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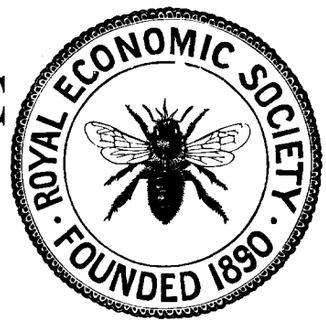

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THE POLICY OF GOVERNMENT STORAGE OF FOOD-STUFFS AND RAW MATERIALS[1]

I

IT is an outstanding fault of the competitive system that there is no sufficient incentive to the individual enterprise to store surplus stocks of materials, so as to maintain continuity of output and to average, as far as possible, periods of high and of low demand. The competitive system abhors the existence of stocks, with as strong a reflex as nature abhors a vacuum, because stocks yield a *negative* return in terms of themselves. It is ready without remorse to tear the structure of output to pieces rather than admit them, and in the effort to rid itself of them. Its smooth and efficient working presumes in practice, as stringently as the static analysis presumes in theory, a steady rate, or a steady growth, of effective demand. If demand fluctuates, a divergence immediately ensues between the general interest and the course of action in respect of stocks which is most advantageous for each competitive enterprise acting independently.

There are several reasons for this. The cost of storage and interest is fairly high, especially in the case of surplus stocks which strain the capacity of the normal accommodation. In the case of many commodities the charges probably approximate to 10 per cent. per annum; whilst the length of time for which holding will be necessary and the ultimate normal price are both matters of great uncertainty. There are, however, two other still more dominating factors. Experience teaches those who are able and willing to run the speculative risk that when the market starts to move downward it is safer and more profitable to await a further decline. The primary producer is, as a rule, unable or unwilling to hold, so that, if the speculative purchaser holds back, he will get the commodity still cheaper. Thus, even if it would pay him to buy at the existing price on long-period considerations, it will often pay him better to wait for a still lower price. The other factor arises out of the lack of incentive to the retailer or the manufacturing consumer to purchase in advance. By purchasing in excess of his immediate needs he may make a speculative profit or loss just like any outside speculator, but as a trader or a manufacturer his position will be competitively satisfactory when the

[1] A paper read before Section F of the British Association, Cambridge, August 1938.

time comes to use the materials, provided he is paying the *current* price. Thus a cautious user would rather pay the current price for his raw materials on which his own selling prices are based than run a speculative risk; and this attitude is reinforced by the fact that his interests are already bound up with activity in the demand for the commodity in question, so that he is multiplying unnecessarily the same kind of risk if he buys his material in advance of his needs. On the other hand, the long-term holding power of the outside speculator is limited—most participants in the market being more interested in a rapid turn-over—and can only be called into action on a sufficient scale by a drastic fall in price which will curtail current output substantially and appears to be a long way below any probable normal cost of future production.

For these various reasons the fluctuations in the prices of the principal raw materials which are produced and marketed in conditions of unrestricted competition, are quite staggering. This is the case not only during well-marked trade cycles, but as a result of all sorts of chance causes which lead to fluctuations in immediate demand. The extent of these is apt to be concealed from those who only watch the movements of index numbers and do not study individual commodities; since index numbers, partly by averaging and partly by including many commodities which are not marketed in fully competitive conditions, mask the short-period price fluctuations of the sensitive commodities. Let me give some illustrations.

Rubber, wheat, lead and cotton will give us a good sample of the class of commodity which I have in mind. Let us examine by what percentage the highest price in each of the last ten years exceeded the lowest price *in that year* :—

Rubber. There has only been one year in the last ten in which the high price of the year has exceeded the low by less than 70 per cent. The average excess of the year's high over the year's low has been 96 per cent. In other words, there is on the average some date in every year in which the price of rubber is approximately double its price at some other date in that year.

Cotton. Since rubber may be regarded as a notoriously fluctuating commodity, in spite of its having been subject to an organised restriction scheme, let us take cotton. Only twice in the last ten years has the high price of the year exceeded the low by less than 33 per cent. and the average excess of the year's high over the year's low has been 42 per cent.

Wheat, however, is nearly as fluctuating in price as rubber, which may perhaps surprise you. If we take the Liverpool contract as our standard, there has been only one year in the last ten when the highest price of the year has exceeded the lowest by less than 47 per cent.; and the average excess of the year's high over the year's low has been no less than 70 per cent.

