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Effects of Regulation on Efficiency of Grain Marketing

by Lowell D. Hill*

I. INTRODUCTION

Increased efficiency in agriculture is frequently circumscribed by rules and regulations which control and organize production and marketing systems. These rules of the game—legal, cultural, and ethical rules—generate incentives as well as place restrictions on the performance of the industry. Regulations determine incentives, incentives direct decisions of private firms and the conjunction of these numerous private decisions set the performance characteristics of the market. Performance criteria, such as efficiency and an adequate supply of food, are linked directly to the policies and regulations established by government. "Overall, the most severe shocks to the global food system have been manmade [i.e., government decisions] and are avoidable." An understanding of the relationships between economic efficiency and the policies and regulations of public agencies is necessary to provide guidance for public decisions and private action.

The relationship between regulation and performance in the grain industry is the primary focus of this article. Cereal grain is the major source of sustenance for a majority of the world's population, accounting for about thirty-five percent of total calories consumed worldwide. Because of the large volume involved, even minute increases or decreases in

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1 Schultz, Markets, Agriculture, and Inflation, in ROLE OF GOVERNMENT IN A MARKET ECONOMY 67 (L. Hill ed. 1982).

2 Gardner, Macroeconomic Policies and Agricultural Programs, in ROLE OF GOVERNMENT IN A MARKET ECONOMY 100 (L. Hill ed. 1982).


4 Grain is interpreted broadly in this paper to include soybeans. However, the term cereal grains excludes oil crops such as soybeans, rapeseed and sunflowers. The major cereal grains used for food and feed in world markets are wheat, corn, oats, barley, rye, and grain sorghum.

production and marketing efficiency can have major impacts on world food supplies and the general welfare of individuals and nations.

II. THE REGULATION OF GRAIN MARKETING DECISIONS

Grain marketing decisions of farmers, merchandisers and international traders are shaped by a wide range of regulations. Some policies are very general in nature. For example price support programs in the United States\(^6\) and the European Community (EC)\(^7\) influence farmers' storage and marketing decisions. Other regulations are quite specific. The U.S. Department of Agriculture (USDA), for example, under the authority of the U.S. Grain Standards Act,\(^8\) specifies the brand of moisture meter acceptable for determining grain grades.\(^9\)

Within the United States, state government regulations provide much of the institutional and regulatory environment for grain marketing. Many of the regulations relate to the operation of grain warehouses. Typical statutory schemes\(^10\) require warehouses to be licensed,\(^11\) bonded\(^12\) and insured\(^13\) and often include detailed provisions dictating the form of warehouse receipts.\(^14\)

The forms and terms of contracts under which grain is traded in the United States are also regulated by state provisions. For example, delayed pricing\(^15\) is a marketing tool frequently used by U.S. farmers to retain the opportunity for price speculation without the responsibility of

\(^6\) GRAIN MARKETING ECONOMICS 266-72 (G. Cramer & W. Heid eds. 1983) [hereinafter cited as Cramer & Heid].


\(^12\) ILL. REV. STAT. ch. 114, §§ 214, 214.8 (1983); N.D. CENT. CODE §§ 60-02, 60-02-09 (1983).


\(^14\) N.D. CENT. CODE §§ 60-02, 60-02-16-3 (1983). A warehouse receipt is a certificate of title that the farmer receives for stored grain from the warehouseman and it is administered under federal or state warehouse laws.

\(^15\) Delayed pricing is a marketing technique used by farmers and country elevators. A delayed price contract permits the seller to establish the price of the grain after ownership of the grain has been transferred to the buyer.
storing and maintaining quality.\textsuperscript{16} Misuse of delayed pricing has sometimes been associated with financial failure of country elevators and subsequent financial loss to farmers.\textsuperscript{17} As a result, delayed price is regulated by statute in the major grain producing states.\textsuperscript{18}

At the federal level, many legislative and regulatory actions affect the performance of the domestic and export markets. For example, the U.S. Grain Standards Act of 1916\textsuperscript{19} eliminated many of the inefficiencies resulting from the frequent arbitrations required to settle disputes over quality when grading and standards were at the discretion of individual boards of trade, grain exchanges, chambers of commerce and state agencies.\textsuperscript{20} The provisions of the 1916 Act authorize the Secretary of Agriculture to develop standards for grain\textsuperscript{21} and specify that all export grain must be graded by official inspection personnel under these standards.\textsuperscript{22} The development of uniform national standards decreased the cost of marketing and the ensuing welfare gains were distributed between farmers and consumers.\textsuperscript{23}

