

# THE SUPPLY CONTROL ROUTE

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## I. Dominant Characteristics of Agriculture

Three characteristics dominate the agricultural scene in the 1950's. They are: widespread technological advance, a competitive market organization, and the inelastic demand for food.

- A. **WIDESPREAD TECHNOLOGICAL ADVANCE.** This is a part of the American creed; Americans value it highly in all sectors of the economy. Since it is generously financed in agriculture, we can expect a continuous outpouring of new technologies. In this dynamic situation farmers do not seek the minimum point on some long-run static planning curve; year after year they move from one long-run planning curve to the next, but always to a lower curve. The only real question is: At what rate is this technological advance going to occur; hence, at what rate is the aggregate supply function going to shift to the right? Technological advance is the key variable in agricultural production.
- B. **A COMPETITIVE MARKET ORGANIZATION.** This is the engine of the farm economic system; a competitive market organization provides the incentive for widespread technological advance. Each farmer reasons that he cannot influence prices, but he can lower his costs by adopting new techniques, new practices. But when all farmers do this, aggregate output expands and since 1951 it has expanded persistently in the face of falling prices. The competitive market organization in agriculture provides the motive power for a continuously expanding aggregate output.
- C. **THE INELASTIC DEMAND FOR FOOD.** Expanding supplies would create no problem if the price and income elasticities for food were greater than 1.0. But they are not; they are exceedingly low—approaching .2 in each case. Thus a little surplus in aggregate supplies causes the farm price level to fall disastrously. Continuously expanding supplies, growing out of widespread technological advance, press against the inelastic demand for food and drive farm prices to low levels and hold them there.
- D. **IN SUMMARY,** three characteristics of agriculture—widespread technological advance, a competitive market organization, and the inelastic demand for food—related as they are, give rise to continual low prices and income in peacetime—making agriculture a chronically sick industry.

## II. Popular Solutions That Do Not Work

- A. **LABOR MOBILITY.** This is the current fad. Economists are all going to solve the farm problem these days by moving workers out of agriculture. These economists seem to forget that people have been moving out of agriculture at a rapid rate since 1940. Some 14 percent of the farm labor force moved out of agriculture in the first six years of the 1950's. We must have this out-migration; it is basic to, necessary to, general economic growth and it is a necessary condition to solving the continuing peacetime price and income problem in agriculture, but it is not a sufficient condition. We are unlikely to move enough people out of agriculture by 1965 to bring supply into balance with demand again. This might require the movement of 30 to 40 percent of the existing labor force out of commercial agriculture. And such a rate of out-migration would create new and difficult social problems in rural communities.
- B. **VERTICAL INTEGRATION.** This will not stop the flood tide of food supplies any more than laying pipes vertically in a flooding river would serve to dam that river. More vertical integration will shift somewhat the bargaining power of buyers and sellers in agricultural commodity markets (probably away from farmer-producers), but it has no capacity to deal with the basic problem of general overproduction.
- C. **THE MANY OTHER POPULAR SOLUTIONS** that might be mentioned (e.g., flexible price supports, more efficient marketing, fixed price supports) all run squarely into the hard facts of too much production this year and too much in the foreseeable future arising out of:
1. Widespread technological advance.
  2. A competitive market organization.
  3. The inelastic demand for food.

## III. Effective Production and Marketing Controls Necessary

*If farmers want good and stable incomes, and if the rest of society will not underwrite the continuing costs of price and income support, then farmers must accept effective production and marketing controls—they have no other alternative. They must accept supply control devices that enable the many producers in agriculture to adjust supplies to demand, commodity by commodity, year after year.*

- A. Since 1951 the urban sector of society has underwritten the cost of price and income support in agriculture—transferring some 3 to 5 billion dollars of income into agriculture in 1957. But will society continue to do this? It seems highly doubtful. The support for Secretary Benson's policy of lowering the level of price and

income support comes from urban areas and on both sides of the political aisle. Urban people are tired of the farm problem; they want to be rid of it and the painful income transfers.

So long as urban people are willing to bear the cost of price and income support in agriculture almost anything will work; even the untidy 1957 farm program provides a great deal of income support for farmers. But when the urban sector no longer is willing to pick up the check, then farm people must make a decision. They must decide whether they want good and stable incomes or complete freedom to plant and reap as they please. They cannot have both in a free, unsupported market. They cannot have the best of these two possible worlds unless the rest of society is willing to underwrite the cost.

