Government Commodity Support Programs In Cash and Futures Markets

BECAUSE OF RECENT and current proposals before Congress to support commodity prices by government action in the market, it seems appropriate to review similar actions in the past as a guide to the future. There are bills pending on government purchases of cash commodities for a so-called "strategic reserve." Recently a proposal was introduced which would have had the government trading in the futures market as a technique of supporting prices. No action was taken, but it is not unreasonable to suspect that similar concepts may again be proposed.

Previous governmental actions of this type, occurring between 1929 and 1932, pre-date the adult experience of many persons now in the business so it seems appropriate to provide a resumé of what took place. It is not our intention to imply that present economic and political conditions are comparable, but only to present historical information which is not readily available.

ACTIVITIES AND OPERATIONS OF THE FEDERAL FARM BOARD

A Report of the Senate Committee on Agriculture and Forestry July 29, 1935

"The Federal Farm Board sought to set up a marketing system, composed of cooperative associations in every wheat State, their membership open to every wheat farmer. Growers then could deliver their wheat as harvested, draw substantial advances against it, and let the cooperatives market the crop through the year at the best possible price, settling finally with the farmers on the basis of the price obtained. To accomplish this purpose, the Board sponsored the organization of Farmers National Grain Corporation (hereinafter referred to as the "Farmers National"). Various wheat pools and producer-owned elevators and sales agencies were in existence. The Farmers National was to keep them out of competition with each other, and to coordinate them into a marketing system.

All the existing State and regional grain cooperatives were invited to send representatives to a meeting called by the Farm Board at Chicago in July 1929, at which the Farmers National was launched. Thirty-two cooperatives were there represented. Ten became the original stockholders of the Farmers National (October 29, 1929). The number grew to 27 on August 16, 1932, the date of the latest stockholder's meeting during the period covered by the special examination made for this committee.

Farmers National was incorporated in Delaware as a private corporation organized for profit. A recipient of Government loans, it was in no sense a Government agency. Its stockholders were regional cooperative associations which deal in grain and which themselves were composed not of individual producers but of local grain cooperatives. Five layers deep in this pyramid of Government and corporate structure was the farmer. That is, the farmer (1) joins a local cooperative, (2) which joins a regional cooperative, (3) which joins the Farmers National, (4) which operates on funds borrowed from the Farm Board, (5) to which the Congress has appropriated Government money.

From its inception, the Farm Board was under strong pressure to peg wheat prices by buying in the market with Government funds. At the meeting in July 1929, when organization of Farmers National was begun, the Farm Board members present had to be emphatic in insisting to the wheat men that the new cooperative was intended as a marketing rather than a stabilizing agency.

For 7 months the Farm Board withstood the pressure, which came from public men as well as growers. The Board believed that the cooperatives, nationally organized and financed with Government loans, could hold wheat off the market for favorable prices. To that end, the Board agreed, August 26, 1929 to lend the cooperatives 10 cents a bushel on their members' stored wheat in addition to the loans thereon from commercial and Federal intermediate credit banks, which customarily loaned up to 75 percent of value. With the Farm Board's supplemental loans, growers could have the use of money equal to 85 or 90 percent of the value of their crop while still holding the wheat off the market. The stored wheat became collateral for security of both the bank and Farm Board loans.

When the stock market collapsed, October 23, 1929, wheat prices fell off sympathetically, a decline which the Farm Board considered unjustified by any fundamental factor in the grain market. The Board in October 1929 established a flat scale of prices ($1.18 at Chicago) which it pledged itself to support with loans through Farmers National. As banks called for reductions of their loans, the Farm Board automatically increased its lendings; so that the total advanced remained unchanged at the value established by the Board's price schedule. The effect was to save the grain held as collateral from being thrown to forced sale and sending the price still lower. In some cases the Board even guaranteed banks' margins pending refinancing.

Wheat poured into the hands of the cooperatives, which took deliveries at prices equal to the loan values which the Farm Board's guarantee supported. The Board's investment in wheat increased tremendously. But the price fell, even below the amounts for which the grain was marketed. In February 1930 the Board decided that the Government should go into the market as a buyer, for the double purpose of upholding the market price and protecting its own loans to the cooperatives.