Federal laws also influence the efficiency in transportation of grain in the United States. Article IV of The Northwest Ordinance of 1787 stated that “the navigable waters leading into the Mississippi . . . shall be common highways and forever free . . . without any impost or duty therefor.”\textsuperscript{24} Implementation of this principle obviously reduced the cost of barge transportation, since waterways were maintained with public funds.\textsuperscript{25} Passage of the Inland Waterway Revenue Act of 1978\textsuperscript{26} reversed this principle by requiring barge companies to pay user fees to cover part of the cost of the waterways in the form of a tax on diesel fuel.\textsuperscript{27} The increased taxes were reflected in higher rates, shifting grain

\textsuperscript{17} Grain Elevators Task Force, supra note 10, at 49-51.
\textsuperscript{20} Address by J. Shanahan, National Grain Dealers Association, Des Moines, Iowa (Oct. 1901).
\textsuperscript{22} Id. §§ 71, 79(a).
\textsuperscript{24} Documents of American History 131 (H. Commager ed. 1963).
\textsuperscript{25} W. Hull & R. Hull, The Origin and Development of the Waterways Policy of the United States 9-10 (1967).
\textsuperscript{27} Id. §§ 4042, 4042(a).
traffic to other modes and reducing grain prices to farmers.\textsuperscript{28}

The efficiency of grain marketing has also been affected by the existence and enforcement of antitrust legislation in the United States. Large traders within the grain industry are quite sensitive to their potential liability and attempt to avoid actions that might be construed as violations of these laws, even at the expense of profit or efficiency opportunities.\textsuperscript{29} Some segments of the grain industry enjoy a limited immunity from antitrust legislation. The Capper-Volstead Act of 1922\textsuperscript{30} allows farmer cooperatives to be more competitive with other marketing firms by limiting the antitrust liability of farmer owned cooperatives. The result is a shift in the balance of power among firms and an alteration in the structure and performance of the industry.\textsuperscript{31} The Export Trading Company Act of 1982 also limits the antitrust liability of companies in the grain trade.\textsuperscript{32} The goal of the Trading Act, to tap the export potential of U.S. businesses and to expand export markets, is facilitated in part by encouraging the formation and operation of export trading companies and associations. A certification process is available to these companies through which they may obtain exemption from potential antitrust liability relating to the pricing and marketing activities described in the certificate. After a certificate is obtained, few legal barriers to export should remain.\textsuperscript{33} Antitrust legislation and regulation has both increased and decreased marketing efficiency.

Not all regulations have resulted in increased efficiency and, of course, some regulations have welfare objectives that conflict with economic efficiency. The Occupational Safety and Health Administration (OSHA)\textsuperscript{34} enforces regulations to protect the health and safety of workers in grain elevators.\textsuperscript{35} In general, these regulations have increased costs and reduced efficiency in elevator operations.\textsuperscript{36} A study conducted by the Midwest Research Institute shows that enforcement of the OSHA standard on dust control in grain elevators would result in annual recur-

\textsuperscript{28} D. Conley & L. Hill, Impact of Waterway User Fees on Illinois Agriculture 1 (Dep't of Agricultural Economics, University of Illinois at Urbana-Champaign, No. AE-4527, Mar. 1982).
\textsuperscript{31} Manchester, \textit{Agricultural Marketing Cooperatives and Antitrust Law}, in \textit{Antitrust Treatment of Agricultural Marketing Cooperatives} 8-54 (E. Jesse ed. 1983).
\textsuperscript{33} B. Jones & M. Anderson, \textit{The Southern States and Export Trade Legislation} 5 (Council of State Governments, 1983).
\textsuperscript{34} Occupational Safety and Health Act, 29 U.S.C. § 651 (1982).
\textsuperscript{35} The term grain elevator is used to mean the firm as well as the physical facilities that receive, store, dry, and ship grain in U.S. and foreign countries.
ring costs of $269,488,000 during the first ten years of the program. However, society (or the political reflection of society's preference function) has determined that worker safety justifies the additional costs.

U.S. policies and farm programs to support farm prices and income illustrate an important but indirect influence on performance in the grain markets. U.S. export subsidies on wheat provided by the Agricultural Act of 1970 were intended to support prices paid to farmers while keeping export prices low enough to be competitive on the world market. However, these subsidies effectively insulated foreign buyers from rising prices caused by increased export sales. Consequently, large purchases of grain by the USSR in 1972 raised domestic prices but not export prices. The use of U.S. tax dollars to lower prices to the USSR raised a public outcry that resulted in new regulations requiring U.S. exporters to report all future grain sales in excess of 50,000 tons to the export sales agency of the USDA.

