of the prices farmers received was defined

solely in terms of prices paid by farmers for products used in production or consumed by the household. In 1935 "interest payments per acre on farm indebtedness secured by real estate and tax payments per acre on farm real estate" were added. That year the index of prices paid was 125; the addition of the other two factors increased the overall index to 130. Thus the change in definition increased parity prices by four per cent. However, by 1942 the rise in prices paid so outstripped the change in mortgage interest and taxes that the inclusion of the latter reduced parity prices. In fact, in 1948 the prices paid index was 264 while the combined index used in calculating parity prices was only 250.

The next major changes in the calculation of parity prices came in 1948 and 1949, when, for the first time, farm wage rates were included in the calculation of parity prices. The inclusion of wage rates would have resulted in a very significant increase in parity prices (about 6 per cent in 1948) but a concurrent revision of the whole index reduced the net effect of the change to about 3.5 per cent for 1948. Although there is no question but that the intent of these changes in the calculation of parity prices was to raise the level of parity prices, their net effect (including the statistical revisions) often has been to leave the parity prices unchanged. If the parity prices were calculated on January 15, 1954 by the method used from 1933 to 1935, the prices paid index would be 284; the index now in use for most commodities is 284. The best laid plans of mice and men often go astray.

There was another change in the calculation of parity prices, however, that has had a substantial impact. In the Agricultural Act of 1948 a new method of determining parity prices was enacted. This method was not designed to change the average level of parity prices; its purpose was to modify the *relative* parity prices of the various farm commodities. It was recognized that the previous methods of calculating parity prices of each commodity had resulted in serious distortions of relative farm prices. Not only did the relative prices which prevailed in the 1910-14 period fail to represent current demand and supply relationships, but over the years many other base periods were used as parity prices were calculated for an ever-increasing number of commodities. In fact, in 1949, only about one-third of the farm commodities for which parity prices were calculated were based entirely on the 1910-14 base periods. The remainder involved various base periods for the interwar period. The 1948 revision specified that the relative parity prices were to be based on actual relative market prices for the ten preceding years. Thus farm products whose market prices were lagging behind the general level of farm prices would have their parity prices lowered.

This revision of parity prices was recognized by most agricultural economists as a decided improvement. But from a political viewpoint,

the new parity formula had the basic disadvantage of lowering parity prices for a number of "politically important" crops—namely, cotton, wheat, corn, and peanuts. As a result, in 1949 Congress legislated that for the four years beginning January 1, 1950 (when the new parity prices were to be effective), the parity price would be the higher of the old or the new parity for the so-called basic commodities (cotton, wheat, rice, corn, peanuts, and tobacco). This provision was later extended until December 31, 1955. It so happened that the new parity formula increased the parity prices of all important livestock and livestock products, except poultry and eggs; some of the increases were quite substantially, 35 per cent for beef cattle, for example. The parity price for wheat, on the other hand, as of January 15, 1954 would be reduced from $2.48 to $2.13 a bushel by the change in formula. Cotton prices would be reduced by only little more than a cent a pound while corn prices would be reduced by 19 cents a bushel (about 11 per cent). There is no question that the current large stocks of wheat and corn would now be appreciably smaller if the lower parity prices had been in effect since 1950, and even the 1.2 cents reduction in the price of cotton would not have been without some influence.

This short discussion of the development of the parity price calculations is intended primarily to indicate the capriciousness of Congress' approach to the concept. But there is another important facet of parity price as an objective, or as a standard for price support, that warrants notice. This is the question of the relation between the support level and full parity. The original Agricultural Adjustment Act did not specify the level of price support as a percentage of parity. The first loans for corn and cotton were established at approximately 70 per cent of parity. In the Agricultural Adjustment Act of 1938, it was specified that loan rates for corn, wheat, and cotton should range between 52 and 75 per cent of parity, relatively modest objectives on the whole. For the years 1938, 1939 and 1940, corn loan rates were at 70-75 per cent of parity and those for cotton and wheat were at 52-57 per cent. In early 1941 the level of price supports for corn, wheat, cotton, and tobacco was increased to 85 per cent and, later that year, the same level of support was extended to the so-called nonbasic products; the purpose being to encourage increased production. The price support legislation was modified in October, 1942, in two ways. First, the price support levels were increased to 90 per cent of parity, and, second, price supports for all basic commodities, and for nonbasic commodities for which the Secretary of Agriculture had found price supports necessary to achieve increased production, were to be maintained at 90 per cent of parity for two years following the close of the war. Except for the changes in the parity formula described earlier, price supports have generally been

unchanged with respect to parity level since 1942. With respect to certain products, however, the Secretary of Agriculture has had some discretion in setting loan rates, as illustrated by the recent decrease in the price support for butter.

To summarize, during the period from 1933 through 1942 there were two important developments in price support legislation. First, the level of price support, expressed as a percentage of parity, increased substantially. Second, the number of commodities provided price supports increased very rapidly—from less than a half dozen in the mid-thirties to more than 100 during World War II. In recent years price supports have been announced for between 30 and 40 different farm products.