A second Delaware corporation, Grain Stabilization Corporation, was set up and was loaned $10,000,000 from the revolving fund. With this and subsequent loans, it bought from the cooperatives and from Farmers National their accumulated wheat stocks; and after protest from independent elevator owners and grain growers not in the cooperatives, it expanded its purchases to include all country run wheat.

Continued decline of price led to abandonment of the "pegged price" and then to cessation of purchase of cash wheat; although Grain Stabilization Corporation continued buying futures to the extent deemed necessary to prevent the price from falling further. By July 1930, when its purchasing ceased, Grain Stabilization Corporation had borrowed and spent $90,000,000 and had bought 65,000,000 bushels of wheat. The price had fallen 33 cents a bushel during the operation. The Farm Board announced that no stabilization purchases would be made from the 1930 crop, and began an unpopular campaign to reduce the wheat acreage.

Nevertheless, November 15, 1930, wheat having dropped to 73 cents at Chicago, the Board authorized a second

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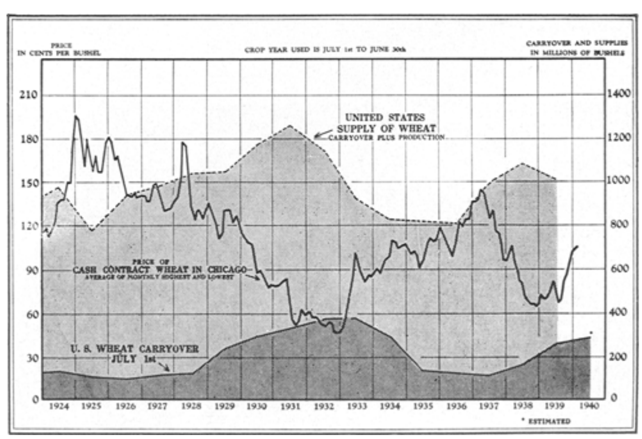

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stabilization program, ran the price gradually to 81 cents and held it there until June 2, 1931. Thereafter there was no systematic buying to sustain wheat prices. This operation accumulated 192,000,000 bushels of wheat and cost $169,000,000 in Government loans. The transaction was criticized as "bank relief," on the ground that more than half the 1930 crop had passed out of farmers' hands when Grain Stabilization Corporation began buying. Protection of collateral in the form of wheat held as security for bank loans appears indeed to have been the main motive, but it was wheat owned and borrowed against by the grain cooperatives."

Rainer Schickele, Chairman of Department of Agricultural Economics, North Dakota Agricultural College, summarizes the Farm Board activities as follows:

A revolving fund of 500 million dollars was authorized for encouraging national farm cooperatives and making commodity loans available to them or acquiring surpluses through "Stabilization Corporations."

The Board worked through national organizations of marketing cooperatives on the assumption that farmers could sell their products in a much more orderly fashion, withholding supplies when prices are low and releasing them gradually when they pick up again. And beyond that, the cooperatives were expected to induce farmers to control their production and prevent surpluses from arising.

These hopes were vain. Prices continued their decline throughout the Board's existence, and farmers did not reduce output. They, as individuals, could not afford to do so, and neither the Board nor the cooperatives had any sanctions at their disposal to secure farmers' compliance with production controls.

The Board financed large-scale operations for only two commodities, wheat and cotton, but loans were made for about 20 commodities some time during the period of the program. At one time the Stabilization Corporations held 257 million bushels of wheat, almost one-third of a normal year's crop, and 3½ million bales of cotton, over one-fourth of a year's crop. The Board could dispose of the surpluses it had acquired according to its own judgment, which meant that these stocks were not fully withdrawn from the market. Private trade could never be sure just when these stocks might be sold, which dampened the price-supporting effect of these measures.

Although a comprehensive appraisal of the net effect of the program on farm income is not available, it might well have been larger than the 329 million dollar loss out of the original 500 million dollars with which the Board ended up after 3 years in operation. Since prices did not pick up, the Board had to sell the wheat and cotton bought or taken over under its loan program at considerable losses, and large quantities were given to the Red Cross for distribution, including sizable shipments to famine-stricken China.