The suspension of sales to the USSR in January, 1980, was a political decision whose legal and moral enforcement generated inefficiencies in trading patterns and distortions in price relationships. "In the Russian grain embargo, Canada, the European Community nations and Australia agreed not to increase their exports to the Soviet Union. The Soviet Union redirected its trade to Argentina, thus increasing the Argentine feed grain price." The change in relative prices altered the origin-destination patterns of world trade. Countries not supporting the embargo increased sales to the USSR and decreased sales to Western Europe. Conversely, countries supporting the embargo shifted sales from USSR to Western Europe, often increasing transport costs and reducing efficiency relative to the previously established grain flow patterns.

Trade associations as well as government agencies generate regulations that govern members of the grain industry in domestic markets. In
the United States, The National Grain and Feed Association has a system for trade arbitration that dates back to 1901, providing "the machinery for compulsory arbitration of trade disputes between members. Arbitration is based on the National's Trade Rules which are commonly accepted in the making of contracts." The trading rules adopted in 1902 govern all disputes of a financial, mercantile or commercial character connected with grain. "Arbitration under these rules is compulsory among members and contributes to the orderly marketing of grain, feed and their by-products."

Efficiency in marketing is encouraged by rules that permit the purchase and sale of "enormous volumes of grain and feedstuffs...largely on the basis of mutual trust."

Other countries have regulations which are similar in many respects to those of the United States. All major importing and exporting countries operate under some form of grading standards to facilitate efficient trading by descriptive contracts. Argentina, South Africa, and Canada have numerical standards and multiple factor grades similar to those of the United States. The USSR publishes standards for each grain that are more descriptive than numerical and vary depending on the use of the grain. The Canadian Wheat Board not only establishes wheat standards but also buys and sells all export wheat, sets producer prices and storage rates, and negotiates export contracts with foreign buyers.

Transportation policies of grain exporting countries influence the cost of transportation and the efficiency with which grain is marketed and delivered to the port. Canadian policy dating back to 1897 regulates rates for moving grain to port elevators under a regulation known as the Crows Nest Pass Act.

A study of the economic effects of these rail rates concluded that under the government rate regulation railroads were

49 See 1979-1980 DIRECTORY, supra note 47, at 204.
50 Shellenberger, Development of an International Grain Quality Certificate, in PROCEEDINGS 7TH WORLD CEREAL AND BREAD CONGRESS 431 (1982).
51 JUNTA NATIONAL DE GRANOS, NUEVAS NORMAS PARA LA CLASIFICACION DE SORGO Y MAIZ (1982) (Resolucion "J.N.G." No. 20.275) [hereinafter cited as Resolucion No. 20.275].
52 Regulations for Regulating the Requirements in Connection with the Export of Maize from the Republic of South Africa, No. R 1070 (June 17, 1977).
53 CANADIAN GRAIN COMMISSION, GRAIN GRADING HANDBOOK FOR EASTERN CANADA (Aug. 1980).
55 CANADIAN INTERNATIONAL GRAINS INSTITUTE, GRAINS AND OILSEEDS—HANDLING, MARKETING, PROCESSING 30-31 (2d ed. 1975).
forced to operate at a loss in moving grain to export points. The authors predicted that unless the rate regulations on railroads were altered the system would degenerate into "an even less efficient and capable rail operation than we have presently." Nationalization of the Argentine railway system in 1946 did not resolve problems of inefficient grain transportation. Six different lines were incorporated into the railroad system and the three different gauges of track limited the interchangeability of equipment. Average operating speeds of 6.25 miles per hour, car shortages and inefficient box car design also reduced efficiency. Regulations in the barge industry created additional inefficiencies. "A regulation that requires a minimum number of laborers on board has tended to make barges more costly than they would be otherwise."

Export policies and domestic support prices are frequently used by many countries to stimulate exports and production and to bolster farm income. The effects on market performance are not always consistent with the policy objectives. For example, price and export strategies for soybeans were instituted by Brazil to encourage production and increase their share of world soybean markets. However, an analysis of Brazilian policies by Williams and Thompson demonstrated that government intervention in the Brazilian soybean industry generally benefited the United States rather than Brazil. "The policies boosted world prices of soybeans while lowering those of soybean products. Production, use and exports of soybeans and products in the United States were all larger as a consequence."