Lead is mainly marketed by a small number of powerful producers acting with some measure of consultation. Yet, even so, the annual range of price fluctuations is on much the same scale as with the commodities already examined. Only twice in the ten years has the price range from lowest to highest been less than 35 per cent., and the annual average range has been 61 per cent.

Thus for these four commodities—rubber, cotton, wheat and lead—which are, I think, fairly representative of raw materials marketed in competitive conditions, the average annual price range over the last ten years has been 67 per cent. An orderly programme of output, either of the raw materials themselves or of their manufactured products, is scarcely possible in such conditions.

The ill effect of these truly frightful fluctuations on trade stability is great. But the ultimate results of the obstacles which they offer to the holding stocks may be even more injurious. In spite of the fact that the difficulty of rapidly altering the scale of output, especially where seasonal crops are concerned, leads to what appear to be very large stocks at the bottom of the market, nevertheless when the turn of the tide comes, stocks nearly always turn out to be insufficient, precisely for the reason that it is just as difficult rapidly to increase the scale of delivered output as it had been to diminish it. Prices rush up, uneconomic and excessive output is stimulated and the seeds are sown of a subsequent collapse.

Even though fluctuations in the demand for many finished commodities owing to changes in fashion and in the direction of demand may be unavoidable, and though it is certainly the case that no radical remedy for fluctuations is possible except through measures to stabilise the aggregate of effective demand, nevertheless some modification should be possible in the case of the great staple raw materials, most of which can be readily stored without serious deterioration, by direct measures affecting the individual commodity. Assuredly nothing can be more inefficient than the present system by which the price is always too high or too low

and there are frequent meaningless fluctuations in the plant and labour force employed.

For many years the orthodoxy of *laissez-faire* and unregulated competition has stood in the way of effective action to fill this outstanding gap in the organisation of competitive industry. Even now the suspicion with which attempts at the long-period stabilisation of individual prices are rightly viewed is often directed also against measures aimed at short-period stabilisation. Nevertheless there are to-day many signs of attempts to tackle the problem by various methods and from various motives. It is these, and in particular certain important pioneer proposals by our own Government, which it is the object of this paper briefly to review.

II

There are, first of all, the devices for stabilising the prices of their products adopted by private enterprises without the aid or encouragement of Governments. In some cases a single producer is responsible for the major part of the output, or a body of producers accepts a joint marketing policy and is in a position to fix the price with only a limited reference to the state of immediate demand. Nickel and diamonds are good examples of commodities subject to such marketing conditions. A recent small change in the British price of aluminium was the first change of any kind for six years. But in such cases the policy of price stabilisation is merely a part of a general policy of monopoly. An approximation to the same state of affairs arises through cartels, quotas and price agreements, sometimes of an international character, such as govern most types of iron and steel products, cement and many other semi-manufactured articles. Where output is in the hands of a small number of financially strong enterprises there may be looser, but nevertheless effective, arrangements, as in the case of copper and oil.

The multitude of such arrangements, which must cover far more products than anyone could specify in detail, only serves to increase the exposure of the remaining materials which are produced by a great number of independent producers, widely scattered in locality, marketing in conditions approximating to those of full competition. For we have to-day two contrasted types of marketing policy existing side by side. On the one hand, those enjoying what have been called " administered " prices[1]—

[1] The term " administered prices " is due to Mr. E. G. Means of the U.S. Dept. of Agriculture.

that is, with prices comparatively stable and fluctuations in demand met by a centralised control of output and by organised arrangements for the withholding of stocks on the part of the producers themselves—and, on the other hand, those with " competitive " prices, where the producers themselves are not in a position to withhold their stocks and the scale of output is governed by price fluctuations. The former arrangement is apt to be objectionable in general, even when it is highly desirable for the particular purpose of meeting fluctuations, because it may be part and parcel of conditions of almost uncontrolled monopoly; whilst the latter arrangement is hardly less objectionable, in that it so greatly increases the risks and losses of enterprise.