- B. I am well aware that farmers generally consider controls over supply to be a nuisance, and I am not sure that they will ever accept effective controls. Certainly they will not if they value freedom of decision making as highly as Mr. Benson thinks they do. But if they value good and stable incomes more than they do complete freedom in farm decision making (as I think they do), and they realize what a free market really means to them (in the middle 1950's with a return to the free market, and assuming away government-owned stocks, the farm price level might be 30 to 40 percent lower than it is and net incomes 25 percent lower), then they may be very happy to accept effective controls over supply.

It is not unrealistic to conclude that when farmers become convinced that good and stable incomes are absolutely dependent upon effective supply control, they will approve of and accept those controls—witness the actions of the tobacco growers, fluid milk producers, and sugar producers. Farmers generally do not realize the seriousness of their situation; they live by a myth—a myth of a “sound,” healthy agriculture that is only a little out of balance. They live by this myth because they have been told repeatedly by politicians and their leaders that agriculture is basically “sound”—that with a little “fixing” this “emergency” will pass and all will be well. But the hard facts are that the core of agriculture—the feed, grain, livestock economy—is sick and no slight-of-hand is going to make it well.

- C. To repeat then—if farmers really want and are determined to have good and stable prices and incomes as a regular thing, they must accept effective production and marketing controls as a regular thing.
1. They must restrain the monster of too much production arising out of widespread technological advance!

2. They can do this only by regulating themselves through group action.

#### IV. The Public Utility Approach

Basic to a supply control approach acceptable to producers and consumers alike is the idea that agriculture be viewed as a public utility—a giant utility composed of many, many small producing units acting in concert with the aid and consent of government to produce the quantities of food and fiber *required* by consumers, at a fair return to the producers involved.

In this view, government establishes the institutional machinery for, and grants the power to, agriculture to enable the many, many producers involved to produce those quantities of farm products demanded by consumers at a fair price. For this grant of monopoly power, government reserves to itself, as in the case of any enfranchised public utility (e.g., the railroads, telephone companies, and gas and electric companies), the right to determine and fix rates and prices, hence the right to determine fair returns to the producers involved.

Where competition has led to ruinously low prices and returns, or poor service, or injury to certain persons or groups, government has historically intervened to regularize that competition, to equalize the bargaining power among contending parties and to redress inequities. Government was performing in this role when it brought the railroads under the control of the Interstate Commerce Commission, when it gave unions the right to bargain collectively, and as it has tried to provide commercial agriculture with price and income support.

Where the continuous and uninterrupted provision of a product, or service, was deemed essential to the well-being of the community, government has traditionally granted certain firms the monopoly right to supply the needs of consumers with that product, or service, under the supervision of government with respect to such things as rates, safety, quality, and so on (i.e., *created public utilities*).

Now it is proposed here that the government adopt this general policy with respect to agriculture to insure producers of reasonably good and stable prices and incomes in the first instance, and perhaps in some later period, when circumstances require it, to insure consumers of an adequate food supply at reasonable prices.

The main outlines of this public utility approach to agriculture were sketched by the speaker at a joint meeting of the American Farm Economic Association and the American Economic Association in December 1956. They are:<sup>1</sup>

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<sup>1</sup> See the article, "An Appraisal of Recent Changes in Agricultural Programs in the United States," *Journal of Farm Economics*, May 1957.

- A. Congress would be responsible for determining and setting forth fair, or parity, prices for agriculture, as it does now. But in this scheme of things the role of parity prices has changed. No longer would parity prices serve as pegs on which to support farm market prices; rather they would serve as guides in the setting of national sales quotas. Thus, in the determination of parity prices for agriculture, Congress would in fact be determining fair prices for both consumers and producers, and the needs and interests of both groups would have to be considered.
- B. The U.S. Department of Agriculture would set national sales quotas for each principal agricultural commodity in amounts which the USDA had estimated would clear the market at the predetermined fair, or parity, prices. In practice this might mean the establishment of national quotas on each principal farm commodity destined for human consumption moving into the marketing channel (say 15 to 25 commodities). These national sales quotas would, of course, vary from year to year as demand conditions changed, or as Congress redefined parity prices. To avoid, or to minimize, the difficult problem of integrating production controls vertically, national sales quotas would not be established for commodities typically consumed on farms, sold among farms, or sold to farms (e.g., feed grains, feeder cattle, baby chicks).
- C. Each farmer at the inception of the program would receive a market share, his *pro rata share*, of the national sales quota for each commodity, based probably on his historical record of production. The farmer's share might be received in small denominational units, to which, for purposes of exposition, we give the name "marketing certificates." Once the program was in operation a farmer could not legally market any commodity having a national quota except insofar as he had marketing certificates to cover the quantities involved. The number of marketing certificates would not be increased, or decreased, from year to year with changes in the national sales quota for a particular commodity. Rather, each farmer could market an announced percentage of the face value of each of his certificates—a percentage in accordance with the national sales quota for the year. By this device the awkward problem of issuing and confiscating marketing certificates would be avoided for the bulk of agricultural production.
- D. Each marketing certificate would be negotiable. Each farmer would be free to buy or sell marketing certificates as he saw fit. By this device freedom of entry and exit would be maintained within a controlled agriculture. By this device the individual farm operator would be free to expand production, or contract it, in light of local

