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Extension and Amendment of P. L. 480 — 3 pages

Allan F. Rau

Stabilization of Foodgrain Prices in India — 4 pages

Rodney H. Mills

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November 10, 1959.

Extension and Amendment of P. L. 480

Allan F. Rau.

The Congress has extended the Agricultural Trade Development and Assistance Act of 1954 (P. L. 480) to December 31, 1961, and amended some of its provisions.

The new Act (P. L. 86-341) authorizes the inauguration of a food stamp system to distribute surplus food commodities to needy persons in the United States at a cost not to exceed $250 million annually, and expands the scope of exports of surplus agricultural commodities.

Overseas disposal of commodities

The Commodity Credit Corporation may continue to spend up to $1.5 billion annually (including the value of the Corporation's own stocks) to finance sales of surplus agricultural commodities for foreign currencies during the calendar years 1960 and 1961 under Title I of P. L. 480. In addition, up to $300 million annually may be used for grants abroad of surplus agricultural commodities under Title II to help friendly foreign people to meet famine or other urgent or extraordinary relief requirements.

Under a new Title IV, "the President is authorized to enter into agreements with friendly nations under which the United States shall undertake to provide for delivery annually of certain quantities of such surplus agricultural commodities for periods of not to exceed ten years, . . . providing such commodities are in surplus at the time delivery is to be made."

Payment for commodities is to be in dollars "with interest at such rate as the Secretary may determine but not more than the cost of the funds to the United States Treasury as determined by the Secretary of the Treasury, taking into consideration the current average market yields on outstanding marketable obligations of the United States having maturity comparable to the maturities of loans made by the President under this section. Payment may be made in approximately equal annual amounts over periods of not to exceed twenty years from the date of the last delivery of commodities in each calendar year under the agreement and interest shall be computed from the date of such last delivery."

"In carrying out the provisions of this title, the Secretary of Agriculture shall endeavor to maximize the sale of United States agricultural commodities taking such reasonable precautions as he determines necessary to avoid replacing any sales which the Secretary finds and determines would otherwise be made for cash dollars."

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"In entering into such agreements, the Secretary shall endeavor to reach agreement with other exporting nations of such commodities for their participation in the supply and assistance program herein authorized on a proportionate and equal basis."

The Act reinstates the authority, removed in 1958, to barter surplus agricultural commodities for materials "to meet requirements of Government agencies." It does not include the Administration's proposals for strengthening the "Food for Peace Program" through the broader use of surplus commodities for food reserve stockpiles and for grants to promote economic development.

Analysis of provisions

During the first four years of the sales for local currencies program under Title I of P. L. 480, Congress authorized the Commodity Credit Corporation to incur costs under the program at the average rate of $1 billion per year. Since the end of the fiscal year 1958, costs under the program have been running at the rate of $1.5 billion per year.

Prior to the 1959 extension of P. L. 480, a total of $800 million had been appropriated for grants for Title II programs. The new appropriation of $300 million per year is a significant increase; however, it should be noted that grants authorized under Section III for distribution to needy persons overseas through nonprofit agencies and intergovernmental organizations are not limited and have been about triple the Title II grants.

The new authorization for 10-year supply contracts with foreign governments implies that our agricultural surpluses will be with us for many years to come. This is the first departure from the principle that agricultural surplus disposal is a temporary short-run matter.

If particular commodities are not in surplus in the future, delivery will not be mandatory under Title IV agreements; thus, in such an eventuality U. S. interests are protected, but the Act does not specify any protection for the purchaser. Nevertheless, such long-term contracts may be helpful to recipient countries, as India has indicated, in enabling them to make long-range plans.

For the first time, the cost of the funds to the U. S. Treasury is the upper rather than the lower limit for the interest rate to be established. Even if the rate of interest for these dollar sales is set at a very low level, it is doubtful whether an appreciable amount of agricultural surpluses will be sold under this program unless the dollar prices established for the various surplus commodities are well below the equivalent prices under Title I local currency sales. While under Title I the recipient countries deposit the foreign currency price of the commodities to the account of the U. S. Government abroad at the time that the commodities are received, more than one-half of these funds is being loaned back to the countries for periods up to 40 years with interest, at the present time, of 4 per cent.

It appears that only less-developed areas are eligible to make purchases under this title; the Act states that "the purpose of this title is to utilize surplus agricultural commodities . . . to assist the economic development of friendly nations by providing long-term credit for purchases of surplus agricultural commodities for domestic consumption during periods of economic development." (Emphasis added.)

