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PRICE CONTROL OF RAW AGRICULTURAL PRODUCTS

By

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Price Control Of Raw Agricultural Products\*

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## PRICE CONTROL OF RAW AGRICULTURAL PRODUCTS

Controlling inflation means bringing stability to price and wage levels, but in addition it involves bringing some orderliness into people's expectations for the future. In restoring stability to economic activity it is very important to feel that everyone is participating in the sacrifices required. It is difficult to ask constraint of one sector of the economy but not another.

The very special character of the agricultural economy and its market price mechanism makes the application of inflation control policies very difficult. On the other hand, the functionality of the economy-wide program to control inflation may hinge on the public's confidence in the universality of its application. In view of this dilemma, I would like 1) to consider the kind of price control policy that might be best adapted to the unique agricultural industries, 2) to provide some analysis of the consequences that might flow from the application of such a policy.

First we must differentiate between retail food prices which are influenced very little by changes in raw product prices, and those in which fluctuations in farm prices have an important bearing on the cost of living index. In the former category I would put baked goods, convenience foods, TV dinners, snack foods, and many canned items. Controlling or limiting agricultural product prices will have little effect on 2/3 of the items purchased in supermarkets. Pricing decisions for these items are influenced much more by labor, packaging and processing costs than by raw product prices. Raw product costs account for less than 15% of a can of red beets and only about 10% of a loaf of bread. The government can do very little about the prices of fruits and vegetables in any event, since they are strongly influenced by the weather.

Thus, one might make a case for trying to do something about the prices of farm products which do have a significant effect on the cost of living--namely milk and dairy products, meats, poultry and eggs, and sugar. By refusing to raise the support level on manufacturing milk, the government has, in effect, limited the potential rise in the farm price of milk (since Class I or fluid prices are closely linked to the manufacturing price, and this, in turn, is strongly influenced by support prices for butter, cheese and nonfat dry milk). The government also has the power to authorize increased supplies of sugar to hold down any rise in wholesale prices for sugar. Egg prices are now so low that it would be very inequitable to producers to freeze them at current levels. This leaves only beef and pork (and possibly broilers although supply effects could be more serious for these) for which some type of control program might be instituted. Even here, the price system performs functions different from those in other industries and requires special consideration.

## PRICE IN THE AGRICULTURAL ECONOMY

The American consumer is accustomed to the pricing behavior which results from "big business" enterprises. Most consumer products come from large national firms which have a substantial advertising and promotion capability. These prices do not fluctuate extensively in an effort to coordinate producers' decisions (supply) and consumers' decisions (demand). Instead such prices are a part of a carefully planned sequence of economic activity supported within large firms by advertising campaigns and by the ability to reduce the quantity going into the market when products do not move at planned prices. Thus, these prices tend to remain rather stable in recession periods and otherwise gradually move upward with inflationary pressures.

The agricultural production and marketing complex also has some of this type of price behavior because it too contains some very large firms. Highly processed products tend to behave in this way. But other segments exist within the agricultural and food complex in which price plays an important allocative role. Meat is an example. In this situation, the production process is not planned by large organizations, but rather emerges from the independent decisions of hundreds of thousands of individual producers. These decisions are affected by prices which in turn may be a function of feed supplies that are influenced by disease and weather in feed producing areas. Price has a special meaning here because it has an influence on producers' willingness to produce, and it also adjusts the demand for the product to fit the amount available at any point in time. In order for price to achieve these coordinating functions it must move up and down. Only by price variations are consumers led to accomodate supplies available and are producers signaled concerning the intensity of demand.

We are so used to the planned prices of a concentrated economic system that we find price movements associated with the true market mechanism startling. In many cases consumers and consumer spokesmen do not know how to classify or interpret these price movements. When prices go up sharply we feel a burden to "find the culprit". This is because we automatically think of price behavior as that associated with the predominant type of industry structure -- namely the big business or oligopoly industries. There isn't a villain creating high meat prices. There are no large concentrated structures in the channel in meat. Meat packers have shown a tendency toward lower concentration for the past twenty years. Supermarkets are the primary processor for beef and largest ten food retailers do less than 30% of the nation's retail meat distribution. The marketing activities of this complex of farmers and handlers is essentially governed by freely moving prices.

It is easy to see that the fluctuating price of meat is harder to control than the more stable prices of the more planned sectors of the economy. To freeze meat prices would substantially interfere with their allocative functions. This would cause major problems in moving a variable and perishable supply of products into consumption. Controlling meat prices at the raw product level would require substituting a system to replace the market mechanism functions of price, perhaps including quantity quotas for producers and rationing procedures for consumers.