The fact that we have two major groups of commodities which respond quite differently to fluctuations in effective demand is of great importance to the general theory of the short period. In practice, however, it is in the United States that administrators have become most expressly conscious of the contrast, and Mr. Roosevelt's administration is simultaneously engaged in attempting to temper the element of monopolistic marketing in the first group and the element of competitive marketing in the second, twin objectives which are not so inconsistent with one another as they are sometimes represented to be. In all parts of the world, however, Governments are now interesting themselves in this problem, and a great variety of schemes, most of them national and a few of them international, have come into being. We have the internationally controlled restriction schemes for sugar, tea, rubber and tin. But it is, at present, only in the case of tin that the restriction scheme is supplemented, as seems only sensible, by concerted arrangements for the withholding of stocks and thus securing a somewhat more continuous rate of output. There are many schemes—indeed, few countries are without them—for the marketing of wheat. Above all, there are the ambitious proposals, only in their initial stages at present, of Mr. Wallace, the U.S. Secretary of Agriculture, for the establishment of what he calls an ever-normal granary.

The motives behind these various schemes are not all the same. In the majority of cases the primary object of the Government has been the protection of its small-scale producers from ruinous price fluctuations, of which the holding of stocks has been a subsidiary and undesired bye-product. There are, however, certain examples of the withholding of stocks for its own sake, with a view to averaging the irregularities of demand and supply. The Buffer Pool for tin and Mr. Wallace's ever-normal granaries for assisting

particular commodities have been already referred to. I have heard mention, but not with details, of an experimental purchase by the Bank of Sweden of certain stocks of commodities as a form of central banking reserves alternative to gold, a policy which could be made a means, if widely pursued, of flattening out the fluctuations of prices. Above all, there is, with the primary object of accumulating stocks for use in time of war, our own extremely important *Essential Commodities Reserves Act* lately passed into law, to the rich possibilities of which I will devote the rest of this paper.

III

If only we could tackle the problems of peace with the same energy and whole-heartedness as we tackle those of war! Defence is old-established as a proper object for the State, whereas economic well-being is still a *parvenu*. Social action which is universally approved for the former purpose is still suspect when it is for the latter. Nevertheless, we are at this moment allowing war expenditure for defence to help solve our problem of unemployment as a bye-product of such spending, whereas if disarmament had prevailed we might have allowed a serious recession to have developed by now before introducing loan-expenditure on a comparable scale for the productive works of peace. So it may be possible, as I hope to show it is, to combine the primary object of the Government's new Act with purposes useful even in peace.

In the first place, the Board of Trade has taken powers to collect comprehensive statistics which it will be free to publish in terms of aggregates, though it is unfortunate that these powers are limited to the commodities which the Board of Trade will handle and does not cover those, such as the metals, which will be purchased by the War Departments (so departmental-minded is our Administration). This is important because, whilst we already have fairly good statistics of the "visible" stocks, we have none of the "invisible" stocks in the hands of manufacturers. Yet fluctuations in the visible stocks are often balanced, in part at least, by opposite fluctuations in the invisible stocks; and if the details of this were known, such extreme fluctuations of prices might sometimes be avoided. Complete facts about the fluctuations in total stocks would be of great value in handling the trade-cycle.

In the second place, the Board of Trade has, very wisely, taken powers to tackle its new and difficult problem by a wide

variety of techniques. Broadly speaking, these fall into two classes—those which involve actual purchase by the Government, and those which aim at increasing the stocks physically held in this country but not owned outright by the authorities. Both classes of technique lend themselves to far-reaching collaboration with the raw-material producers of the Empire. As regards outright purchases, the defence object is to save time and shipping. But it is not essential that the commodities held should always be the same ones. For example, when the crops of sugar are redundant and the price is low, we might come to the rescue of Empire sugar-producers by taking over a part of their output; and in another year when wheat is redundant and cheap, but sugar has recovered, the sugar might be replaced by wheat. But I am chiefly interested to-day in the possibilities of measures, not of outright purchase, but for increasing the stocks physically held in this country but remaining part of the supplies available to the market in a normal way.

The Act has taken wide powers for the provision or subsidy of storage and finance for the purpose of inducing traders to hold augmented stocks. I suggest that this side of the Act should be systematically employed to make this country much the cheapest place for holders of commodities to keep their stocks in and that this should be done in close collaboration with Empire producers. I have the impression that in former years the world surplus stocks were held in this country to a greater extent than is the case to-day; though I have not the statistics with which to confirm this impression. But however this may be, a very large volume of surplus stocks is now held overseas in the countries which have produced them. For example, a heavy tonnage of tin and rubber is being retained in the East; when the Canadian Government was holding surplus wheat, it held it in Canada; and generally speaking it is worth while to save shipping costs for as long as possible by retaining output in the country of origin.