Less-developed countries that are not able to purchase the amount of agricultural commodities they desire under Title I, because in the opinion of the U. S. Department of Agriculture they have dollars available to meet dollar payments, might be interested in Title IV dollar sales if they expect to have sufficient dollars available as the payments fall due. However, as in the case of Title I local currency sales, such sales might be ruled out if they were to displace "normal" dollar sales.

Since deliveries under the agreements would extend over periods of up to 10 years, it would be virtually impossible to determine at the time of the negotiation of the agreements whether or not all the deliveries under the agreements would be in addition to "normal" dollar sales. The Department of Agriculture has not decided how it will solve this problem. It might include an "escape clause" in the agreements which would allow cancellation of scheduled deliveries if at any time during the life of the delivery contract the Secretary of Agriculture should determine that such deliveries would displace "normal" dollar sales. Such "escape clauses" would, however, make Title IV sales less desirable for the recipient country.

The reference to possible cooperation with other countries indicates that the Congress desires to minimize complaints of other agricultural exporters by giving them a voice in the allocation of Title IV sales, and possibly also to make other countries "share the burden" of such long-term credit sales.

The National Advisory Council on International Monetary and Financial Problems will determine conditions of Title IV lending. Therefore, through the NAC, the Federal Reserve will be involved in the problems created by this new lending program if it is put into operation. However, considering the Administration's opposition to the enactment of Title IV, it would be reasonable to expect that little action will be taken under its authority.

November 10, 1959

Stabilization of Foodgrain Prices in India

Rodney H. Mills

The rate of increase of food production in India over the past six years has fallen short of the rise in the demand for food generated by population growth and increasing per-capita real income. The consequent rise in food prices relative to other prices is symptomatic of a growing sectoral imbalance in the Indian economy. In the early months of 1959, a team of U.S. agricultural experts, under the sponsorship of the Ford Foundation, visited India, to assess the country's agricultural production methods, its future food requirements, and the prospects for meeting those requirements from higher domestic output. The mission concluded that food production must increase at a far faster rate than it has in the past decade if India is to avoid a serious food crisis. These experts recommended that one of the major steps which India should take to stimulate greater food production was to introduce a program for stabilizing the prices of foodgrains.1/ In view of the financial costs of such a program and the difficulties other countries have experienced with such measures, it is desirable that this suggestion be very carefully scrutinized.

Arguments for stabilization

The Johnson report maintains that injurious effects result from the several types of variation to which foodgrain prices in India are subject. First, it is said that during the course of the agricultural year prices tend to be lowest at harvest time, when the farmer must sell to meet his obligations. This seasonal fluctuation is customarily greater than can be warranted by the costs of storage and risk of quality deterioration, and reflects the weak bargaining position of the farmer and his inability to retain possession of the harvested crops. Second, it is alleged that from market to market there exist differentials in the prices of the same commodity at the same time which exceed the cost of shipping goods from place to place. These differentials are the consequence of ignorance, lack of communication, and insufficient transportation facilities. Third, prices of foodgrains tend to fluctuate widely from year to year. The report declares that as a result of this instability producers, especially small farmers, hesitate to invest and to incur additional operating expenses for fear that prices will fall and that future receipts will not cover the cost of the added outlays. This is said to retard the expansion of production. The Johnson mission believes that the producer should be assured of a price for his crop, announced in advance of the sowing season, which "will enable him to

1/ See Rodney H. Mills, "India's Food Crisis," Review of Foreign Developments, August 11, 1959, for a discussion of other recommendations of the mission.

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invest in fertilizer, seed, and new equipment knowing that, with average crop conditions, he can repay any debts with the added income that results from adoption of improved practices. Such assurance would constitute an important incentive to increased production."

The Johnson recommendations dovetail with a program to stabilize foodgrains prices advocated by the Foodgrains Enquiry Committee of the Indian Government in its report published in November 1957. The reasons put forth by this committee in support of its recommendation are obscurely worded, but seem to be as follows: (1) sharp fluctuations are undesirable per se because "prices often get completely out of parity with costs and incomes"; (2) "semi-monopolistic elements" create unjustified regional price disparities; (3) the farmer requires the assurance that prices will not be allowed to fall below "economic levels" to maintain his incentive to invest in his property; (4) declines in foodgrains prices shortly thereafter result in depressed levels of production.

Potential consequence of a stabilization program

Like the Johnson mission, the Foodgrains Enquiry Committee advocated a buffer stock scheme, involving government purchases and sales in the market to keep prices above or below minimum and maximum "desirable" levels. We may get some idea of what this scheme would involve from the Committee's report. It would be costly. The Committee estimated that the agency in charge of operating the program "should be able to manage with a capital of one billion rupees, which may be subsequently increased as its business expands." This amount is equal to over 5 per cent of total budgeted central government disbursements in 1959-60. The question arises whether it would be in the national interest to keep that amount of resources tied up in such a scheme.