At the present time, it may be noted, there seems to be less willingness to experiment with different methods of price support than was true fifteen years ago. Today major reliance is placed upon purchases and loans, with acreage restrictions being imposed when the former result in stocks that become difficult to manage. But in the thirties it was fairly generally accepted that some income transfers might be made through techniques other than price supports. Two illustrations may be given. During 1935 and 1936 direct price payments were made to producers on each pound of cotton sold as a means of encouraging farmers to sell their cotton rather than to place it under loan. The loan rate was set at 10 cents a pound, but farmers were paid the difference between the actual market price and 12 cents a pound, up to a maximum of 2 cents a pound. The Agricultural Adjustment Act of 1938 included a provision for parity payments which was designed to supplement price supports and to bring the return to the farmer up to 75 per cent of parity. Such payments, totalling $967 million, were made in 1939 through 1942.

A general over-all view of the price support and related activities from 1933 to the present would note the following points. During the last twenty-one years, attempts to regulate production (if one excludes tobacco) were made in only eight years. Most agricultural economists would agree that the methods used to limit output have been relatively ineffective, having been accompanied by positive incentives to increase production. Not only were price supports maintained at relatively profitable levels and direct payments made to producers, but many of the activities associated with the farm programs have been effective means of increasing output by inducing or aiding farmers to adopt improved production techniques.

Contrary to common belief, the *direct* costs of price support operations (up to mid-1953) have been relatively modest—approximately $3.5 billion, which includes such questionable items as $800 million for the School Lunch Program. In part the low financial cost of the farm price support operations has been due to the coincidence of a nationwide

drought and two wars. The moderate crop output of the mid-thirties prevented large stocks from accumulating at that time, while the conduct of World War II consumed the large stocks of corn, wheat, and cotton accumulated by 1942. Again, in 1950 the Korean conflict absorbed the large stocks accumulated in 1948 and 1949.

III. THE INCONSISTENT ELEMENTS

The above sketch of farm price support programs does not indicate specifically the elements of inconsistency between those programs and the objective of freer foreign trade. The basic source of conflict is not hard to determine. Many of the support prices are for products for which the United States is either an exporter or an importer. In either case, an effective price support in the American market soon presents serious and obvious problems. If the price support is for a product that is exported and that price support has any influence in increasing domestic prices, exports decline and domestic stocks rise. This loss of foreign markets may be of major importance to some sectors of the farm community and may, indeed, prevent the United States from taking full advantage of its real comparative cost advantages. If the price support is for an imported product, the domestic price support attracts increased imports, as has recently been illustrated by the relatively large imports of oats from Canada, and may create significant strains on our relations with friendly governments if, as has often been the case, measures are taken to prevent such imports.

In the first four or five years of the development of farm programs under the New Deal, the role given to price supports was secondary to other aspects of the programs. It was generally believed that the adjustment features of the programs—restrictions on acreages, transfer of land from one product to another, payments directly to farmers, and creation of orderly markets—were more important than the non-recourse loans. As a result, the first uses of restrictions on imports were not envisioned as an adjunct to price supports, but as a means of retaining to farmers any benefits that might accrue to them from making certain adjustments. The first restriction on imports was made in 1934 in connection with the sugar program, which did not include a price support or commodity loan provision. The first general legislative approval for import restrictions was enacted in 1935 as an amendment to the Agricultural Adjustment Act of 1933. This amendment allowed restrictions (import quotas) only for commodities for which there was an adjustment program under the Act. Section 22, as this authority became generally known, was soon extended to include programs operated under the Soil Conservation Act of 1937 and the Marketing Agreements Act.

Authority was also granted to impose, in addition to import quotas, import fees up to 50 per cent ad valorem and to impose either in connection with any program using Section 32 funds (see below).

Until 1941 import quotas were established under Section 22 only for wheat and cotton. These quotas are still in effect. During the war numerous restrictions were placed on imports, primarily to aid the administration of various schemes for the international allocation of relatively scarce agricultural products. Some imports, such as butter, were prohibited entirely.

At the end of the war spokesmen for certain farming interests argued that the provisions for action under Section 22 authority were too restrictive. Many of the price support operations were not conducted under authority granted in the various acts referred to above. As a result, Section 22 authority was extended to any program undertaken by the Department of Agriculture.

It should be noted that until recently the Executive Branch of the Government has used the authority under Section 22 with considerable restraint. The only new Section 22 action from the end of the war through mid-1953 was the imposition of import fees on almonds; the quotas on wheat and cotton have been continued, however. Under authority given in the Second War Powers Act, the importation of butter, flaxseed, linseed oil, peanuts, peanut oil, and rice and rice products were prohibited. These controls were continued until July 1, 1951, and the following month the Secretary of Agriculture was given broader authority to restrict imports by Section 104, as amended, of the Defense Production Act of 1950. While action under Section 22 is essentially discretionary with the President, the conditions laid down in Section 104 were such as to leave the Secretary of Agriculture little room for discretion. For a specified list of products, *no* imports were permitted if the Secretary determined that imports would (a) impair or reduce domestic production, or (b) interfere with the orderly domestic marketing or storing of the commodity, or (c) result in any unnecessary burden or expenditure under any government price support program. Imports of butter, nonfat dried milk solids, peanuts, peanut oil, flaxseed, linseed oil, and rice were prohibited and quantitative restrictions were placed on cheese.

The restrictions on the imports of cheese came at a rather unpropitious time, since the United States, under the Economic Cooperation Administration, had been encouraging certain countries, especially France, Italy and the Scandinavian countries, to expand production of cheese for the American market. Canada was also displeased, to put it lightly, at the reduction in access to the American market.

In mid-1953 Congress let Section 104 lapse, but it agreed to do so