My proposal is, therefore, that the Government should offer storage to all Empire producers of specified raw materials, either free of warehouse charges and interest or for a nominal charge, provided they ship their surplus produce to approved warehouses in this country. The Government would not become the outright owners of the stocks in question, which would remain in the ownership of the depositors, who would run the risk of price changes and would be free to remove and dispose of the stocks at any time or to deal in them against warehouse warrants. So far as finance is concerned, the Government might offer to advance either free of

interest or at a rate equal to the rate on Treasury Bills up to 90 per cent. of the market price at the date of delivery into storage, the margin of 10 per cent. of the current market price being subsequently maintained by the owners. It might prove advisable to require a certain notice—say, a month—of delivery and withdrawal and a minimum period of deposit—say, three months—so as not to attract normal trading stocks which would be held here in any case.

Under such an arrangement the volume and character of the goods in store would vary from time to time. But one could feel considerable assurance that at most times the aggregate would materially exceed the stocks which would be held without such an arrangement. Moreover, if at any time the aggregate amount appeared to be falling too low, or if the international prospects appeared to be particularly threatening, the Government could secure the position by purchase and the substitution of outright ownership.

I submit that such a plan would have several advantages, of which the following may be emphasised :—

(1) The cost to the Treasury would be very small in relation to the volume of resources involved. For warehouse costs and interest, provided on the lines suggested above, would cost a great deal less than the 10 per cent. per annum which I have estimated above as a normal expense to the outside holder who has no special facilities. The total cost would vary with the commodity, and I am not in a position to estimate it closely; but it might average, perhaps, at 4 per cent.[1] If we take this as sufficiently indicative of the order of magnitude of the figures, we could store £500,000,000 of stuff at an annual cost of £20,000,000. It is evident that the provision of stocks on that scale would give us much more security than we have at present, whilst the cost would be easily supportable.

(2) The technique adopted, so far from interfering with the ordinary course of trade, would facilitate it. The provision of additional stocks on the spot would avoid time-lags in the response of supply to an improved demand, whether in the home or

[1] Mr. Benjamin Graham in his recent book on *Storage and Stability* (p. 108) estimates the average commercial cost to dealers in the commodity exchanges of storing 23 standard raw materials at 13½ per cent. of their value per annum, exclusive of interest, whilst he considers that organised government storage could be provided at a quarter of this cost. His estimate of the commercial cost is considerably higher than mine, which is intended to include interest, but his average is somewhat inflated by the exceptionally high cost of storing maize, oats and petroleum.

in the re-export trades. The position of this country for entrepôt business would be ensured. An important cost, which is a potent generator of price fluctuations, would be eliminated, with the result of moderating price fluctuations and allowing, at the same time, a more continuous scale of output in the producing countries. Knowledge and experience would be gained which would be valuable in the future control of the trade cycle.

(3) Far-reaching arrangements would become possible with producers of raw materials within the Empire and with their governments. If, for example, as seems likely, the Canadian Government finds itself faced this year with the necessity of acquiring wheat beyond what the market can currently absorb, an agreement would be made for the physical storage of the wheat in this country, whilst it would remain the property of the Canadian Government. The possible field for the application of this principle is wide—sugar from the West Indies, jute from India, wool from Australia, vegetable oil products from West Africa, non-ferrous metals, and all the endless variety of Empire products which must be stored somewhere. There is, moreover, an outstanding case of a home product which should not be overlooked, namely pig-iron. We have recently had experience of the disturbance caused by a temporary shortage of pig-iron. The advantage of substantial stocks of pig-iron for munitions does not need emphasising; and the advantage in smoothing the trade cycle is hardly less obvious. In war such reserves held in this country would be better than a gold-mine; in peace we might find that we had taken the first step towards making possible a steadier scale of output of the principal raw materials, and thus avoiding extreme fluctuations of demand for our own exports from the raw material countries.

(4) The possible strain on the exchanges needs, however, a careful handling. It is for that reason that I have laid special stress on supplies from the Empire. For an important proportion of these may be financed in London, wherever they are situated, whilst in their case the proceeds of additional financing are more likely to remain here as an accretion to the banking reserves of the sterling area. Nevertheless it is certain that a substantial additional burden would fall on the exchanges during the initial period. In the case of Canadian wheat, for example, the major part of the finance would not normally fall on London, and it might be necessary here to make special arrangements with the Canadian Government. Moreover, there are certain products where it would be particularly useful to accumulate stocks—for

example, timber and oil—which might not conveniently come, mainly or exclusively, from Empire sources.