conditions, as total output was adjusted to demand at a defined fair price. The value of operating in a stabilized agriculture where product prices and returns were relatively certain and relatively good, and where long-range production plans could be formulated with reasonable assurance of materializing would, of course, get capitalized into these marketing certificates. The price of these certificates would become the cost of doing business in a stabilized agriculture.

- E. Many other programs could, and possibly should, be linked to the above skeletonized proposal. To illustrate, the United States might for a variety of reasons (e.g., human welfare, international collective security) wish to subsidize food exports to needy nations to help finance their long-term programs of economic development. Thus, the national sales quota for any one year would equal domestic demand, plus any commercial exports plus subsidized exports. If the decision were made to include establishment and maintenance of a strategic food reserve, the requirements of such a reserve would need to be taken into account each year in the determination of national sales quotas.

In another direction, it might prove beneficial to both producers and consumers for the U.S. Department of Agriculture to operate a purchase, storage, and disposal program in connection with the general control program. In years of below-average yields government held stocks would be put on the market to hold prices at the defined parity prices, and in years of above-average yields marketing quotas would be increased by a few percentage points and the excess supply would be purchased and placed in storage. This type of bona fide storage program would serve to stabilize marketable supplies, and ease the production problems of farmers arising out of weather uncertainty.

## **V. Criticisms of Public Utilities Approach**

Numerous criticisms have and can be leveled at this supply control approach. The most common are: (1) the capitalization of monopoly gains into land values argument and (2) the loss of efficiency argument.

- A. It is commonly argued that the monopoly gains resulting from the successful control of supplies would be capitalized into land values; hence the question is asked: Of what possible benefit could such controls be to farmers? The question might be turned around: When have farmers ever experienced increased returns when those increased returns were not capitalized into higher land values? Increased net farm incomes, whether they arise out of wartime

demand, supply control, or a natural shortage of land, always are capitalized into land values. Thus, the final question might be asked: Are we never to help, or to expect, farm incomes to rise because such income increases are capitalized into land?

This speaker does not question the proposition that benefits to farmers resulting from effective supply control (i.e., rising net incomes first, and more stable incomes second) would be capitalized into land values, and in the longer run average costs per unit of output would equal average revenue. But this is not bad; it is simply a restatement of the old adage that “you don’t get something for nothing in this world.” In this longer run situation, however, farmers would benefit from supply control in two ways:

1. Production planning would be facilitated as year-to-year commodity price variations were leveled out.
2. Farmers would be free of that gnawing fear that they might lose their farm, and see their other assets melt away, under one of those wide and periodic down swings in the farm price level.

In summary, with effective supply control, farmers would be operating in a stabilized market—in the kind of market that much of industry enjoys.

- B. There is no reason to believe that the supply control route outlined here would result in any important loss in efficiency to society. Farmers would continue to take prices as given, and each farmer would seek to produce his quota share as cheaply as possible and hence maximize his individual profits. The incentive to adopt new cost reducing technologies is still a part of the system. If at the parity prices established by Congress, farmers generally began to make excessive profits—higher returns on their investments than in other parts of the economy—this would be used as evidence in political debate to lower the level of parity prices to farmers. Parity prices in this context would be set and reset in the same general way that tariffs and rates are set for the more conventional public utilities, namely, through public pressure, political debate, and group action. Assuming a constant price level, we could expect the benefits arising out of farm technological advances to be passed along to consumers as the level of parity prices was lowered through political action.

## VI. Conclusion

The supply control approach is not designed to cope with all the problems of agriculture. It cannot, for example, provide good incomes to farmers on small, inadequate units. It cannot stop the trend to larger

and larger farms and the probable demise of the family farm. It cannot provide managerial ability where that capacity is lacking. But it can do one thing, provided farmers generally are willing to accept controls: *It can stabilize the market.* It can take the feast and famine characteristic out of agriculture and guarantee a good and stable income to the aggregate of farm operators. It can do this if farmers generally value good and stable incomes enough to accept the controls over supply that are prerequisites to such incomes in American agriculture in the 1950's and 1960's.