Support prices in the European Community (EC) and their system

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58 Id. at 76.
60 Id. at 13.
61 Id. at 15-16.
62 Id. at 19.
65 Williams & Thompson, Brazilian Soybean Policy: The International Effects of Intervention, 66 AM. J. AGRIC. ECON. 497 (Nov. 1984).
66 Id. at 498.
67 The European Community was founded by the Treaty of Rome, signed by Belgium, France, Italy, Luxemborg, the Netherlands, and West Germany. It became effective on January 1, 1958. The United Kingdom, Denmark, and Ireland joined the Community on January 1, 1973.
of variable levies\textsuperscript{68} have generated large surplus stocks of several commodities that require public expenditures to pay storage costs.\textsuperscript{69} For example, under the Treaty of Rome,\textsuperscript{70} the EC established a set of grain trade regulations as part of the Common Agricultural Policy (CAP) in 1962.\textsuperscript{71} The purpose of the CAP was to increase EC agricultural productivity while simultaneously providing EC farmers with an income level equal to that of the non-farm sector.\textsuperscript{72} In order to accomplish these goals, two trade mechanisms were established.\textsuperscript{73} The first mechanism is a grain pricing system that raises EC grain market prices above their free market levels\textsuperscript{74} using a system of target and intervention prices.\textsuperscript{75} The target price "reflects the market price which the EC feels farmers should get for their grain."\textsuperscript{76} The intervention price is a floor price at which the EC government must buy all the grain offered.\textsuperscript{77}

The second trade mechanism involves a threshold price and a variable levy. "The threshold price is the minimum price at which grain imports are permitted to enter EC markets."\textsuperscript{78} The threshold price deters the "much more competitively priced non-EC grain" from flooding the EC market and consequently displacing the EC domestic grain sales.\textsuperscript{79} A variable levy is applied to all grain imports from countries outside the EC\textsuperscript{80} in order to raise the price of any imported grain above the guaranteed price of the identical, EC produced commodity.\textsuperscript{81}

Although the pricing system and the variable levy have both increased EC grain production and supplemented farm income, the EC CAP causes several negative side effects.\textsuperscript{82} Inter-EC problems caused by

\textsuperscript{68} A variable levy is a variable tax used by the European Community to stabilize prices for producers in member countries and also limit the impacts of variations in world prices. It is the difference between the EC threshold price and the world price.

\textsuperscript{69} Comptroller General of the United States, Grain Marketing Systems in Argentina, Australia, Canada and the European Community; Soybean Marketing System in Brazil 54 (May 28, 1976) [hereinafter cited as Grain Marketing Systems].

\textsuperscript{70} Treaty Establishing the European Economic Community, Mar. 25, 1957, 298 U.N.T.S. 3.


\textsuperscript{72} Foreign Agricultural Service, U.S. Dep't of Agriculture, Foreign Agriculture Circular: Grains 2 (Dec. 11, 1981) [hereinafter cited as Foreign Agriculture Circular].

\textsuperscript{73} C. Jabara & A. Brigida, supra note 63, at 2.

\textsuperscript{74} Id.

\textsuperscript{75} Id.

\textsuperscript{76} Foreign Agriculture Circular, supra note 72, at 5.

\textsuperscript{77} Id. at 6.

\textsuperscript{78} C. Jabara & A. Brigida, supra note 63, at 4.

\textsuperscript{79} Id.

\textsuperscript{80} Foreign Agriculture Circular, supra note 72, at 6.

\textsuperscript{81} C. Jabara & A. Brigida, supra note 63, at 4.

\textsuperscript{82} Id. at 3, 11.
the CAP include expensive farm surpluses and escalated food prices for the EC consumer.\textsuperscript{83} Not only does the CAP pricing system transfer extra costs to the consumer, but it also presents the EC governments with the expense of maintaining the price supports that encourage the domestic production.\textsuperscript{84} Inefficient use of resources is another problem caused by the CAP. The incentive is to grow those crops for which prices are supported above equilibrium levels. Consequently, large surpluses of certain crops accumulate,\textsuperscript{85} while other crops not receiving a subsidy are in short supply.

The CAP causes problems outside of the EC as well. The variable levy is largely responsible for the steadily decreasing level of U.S. exports to the EC.\textsuperscript{86} Not only do the threshold prices and variable levies reduce U.S. exports into the EC, but the CAP support prices have generated such an increase in EC grain production that the EC was a net exporter of total grains for the first time in 1980.\textsuperscript{87} The EC has already exercised its newly attained status as an exporter, displacing grain exports from Argentina, Australia, Canada and the United States.\textsuperscript{88} Returning the major food producing nations to a more rational and efficient use of resources will require major revisions in trade and production policies of the EC and other nations.