Perhaps it is not fair to pronounce the Federal Farm Board program a failure. In 1929 and 1930 no one could foresee the devastating proportions which the Depression was to assume. If world recovery had begun in 1931, the Farm Board would have been a shining success. It shared with other price stabilization programs in other countries, like the Canadian Wheat Pool, the frustrating experience of trying to fight a deep and prolonged depression with conventional, timid, emergency measures. From the viewpoint of the economy as a whole, no real losses were suffered as a result of the program, since all the surpluses were actually channeled into appropriate uses. There was no output reduction, diversion into inferior uses, or destruction of commodities. Still, the means employed in this program proved woefully inadequate to achieve its end.

The Federal Farm Board Annual Report of December 1930 recognized its operational difficulties long before its activities were terminated.

"Final effect on the revolving fund cannot be stated until the Stabilization Corporation has disposed of its holdings. The outcome, so far as it can now be appraised, was not all that had been hoped for. While some contribution was made toward stabilizing wheat prices, at no mean cost in various forms, declines in prices of wheat and other agricultural products, while retarded, were not permanently prevented. Action taken was based on interpretation of world conditions, in the light of which wheat price declines appear unwarranted. This view was not borne out by actual developments. Facts eventually proved it wrong. The major error lay in the estimate of European import purchases. Three important factors were incorrectly forecast: (a) European carryovers of wheat were unusually large; (b) Europe's excellent crops of cereals, as well as wheat, made possible substantial curtailment of wheat imports; (c) European countries took steps to restrain wheat imports, by milling regulations, increased tariffs, and otherwise—and in a few cases, notably France, to encourage wheat exports." Summing up its year's experience, the Farm Board report continues:

1. "In a major stabilization operation with a commodity such as wheat, it is inevitable that a large quantity of the commodity must be taken in order to exert any material effect on the market. Furthermore, the accumulation of a substantial volume, the most of which necessarily must be in the visible supply, has a somewhat depressing effect upon prices. Announcement that such accumulations will not be sold is not sufficient to reassure buyers unless the quantity thus held renders difficult the purchase of supplies adequate to the demand. Even then, the demand is curtailed or limited to immediate requirements, and forward buying in anticipation of future needs is lessened.

2. "Purchase in the cash market alone are inadequate to sustain prices and do great injury to legitimate operations in the option market by throwing cash prices out of line with the futures. This being true, a stabilization activity must be conducted along the entire line with the inevitable result that large purchases for future delivery must be made. Wheat thus secured by delivery on futures contracts is contract grade and may vary in actual value from 2 to 5 cents below country run wheat.

3. "Transactions in the futures market having been entered upon, there is no good place to stop, even within the limits of a single crop-marketing period. Option prices are published covering a period of from six to nine months in advance, and as soon as any future option is abandoned or militated against, that option gets out of line with the cash market and other options. This imposes considerable hardship upon processors whose customary practice of hedging or insuring their purchases is conducted through the futures market.

4. "The storage problem is a serious one in any stabilization activity. The grain must be in a position where warehouse receipts can be issued against it as a means of insuring safe delivery of the commodity. The facilities for doing this are limited. Mostly they are needed for the ordinary storing and merchandising of all kinds of grain. Therefore, when a large quantity of wheat is purchased and held in terminals or public warehouses, it not only becomes a part of the visible supply but renders the facilities inadequate for handling the grain of the growers, merchants and processors. Some of the grain of the Stabilization Corporation inevitably gets out of position for most economical use or sale.

5. "Stabilization Corporation activities, as usually considered, mean principally buying, not selling. This is particularly true when the price is low and markets are weak. Sales by a stabilization corporation tend promptly to turn the market downward and abundant complaint is received from growers who are still holding their grain. With the price at a level satisfactory to growers, assuming it can be put there, wheat rolls into the terminals. When the terminals are full, farmers who cannot sell complain bitterly; the visible supply is increased, in the first six months of the new crop year our best export period passes

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and the Stabilization Corporation finds itself with abundant supplies to be marketed in competition with all export countries. Charges for carrying are cumulative at about $1\frac{1}{2}$ cents per bushel per month, and the operation, to break even, must include these charges when the grain is sold."