### ALTERNATIVE CONTROL POSSIBILITIES

The concept of implementing price control in the form of a ceiling price might be considered. For purposes of analysis, it is useful to assume establishing as a ceiling price the levels of beef, pork and broiler prices during February 1972. Since I believe this is the wrong policy, particularly for the long run, I will assume such a ceiling would be in effect for no longer than one year. This analysis then involves rather immediate and short run consequences of such a stabilization policy. The ceiling price concept used in this example is probably the type of price control mechanism most applicable to the meat industries.

The first consequence which would flow from a ceiling price policy of this sort pertains to expectations concerning supply levels and demands for these products during the next year. Most analyses which I have seen for beef indicate an expectation that price levels will fluctuate below the February level during the coming year. If anticipations are fulfilled, the ceiling price at February levels would not influence the beef industry in any way.

The case for pork is not quite the same. Pork prices have eased off some since February but are expected to return to February levels later in the year. These higher prices for pork relate to production cutbacks which resulted from low prices for hogs and from higher corn prices which were the result of the 1970 corn blight. In addition, broilers are expected to have upward price pressure as pork becomes scarce. While February ceilings would not conflict with expected price movements for the immediate future, it is possible that ceilings at that level would conflict with price movements later in the year for both pork and broilers.

What would happen if market prices pressed up against the ceiling? The coordinating mechanism of the meat industry would be inoperative. Past experience in similar situations suggests that a rationing mechanism may be required to control the excess demand relative to supply at the ceiling price. If an artificial price ceiling prohibited upward price movements, some part of the demand would go unsatisfied. As a general principle, therefore, it must still follow that artificially restricting the upward movement of price must be accommodated by some artificial rationing system.

However, the magnitude of unfulfilled demand at these prices probably would be small. In addition, the likelihood of frustration of consumers in the market and the tendency for black market operations perhaps would be diminished by the expectation that the program would be of short duration. In essence, this policy would ask both the producers and consumers to make modest sacrifice in the public interest for a short period of time. It strikes me that affluent consumers are too occupied with interests beyond the household to spend very much energy organizing a black market which would enable them to pay more for meat. It should also be pointed out that today's market for food and food products has many alternatives which were not available a few decades ago when similar policy was in use.

A shortage of some products might have different consequences today than in times past. The widespread availability of home freezers might enable the well-to-do to buy when supplies are available and store the products until needed. As a result, the distribution of scarce products among buyers might be inequitable to the low income buyer.

Meat shortages might also be regional in intensity. Neither theory nor experience clearly outlines what might happen to regional patterns of distribution. It seems likely that a shortage, of say 2% would not be equally spread across the U. S. It is more likely that chronic deficit areas, such as the North East, might run a higher shortage while surplus areas took care of their local markets' total needs.

Any ceiling price policy of this type would require careful scrutiny of the marketing and distribution system for meat and aggressive enforcement of the margin regulations of Phase II. This policy would in effect give the marketing-distribution system a monopoly on scarce goods for which their price could not rise, and natural market tendencies would encourage higher prices at various marketing levels and black markets.

There would be some complications in terminating this policy. If prices for beef or pork particularly were at ceiling levels, there would be some incentive for producers to withhold products until after the termination date if such date were known. This behavior might reduce supplies artificially during the control period and preclude price from dropping below the ceiling when it otherwise might have. In addition, a small effect would be the diminution of product quality to the extent that animals are held past normal marketing dates. This argument would encourage a policy in which the date for lifting the price ceiling would not be announced. It should be kept in mind, however, that the workability and public confidence in the meat price ceiling policy would be related to an expectation that it was of short run duration from the outset.

Another question is the matter of equity. When policy is taken which disrupts the function of markets one result is a distortion of the equity position of various economy participants. This has relevance to the position of farmers in the livestock business as compared to those in other farm enterprises.

I would make no claim that this policy provides fair or equitable treatment either within agriculture or between agriculture and other sectors of the economy. In fact I expect that its result would be inequitable. On the other hand, I expect its economic result would be relatively small and therefore its effects on anybody's equity position would be relatively small. I think it might be the kind of a policy which could be tolerated for a brief period if it were felt to have salutary influence on the public interest in general the need to suppress inflation, etc.

### CONCLUSIONS

I should like to make clear that I am not recommending for or against a policy of price controls for meat at the raw product level. This decision is made weighing the disadvantages in agriculture with whatever advantages it may have in the economy generally.

If such policy should be considered important in the public interest, I would make the following suggestions:

1. Price ceilings instead of price fixing is probably more feasible in some agricultural products.
2. If ceilings are instituted, they should be on a short term basis. Longer run effects would be adverse to industry and public interest.
3. Price ceilings for beef, pork and broilers at February 1972 levels would cause only minor market disruptions during a period of application not longer than one year.