In addition to the rules and regulations governing marketing activities within individual countries, many trade regulations and policies have consequences which extend beyond national borders. The cost of marketing grain is dramatically reduced by the enforcement of contracts in domestic and foreign trade, permitting the purchase or sale of millions of bushels with no more than a phone call.\textsuperscript{89} Standardized contracts developed by organizations such as The Grain and Feed Trade Association of London (GAFTA) also simplify transactions and reduce the cost of exchanges of title. Such contracts are very detailed and attempt to cover all possible contingencies, and are used by all major grain importing and exporting countries. Despite these attempts to avoid misunderstandings, contract disputes do occur. When this happens, an agreement to submit to arbitration can speed resolution. The 1958 United Nations Convention on the Recognition and Enforcement of Foreign Arbitral

\textsuperscript{83} Agriculture Council of America, U.S. Farm Export Education Project, U.S. Farm Export Strategies for the Eighties 159 (Feb. 1981) [hereinafter cited as U.S. Farm Export Strategies].

\textsuperscript{84} Grain Marketing Systems, supra note 69, at 50.

\textsuperscript{85} H. McNitt, supra note 71, at i.

\textsuperscript{86} H. McNitt, supra note 71, at 12.

\textsuperscript{87} Foreign Agriculture Circular, supra note 72, at 2.

\textsuperscript{88} Id.

\textsuperscript{89} D. Morgan, supra note 39, at 64.
Awards has aided in the enforcement of arbitration awards in the international grain trade. Courts of most major grain trading nations respect contractual obligations for arbitration and arbitration conditions are generally included in these contracts. U.S. courts are favorably disposed to recognize such agreements and once it is determined that a valid contract containing a valid arbitration clause exists, the agreement cannot be easily revoked. Only if the arbiters "deliberately disregarded what they knew to be the law in order to reach the result they did" can the agreement be vacated. Clauses stipulating that disputes be resolved pursuant to the law of a given jurisdiction are generally honored. Time and money of both the litigants and arbitors is conserved by the consolidation of related proceedings of commodity and maritime cases which deal with common facts and issues. U.S. courts may compel consolidation "if the issues [in the several arbitrations] are substantially the same and if no substantial right is prejudiced." Standardized contracts and organized markets, combined with the current regulatory climate, produce a system whose performance closely approximates that of the theoretical perfect market in terms of pricing efficiency and responsiveness to incentives.

World War I was a major stimulus for agricultural trade between the U.S. and Europe. However, the increased trade only lasted until the armistice and the subsequent recovery of European agriculture greatly reduced U.S. agricultural exports. Without export markets to absorb surplus production, U.S. farmers "called for higher tariffs against foreign imports." This demand for import restrictions prompted Congress to enact the Hawley-Smoot Tariff in 1930, which generated some of the highest tariffs in U.S. history. Although the tariffs successfully limited U.S. imports, it became apparent that international markets were important for the growth of U.S. agricultural trade and for the expansion of mar-

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92 A. Slabotzky, Grain Contracts and Arbitration for Shipments from the United States and Canada 99 (1984) (citing U.S. District Court for the Southern District of New York, 82 Civ. 1302 (PNL)).
93 Id.
94 See, e.g., A. Slabotzky, supra note 92, at 94 (citing U.S. District Court for the Southern District of New York, 82 Civ. 2886 CSH). See generally id. at 83-102.
97 Cramer & Heid, supra note 6, at 280.
98 Id.
kets for grain farmers. Federal legislation was needed to re-open foreign markets that had been restricted by high U.S. tariffs.

The Reciprocal Trade Agreement Act of 1934\(^9\) emphasized the importance of world markets for U.S. products and fostered several new marketing strategies. One of the most important elements of the Act was the authorization of bilateral trade agreements.\(^{100}\) Trade agreements with over thirty countries opened new markets and provided the conditions necessary for expanded trade.\(^{101}\)

Continued concern over trade barriers stimulated development of an international agreement to move the participating nations toward freer trade.\(^{102}\) The resulting document, the Charter for the International Trade Organization (ITO), was never ratified. Instead, the General Agreement on Tariffs and Trade (GATT)\(^{103}\) replaced the ITO as an international agreement for the conduct of trade: “The provisions of GATT include: unconditional most-favored-nation treatment of member nations,\(^{104}\) no quantitative restrictions,\(^{105}\) free transit of goods,\(^{106}\) equality of internal taxation of imported and domestic goods,\(^{107}\) simplification of custom procedures,\(^{108}\) and periodic examination of members’ subsidies.”\(^{109}\)