The price policy outlined by the Foodgrains Enquiry Committee was one which was intended to mitigate wide swings but which would not interfere with "secular or long-term trends" as shaped by factors affecting the price level as a whole as well as changes in technology or consumption patterns which would alter foodgrains prices relative to other prices. However, the attempt to achieve such an objective could lead to severe complications to which the advocates of price stabilization fail to give due consideration. To know when, and by how much, to intervene in the market presupposes an ability to foresee future supply and demand forces, and to separate the long-run from the short-run forces. A wrong prognostication might lead to a prolonged build-up of the buffer stock, and this withholding of resources would be detrimental to the welfare of consumers (whose economic status is not much above that of the farmers). Eventually such an error would be recognized, but the undoing of the error by a reduction in the support prices and dumping of the buffer stock might bring more ruin to the farmers than would have resulted from freely-fluctuating prices. On the other hand, price-suppressing sales of the

buffer stock, intended as a counteractive to what was believed to be a short-period, reversible phenomenon, might turn out to be a device by which the farmers were deprived of what was rightfully theirs when economic forces dictated a long-run increase in foodgrains prices. The effect of such an experience on the farmer's incentive to invest can be well imagined. In short, an attempt at price stabilization could lead to costly mistakes which India can ill afford.

Validity of arguments for stabilization

In view of the high cost and risks involved in a price stabilization program, it would be well to inquire very carefully into the validity of the arguments made by the Johnson team and the Foodgrains Enquiry Committee that price fluctuations are in fact a deterrent to the expansion of agricultural production in India. It seems plausible to say that the fear of falling prices tends to keep farmers from investing in fertilizers, irrigation and improved equipment. However, this contention does not seem to be based on any empirical observation, and it is equally possible to argue that price fluctuations are a spur to saving and investment. Studies in the economics of farm management in India and other Asian countries that are available here do not indicate that price fluctuations have been a factor in determining the level or pattern of investment. The main problem seems to be a traditional preference for investment in land rather than in the materials necessary to raise productivity.

It is of interest to attempt to ascertain the validity of the contention made by the Foodgrains Enquiry Committee that declines in the prices of foodgrains hold down production in the immediately-following period. (Presumably this is supposed to restrict the long-run growth of foodgrains production, although in just what way it should do this is not clear.) The only way to test the validity of the charge is to compare price changes with changes in the acreages under foodgrains, since yields per acre are so highly influenced by climatic conditions. We have done this with a rank correlation which employs the yearly percentage changes in wholesale prices in given years, and the yearly percentage changes in acreage in each following year, for wheat, rice, jowar (sorghum), and bajra (a type of millet) during the period covered by the crop years 1949-50 to 1957-58.1/ For each of the four commodities, an algebraic ranking is made of both the percentage changes in price and the percentage changes in acreage, and the rank value of the change in price in each given year is paired with the rank value of the change in price in the following year. The paired rank values for each crop are combined in a single correlation. The correlation would show whether relatively large declines in price led to relatively large declines (or relatively small increases) in acreage, and conversely whether relatively large increases in price were followed by relatively large increases (or small declines) in acreage. This procedure gives a coefficient of rank correlation of

1/ Rank correlation is used because of the upward tendencies in acreage.

-.370, which is barely above even the .05 level of significance for 28 pairs of observations and which is negative instead of positive. In India, a vast country in which given climatic conditions obtain, from region to region, at different times of the year, production of the various foodgrains is taking place in one area or another almost continuously. A particular crop is sown in one region at the beginning of the agricultural year, in another region in the middle of the year, and in another region at the end. Thus it is advisable to see if there was any regular relationship between changes in price and changes in acreage in the same (instead of the following) year. Rank correlation of the type previously employed, for the same commodities and time period, give a coefficient of .0015, indicating no regular relationship whatsoever. It does not appear that price declines have led to restrictions in acreage and that a price stabilization program can be justified on these grounds.

The writer is not prepared to prescribe remedies for any injurious effects on the incentive to invest which might stem from price instability. Possibly the answer lies in the field of expanded and improved credit facilities which would enable farmers to borrow at lower rates of interest and on long enough terms so that repayment could be made with "average" proceeds earned over a period that included both low-price and high price years. In view of the very slow progress made by the cooperative credit movement in India, there is no assurance that efforts in this direction would meet with substantial and quick success. But whatever the answer may be, interference with the price mechanism would be gambling with the future. Soundly-based policies are the best guarantee for India's economic development.