Secretary of Agriculture Hyde said, in his annual report of 1930:

"By this time it is evident that supply and demand conditions cannot be set aside by legislation, that the dumping of surpluses abroad is not feasible, that the indefinite storing of surpluses tends to prevent rather than cause a rise in prices, that tariff duties are not effective on commodities produced largely for export and that subsidies would increase rather than restrain production."

James M. Beck, Representative from Pennsylvania, said on November 10, 1931:

"The Farm Board sought to minimize speculation and became the greatest speculator in grain and cotton; it sought to stabilize prices and it drove them downward until they fell below the cost of production; it sought to prevent a surplus and only increased the surplus; it sought to decrease the planting acreage and only increased it; it sought to secure orderly marketing and with the government as the biggest speculator in wheat and cotton with unlimited means, the orderly marketing became disorderly past precedent. It sought to prevent depression in agriculture and it has contributed to the greatest depression in our history; it sought to prevent wasteful methods of distribution and only succeeded in imposing upon the people of the United States at least one-half of the present governmental deficit.

The Grain Committee on National Affairs, a group representing the grain trade industry, summed up the attempt to support prices as follows:

This was an attempt to find farm relief through a price setting commodity approach and was the most pretentious effort to reverse currents of commerce through legislative enactment in all the world's history. Invested with responsibility, authority and resources beyond anything ever before conferred upon a civil organization aimed to benefit a class of citizens, the Federal Farm Board was favored by a combination of circumstances such as no other government agency ever enjoyed. It was created without serious opposition. Aside from the grain trade, small in number and financially unimportant, it was approved by business. Bankers were on its advisory board and an outstanding industrial leader was at its head. The time was propitious for such a trial. Agricultural liquidation from war-time price inflation had been accomplished. It operated in years of serious crop losses, either at home or abroad.

When the Farm Board so equipped, with such support, resources and power, starting under such circumstances and meeting such crop developments, has completely failed it seems the inevitable conclusion that all such efforts at legislation must fail. If in addition to its complete failure to advance farm price levels, it has brought about world conditions under which prices have sunk to a lower level than prevailed when farm land sold for less than it is now taxed, the conclusion is inevitable that the only power such legislation has over commerce is the power to destroy it. The whole of the accomplishment of this ill-starred effort to create value by law may be summed up in this tragic loss; millions to the grain trade and transportation lines; hundreds of millions to tax payers; a billion or more to agriculture and a degree of responsibility for an industrial and financial collapse that has carried in its train a political revolution and a sum of human misery beyond any precedent in America.

The failure of this effort is not to be sought in mistakes of the men charged with administration of the law, though the personal equation may have contributed to the speed of the debacle. The failure was inherent in the plan itself. There was no individual intention to destroy established business; to ruin established farmer cooperative ventures; to undermine the price level of commodities, nor to waste the taxpayers funds, but the whole process was inevitable as it must be in all legislation which seeks to supplant the distributing tides of a profitable commerce with the stagnating waters of a government monopoly.

The fundamental error in this, as in all similar plans yet suggested, is the effort to artificially enhance the selling price of a selected product instead of an effort to seek out and treat the cause of the growing disparity between farm and general commodity prices.

It is especially interesting to note current thinking on the topic of government purchases as a price supporting mechanism. On April 23, 1968, the dialogue in a House Agriculture Committee hearing went like this:

Rep. Page Belcher, (Rep., Okla.) accused proponents of a commodity reserve of sacrificing future farm prices, when demand might outstrip available supply, in order to bolster current prices.

Chairman W. R. Poage (Dem., Tex.) also expressed reservations about the reserve idea as an aid to farmers prices, but he indicated that his recent trip to Taiwan and Japan on a trade mission convinced him that there were other reasons to favor the bill.

"It is important to say to our foreign customers that we have the goods and ability to deliver the goods at any time." Rep. Poage said. But, he added that "We are fooling ourselves if we think we can help farmer bargaining power by collecting surpluses."

Witnesses, however, disagreed. Clifford Daleness, a South Dakota wheat farmer and representative of the National Association of Farmer Elected Committeemen, told the committee members that locking away excess grain "is preferable to leaving it in farmers hands so you never know when it will hit the market."

David M. Bartholomew, Commodity Analyst, Merrill Lynch, Pierce, Fenner & Smith Incorporated.