Although the provisions of the GATT should greatly reduce international agricultural trade barriers, several policy problems restrict its effectiveness. The first is the lack of power to enforce agreements. There are only two punitive courses of action available under the GATT: (1) bring public opinion to bear on the offending country,\(^{110}\) or (2) permit the plaintiff country to retaliate through the imposition of its own trade barriers.\(^{111}\) A second problem is that GATT membership does not include most of the centrally planned and less developed countries. Unfortunately, these two particular groups have expanded their agricultural trade most rapidly. Because these countries are not members of the GATT, a major portion of world agricultural trade can neither benefit

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\(^{100}\) A bilateral trade agreement is an agreement between an exporting and an importing country to purchase or sell a certain amount of products per year.

\(^{101}\) Cramer & Heid, supra note 6, at 281.

\(^{102}\) Id.


\(^{104}\) Id. at art. I.

\(^{105}\) Id. at art. XI.

\(^{106}\) Id. at art. V.

\(^{107}\) Id. at art. III.

\(^{108}\) Id. at art. VII.

\(^{109}\) Id. at art. XVI.

\(^{110}\) A. Webb, supra note 43, at 34.

\(^{111}\) Id.
from nor be restricted by the provisions of GATT. Third, most of the GATT negotiations have not dealt with agricultural trade barriers. Only the last three rounds, the Dillon Round (1960-61), the Kennedy Round (1963-67) and the Tokyo Round (1973-79), have included agricultural trade barriers and these achieved only limited success in increasing efficiency of international grain trade through reductions. If the GATT is to be more effective in the future, these policy problems must be resolved in order to slow the trend toward protectionism and the consequent inefficient use of resources.

In an effort to moderate the erratic effects of foreign grain production and demand on domestic and world prices, the United States has periodically entered into bilateral or long-term agreements (LTA) with several countries, including Poland, Mexico, and most recently the People’s Republic of China (PRC) and the USSR.

The provisions of a bilateral agreement “specify the flow of one or more commodities between two countries for a given time period.” An exporting country benefits from an LTA through expanded markets and a stabilized demand for exports. It was largely this feature that made the recent U.S.-USSR and U.S.-PRC long-term agreements so attractive. Both the USSR and PRC are large, unpredictable customers in the world grain market; an LTA allows the United States to “stabilize to some degree the quantities directly purchased” from the United States, while at the same time providing the United States with valuable market information disclosed through the agreement.

Importing countries also benefit from bilateral agreements. To the importer, a long-term agreement represents a guaranteed grain supply for a specified time period. When world population is growing at a rate faster than world agricultural production, an increasing number of countries want to lock in grain supplies through the provisions of an LTA.

The United States is not the only nation to utilize LTA’s; other countries that have negotiated bilateral agreements include China, Argentina and Canada. China has negotiated agreements with Argentina,
Australia, Canada, the EC and the United States.\footnote{120 \textit{ECONOMIC RESEARCH SERVICE, U.S. DEP'T OF AGRICULTURE, CHINA: OUTLOOK AND SITUATION REPORT} 27 (June 1984).} Argentina has had agreements with the Iraq, Mexico, Algeria, Cuba and the PRC.\footnote{121 \textit{CORN}, supra note 45, at 17.} Canada has had agreements with Brazil, China, Jamaica, Mexico, Poland, and the USSR.\footnote{122 Cramer & Heid, \textit{supra} note 6, at 311.} As the previous list indicates, long-term agreements are very popular, largely because they "help stabilize trade flows between two countries."\footnote{123 A. Webb & E. Wilson, \textit{supra} note 116, at 5.} Regardless of their benefits, bilateral agreements have distinct disadvantages. The most obvious problem created by bilateral agreements is the restriction of free market mechanics.\footnote{124 Nuttal & Sorenson, \textit{Bilateral Agreements as a Response to Emerging International Market Conditions}, in \textit{CONSORTIUM ON TRADE RESEARCH: AGRICULTURAL IMPORT DEMAND IN LOW INCOME, MIDDLE INCOME AND CENTRALLY PLANNED COUNTRIES} 24 (U.S. Dep't of Agriculture, Foreign Agricultural Economic Report No. 173, Aug. 1982).} "As an increasing share of global grain trade is brought under such agreements, one can expect more severe adjustment burdens in countries that rely on relatively free market conditions to balance changing supplies with demand."\footnote{125 \textit{THE WORLD FOOD INSTITUTE, WORLD FOOD TRADE AND U.S. AGRICULTURE, 1960-1982}, at 50 (Iowa State University, Aug. 1983).} The decreasing available grain supply in turn increases price instability for nonparticipating countries.\footnote{126 Id. at 10-11.}