Yet, even in this respect, we might contrive to draw advantage out of the difficulty itself. In so far as we were financing or paying for imports in excess of what we should do otherwise, the effect on our own export trade would be exactly the same as an increase in the scale of our current foreign lending. We might reasonably expect some stimulation to our own exports; and sometimes we might be able to link the agreement to import with express arrangements to aid corresponding exports. It would be a form of foreign investment, the security for which would offer the great advantage of being situated at home! It would, of course, be a once-for-all transaction. That is to say, we should be accumulating stocks up to a value of (say) £500,000,000 within the next two or three years; and thereafter we should have no occasion to increase, on balance, the amount of this particular form of investment. But at this juncture of affairs I can see no form of foreign investment which it would be safer or more advantageous for us to accumulate. It is true, of course, that the income we should derive from it would not be in the shape of money interest or dividends, but in the shape of security and in the facility to avoid paying excessive prices for purchases made subsequently in circumstances of unusual need. But, on the other hand, here is an opportunity for a substantial volume of foreign investment, where the capital involved is absolutely safe. And in these days that is a primary consideration. We should be enabled by this technique to make loans, where for other reasons we might desire to make them—in South-eastern Europe, for example—on the absolute security of commodities physically situated within this country. It would be overwhelmingly worth our while to forego the cash income of £20,000,000 a year in return for the compensating advantages in the shape of security, a stimulus to our export industries, an increased control over the trade cycle, and an insurance against having to pay excessive prices at a subsequent date. The gain to our prestige and to our apparent security of so vast an accumulation of these liquid forms of wealth situated at home, an accumulation which others could not afford to imitate, would be worth in itself the really trifling expense. It would be a demonstration of reserve resources which would catch the imagination of the world. And if it should also serve the causes of peace, and prove to be a new and useful instrument in our armoury for the control (which will need more instruments than one) of the trade cycle, let no one complain.

(5) Even if foreign investment of this type is advantageous, it does not follow that it will not throw a burden on the exchanges which will lead to a loss of gold by the Exchange Equalisation Fund. We must expect that the accumulation, on such a scale as is suggested, of liquid resources in the shape of a mixed bag of commodities will be partly in substitution for our existing liquid resources in the shape of gold. But will there be a disadvantage in this? In time of war goods on the spot will be better worth having than the gold. In time of peace to substitute goods for gold when goods are cheap in terms of gold, and gold for goods when goods are dear in terms of gold, will be both socially and financially profitable.

I should be much inclined, therefore, though this is not essential to the scheme, to link up the finance of commodity storage with the finance of the Exchange Equalisation Fund, and to regard the policy of holding liquid stocks of raw materials as a natural evolution of the policy of holding liquid stocks of gold outside the banking system. The finance required by the new policy is of the same character as the finance required by the Exchange Fund, and should be segregated from the normal budget in the same way and for the same reasons. It also happens that the amounts required will tend to be complementary—the greater the finance required to hold stocks, the smaller is the finance required to hold gold likely to be. Moreover, the object of narrowing the range of movement of international commodity prices is a natural development of the policy of narrowing the range of the foreign exchanges. Investment in stocks will be of the same advantage to our trade as foreign investment would be, without, however, diminishing the strength of our liquid position, a consideration which, obviously, is of great importance in present conditions. Our liquid position, internationally, will be properly measured by adding the value of our liquid stocks of commodities to our stock of gold, which is a further reason for treating the finance of the two as a single problem.

The objects of carrying a steady volume of stocks as a war-insurance and of carrying a fluctuating volume so as to damp down the trade cycle are, it is evident, objects which partly conflict. At the present time the former must, presumably, prevail, and the latter must await the arrival of happier days. I must not be supposed to overlook this conflict. But I seek to reinforce the former purpose by pointing out that measures useful for defence may eventually evolve into measures of per-

manent usefulness in peace. Even in the first instance they do not wholly conflict. As a war-insurance it does not greatly matter which particular commodities are stored, so that seasonal, as distinct from cyclical, fluctuations can be averaged out. Moreover, it is of substantial advantage as a war-insurance if the average volume of international stocks, physically located in this country, is largely increased, even though this volume fluctuates somewhat widely between a higher and a lower limit; and if the stocks held here are normally larger than they would have been otherwise, our authorities will be able to act with greater rapidity, if circumstances make it advisable to convert privately owned deposits into outright Government ownership.

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