SUPPLY MANAGEMENT: CONCEPT AND PRACTICE

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I. The Agricultural Problem

Three characteristics dominate the agricultural scene in the 1960's as was the case in the 1950's. They are: widespread technological advance, a competitive market organization, and an inelastic demand for food, and these interrelated factors give rise to chronically low prices and incomes in peacetime.

A. Widespread technological advance. This is a part of the American creed; Americans value it highly in all sectors of the economy. It is generously financed in agriculture; hence, 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 and the motive power for a continuously expanding aggregate output. Each farmer reasons that he cannot influence prices, but he can get his costs down by adopting new techniques, new practices. When all farmers do this, aggregate output expands, and since 1940 it has expanded persistently.

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 0.2 in the aggregate. 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.

II. Popular Solutions That Do Not Work

A. Labor mobility. The farm problem under the CED[1] approach is to be solved by moving workers out of agriculture. Farm people have been moving out of agriculture at a rapid rate since 1940. The farm labor force has declined at an average annual rate of 150,000 since 1951. The CED recommends that this rate be stepped up to 400,000 to 500,000 per year in the next five years. Two serious objections to this CED approach are:

1. The economy is already faced with higher rates of unemployment than are generally tolerable; hence, it should not be asked to absorb an accelerated rate of movement off farms. The prospects for such a movement are very remote.

2. The CED made the assumption that most of the proposed outmigration would come from commercial agriculture, and hence, that it would have an important effect on farm output. It seems more realistic to expect the low-income farm population to make up the bulk of movement from agriculture, whether at accelerated or recent rates. This makes a great deal of difference, for the average farm worker on the highly commercial farm produces more than twice as much as the worker in the $2,500 to $5,000 sales group, and more than five times as much as the average worker on farms with sales of less than $2,500 per year. If the large reduction in farm workers projected by CED came heavily from low-income areas, it could not possibly be expected to cut farm output. Even if migration from commercial agriculture were to be rapid, farm output should not be expected to decline significantly, since farm technology will readily bridge the gap.

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 the bargaining power of buyers and sellers in agricultural commodity markets around a bit (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, production payments, fixed price supports) all run squarely into the hard facts of too much production this year and too much in the foreseeable future.

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[1] *An Adaptive Program for Agriculture,* Committee for Economic Development, New York, 1962.

III. The Supply Management Approach

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 some form of supply management—there is no other alternative. They must accept supply management devices that enable the many producers in agriculture *to adjust supplies to demand,* in the great problem commodities.

A. Since 1951 the urban sector of society has underwritten the cost of price and income support in agriculture—transferring directly some 2 to 5 billion dollars of income into agriculture each year in the past decade through price and income programs and commodity disposal operations. But will society continue to do this? It seems highly doubtful. When the urban sector no longer is willing to pick up the check, then farm people must decide whether they want good and stable incomes or complete freedom to plant and reap as they please. They cannot have the best of these two possible worlds unless the rest of society is willing to pick up the check.

B. I am well aware that farmers generally consider controls over supply to be a nuisance, and I am not sure that they will come to adopt effective supply management programs in the next few years. Certainly they will not if farmers value freedom of decision making as highly as some farm leaders think 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 come to realize what a free market really means to them (in the middle 1960's a return to the free market, and assuming away government-owned stocks, the farm price level might be 25 to 40 percent lower than it is and net incomes more than 50 percent lower), then they may be very happy to adopt effective supply management. 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 these controls —witness the actions of tobacco growers and sugar producers.

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 come to accept effective production and marketing controls.

   1. They must curb the force of too much production arising from widespread technological advance.

   2. They can do this only by disciplining themselves through the

development of, and acceptance of, effective supply management.

D. Basic to the supply management approach is the concept of an industry composed of many, many small producing units acting in concert with the aid and consent of Congress 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 and grants the limited 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 limited power, government reserves for itself the right to determine price-support levels, hence the right to determine fair returns to the producers involved and protect the consumer interest.

E. The basic principles of this supply management approach to agriculture are as follows:

1. Congress would set fair, or parity, prices for agriculture, as it does now. But in this scheme of things the role of parity prices has changed. Parity prices would serve as guides for setting national marketing quotas rather than for setting price supports. Thus, in determining parity prices for agriculture, the 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.

2. The U. S. Department of Agriculture would set national marketing quotas for those principal agricultural commodities for which programs were adopted, in such amounts as the USDA estimates will clear the market at the predetermined fair, or parity, prices. Depending upon the commodity, this might or might not mean spelling the national quota out into acreage allotments by states, counties, and farms. These national marketing quotas would, of course, vary from year to year as demand conditions changed, or as Congress redefined parity prices.

3. 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. Depending upon the commodity, this market share might be stated in commodity units or acreage. Each farmer would be permitted to market his market share free of penalty, but on amounts in excess of his market share he would pay a

fee. The size of this fee would vary with the commodity program.

4. Marketing rights would be negotiable. Each farmer would be free to transfer his market share either by sale, rental, or administrative rule. By this device freedom of entry and exit would be maintained within a managed agriculture; the individual farm operator would be free to expand or contract production, in light of local conditions, as total output was adjusted to demand at a defined fair price. This final principle represents a long-range goal of supply management which is not yet fully accepted but which must come if supply management is to be effective and successful.

F. Many side 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. And if the decision were made to establish and maintain 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, where in years of below-average yields government held stocks were put on the market to hold prices at the defined parity prices, and in years of above-average yields marketing quotas were increased by a few percentage points and the excess supply was 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.

IV. Practical Application of Supply Management Principles

Three major commodity proposals have been made to Congress by the administration in the past year--for feed grains, wheat, and milk.

The feed grains and wheat programs would start with a determination of the requirements of the market at price-support levels geared

to the income objectives of Congress and the Executive Branch. This total requirement, or aggregate demand, would be expressed nationally as a marketing or sales quota, and as a national acreage requirement. Beyond the national level, however, each state, each county, and each farm would find its share of the market expressed in terms of the number of acres which—with average expected yields—would produce the respective share of the national marketing quota.

Price support, in the case of feed grains, would be provided on all production on the acreage allotment. For wheat, price support would be provided at a level between 75 and 90 percent of parity for an amount of wheat used domestically and a share of the export market, and at a level related to the feed grain and world wheat prices for the balance.

A feature of both programs—essential to the shrinking of aggregate supply—would be diversion of the acreage removed from grains to conservation uses or other more extensive purposes. Payments would be provided for a limited time to support incomes but with the mandatory program, would not be essential to effective operation.

In both cases, failure of producers to approve the program by a two-thirds majority, would result in unlimited production with either no price support or very limited price support.

V. Criticisms of Supply Control 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? Increased net farm incomes, whether they arise out of wartime demand, supply control, or a natural shortage of land, always get capitalized into land values. Thus, the question might be asked—are we never to help increase farm incomes because such income increases get capitalized into land? Benefits to farmers resulting from effective supply management (i.e., rising net incomes first, and more stable incomes second) would get capitalized into land values, and in the longer run average costs per unit of output would come to 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, farmers would benefit from supply management 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.

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

B. There is no reason to believe that society would suffer any important loss in efficiency under the supply management route outlined here. Farmers would continue to take prices as given, and each farmer would seek to produce his quota share as cheaply as possible to 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 as they are now, 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. Summary

The supply management 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. It cannot provide managerial ability where that capacity is lacking. But it can do one thing, providing 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 adopt the discipline of supply management that is prerequisite to such incomes in American agriculture in the 1960's.