Another problem that arises with LTA's is that bilateral agreements are government-to-government, instead of private grain company transactions.\footnote{127 Id. at 10.} Many importers prefer government agreements because "agreements with private firms are easily negated by political and foreign policy considerations."\footnote{128 Id. at 8.} Understandably, private grain firms do not share this attitude and look at bilateral agreements as government interference that negatively affects their business.\footnote{129 Id. at 10.} In the long run, the increased utilization of bilateral agreements will only be feasible if price and supply compensation is provided for those parties who are unable to participate in the agreements.

The regulations in the preceding examples have an influence on the efficiency of grain marketing and indirectly on the cost and availability of food in the United States and around the globe. Although a complete review of regulations is not available, economic analyses of individual policies or categories of regulations provide abundant examples of the

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\footnote{120 \textit{ECONOMIC RESEARCH SERVICE, U.S. DEP'T OF AGRICULTURE, CHINA: OUTLOOK AND SITUATION REPORT} 27 (June 1984).}
\footnote{121 \textit{CORN}, \textit{supra} note 45, at 17.}
\footnote{122 Cramer & Heid, \textit{supra} note 6, at 311.}
\footnote{123 A. Webb & E. Wilson, \textit{supra} note 116, at 5.}
\footnote{124 Nuttal & Sorenson, \textit{Bilateral Agreements as a Response to Emerging International Market Conditions}, in \textit{CONSORTIUM ON TRADE RESEARCH: AGRICULTURAL IMPORT DEMAND IN LOW INCOME, MIDDLE INCOME AND CENTRALLY PLANNED COUNTRIES} 24 (U.S. Dep't of Agriculture, Foreign Agricultural Economic Report No. 173, Aug. 1982).}
\footnote{125 \textit{THE WORLD FOOD INSTITUTE, WORLD FOOD TRADE AND U.S. AGRICULTURE, 1960-1982}, at 50 (Iowa State University, Aug. 1983).}
\footnote{126 Nuttal & Sorenson, \textit{supra} note 124, at 24.}
\footnote{127 A. Webb & E. Wilson, \textit{supra} note 116, at 8.}
\footnote{128 Id. at 10-11.}
\footnote{129 Id. at 10.}
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economic consequences of government involvement in the operation of international grain trade.

An incentive-response model provides an explanation of the connection between regulatory policies and economic efficiency as identified in the preceding examples. The conceptual model is one in which informed decision makers respond to economic incentives within the limits created by the regulatory environment. Changes in these decisions and in operational efficiency can be induced by altering the incentives or the regulatory environment. The orderly, regulated system for marketing grain and the availability of sophisticated pricing and marketing institutions lowers the cost of marketing and accounts for much of the economic progress in developed economies. The production of adequate food supplies is also technically feasible in most developing economies, but the distortion of incentives leads to inefficiencies in the marketing and distribution system which in turn thwarts attempts to increase food supplies. Legislation and regulations, and the institutions which they foster, influence the cost of grain marketing and generate the incentives to which farmers and marketing firms respond. The quantity and quality of grain available to consumers are the result of responses to these incentives and the regulations from which they emanate.

III. THE IMPACT OF REGULATORY POLICY ON EFFICIENCY

Three examples will be selected from the preceding list to illustrate the role of regulatory policy on efficiency. The three examples are: (1) state and federal warehouse laws and related legislation which protects producers in case of elevator bankruptcy, (2) federal grades and standards for grain, and (3) marketing practices in international trade.

A. State and Federal Warehouse Laws

In the United States, state and federal warehouse laws provide legal protection for farmers storing grain in commercial facilities. Since farmers often wish to retain ownership of grain in anticipation of price rises after harvest, storage is a necessary function. The least cost pattern of storage would allocate most of the grain marketed to commercial

130 Cramer & Heid, supra note 6, at 141, 239.
132 Schultz, supra note 1, at 67.
133 CORN, supra note 45, at 31.
warehouses, because economies of scale favor large commercial bins over small farm bins. Use of commercial warehouses by farmers is encouraged by assurance that the quantity and quality of grain deposited for storage will be maintained. This assurance is provided by federal and state warehouse laws that regulate public grain warehousmen. Despite these regulations and the accompanying inspection of facilities, farmers have frequently suffered losses associated with financial failures of country elevators. During recent bankruptcy proceedings, farmers received payment for less than seventy percent of the full value of grain warehouse claims at elevators filing for bankruptcy. Additional changes in Illinois law provide an insurance fund for protection against losses, especially where illegal actions by a manager might leave insufficient grain in the warehouse to cover the amount represented by outstanding warehouse receipts.

Early warehouse laws required the warehouseman to maintain the integrity of each lot of grain absent the consent of the owner. Since grain identified by federal grades is, in general, a homogeneous, interchangeable commodity, the need for segregating each lot unnecessarily increased the cost of storing grain. This increased cost of storage was in turn passed on to the farmer and inefficiencies resulted.

These inefficiencies have been largely eliminated. Changes advocated by the grain industry and later by state regulatory agencies have been adopted and warehouse laws now commonly permit the practice of comingling grain of the same kind and grade. In fact, Illinois law allows a warehouseman to refuse to accept grain when the identity of the lot is to be preserved.

Under current warehouse laws, each farmer-seller receives a warehouse receipt for the quantity and quality of grain delivered. The ele-

136 C. CHASE & D. HELGESON, COST ANALYSIS OF POTENTIAL NORTH DAKOTA SUBTERMINAL SYSTEMS 3 (Dep't of Agricultural Economics, N. Dakota State University, Agricultural Economics Report No. 156, Feb. 1983).
139 REPORT OF THE AD HOC SUBCOMMITTEE ON GRAIN ELEVATOR BANKRUPTCY TO THE HOUSE COMM. ON AGRICULTURE, 98TH CONG., 1ST SESS. 37 (Comm. Print 1983).
141 See, e.g., ILL. CONST. OF 1870 art. XIII, § 2.
143 See, e.g., ILL. REV. STAT. ch. 114, § 214-(1983).
144 Id. §§ 214, 214.11.
vator manager is held responsible for maintaining on the premises the quantity and quality represented by the sum of all the individual warehouse receipts, but need not maintain the identity of each individual lot. Thus, costs of storage are reduced and the increased efficiency is reflected in lower storage charges to the producer.

These lower charges are an incentive to farmers to store in commercial facilities rather than to build storage bins on the farm. Thus, the changes just described in warehouse laws altered the balance between on-farm and off-farm storage capacity, reduced investment in farm storage bins, increased the value of stored grain warehouse receipts and improved the profitability of storing grain in commercial facilities.

The warehouse laws become especially important when elevators encounter financial problems and are unable to pay producers and other creditors. Although state warehouse receipts were intended to protect farmers with grain stored for them by commercial grain warehousemen, several bankruptcy cases in Illinois and other states left insufficient funds to repay holders of warehouse receipts as well as unsecured creditors. From January 1974 through May 1982 Illinois farmers lost $1.5 million through elevator insolvencies and bankruptcy proceedings. Neither bankruptcy regulations or warehouse receipts were sufficient protection for farmers. Changes in the Illinois Public Grain Warehouse Act and the Grain Dealers Act provided increased protection for producers. The Illinois warehouse law as amended gave the Department of Agriculture authority to raise bonding requirements for dealers of questionable financial position to restrict speculation, and to require annual financial statements prepared according to generally accepted accounting principles. These requirements increased costs to elevator managers but reduced the risk of financial loss to farmers storing grain in commercial warehouses. This increased protection was still considered inadequate by many and on August 16, 1983, Illinois passed the Grain Insurance Act. Collection of mandatory premiums from grain warehousemen created an insurance fund that has provided more complete

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147 J. SCOTT, THE ECONOMICS OF CORN CONDITIONING AND STORAGE ALTERNATIVES FOR FARMERS 13 (Dep’t of Agricultural Economics, University of Illinois at Urbana-Champaign, No. AERR-98, Jan. 1989).
149 Id.
151 Id. ch. 111, § 301.
152 Id. ch. 114, §§ 214, 214.8.
153 Letter from Ill. Dep’t of Agriculture to all Illinois Grain Dealers (June 24, 1980) (discussing policy).
155 Id. § 701.
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protection. According to statements by Illinois Department of Agriculture officials, "every claim by farmers that has been adjudicated valid has been paid in full, either by elevator assets or from the insurance fund," since the implementation of the Act.\(^{156}\)

Most other grain exporting nations also have warehouse laws to protect storers of grain. For example, Argentina has separate warehouse regulations for grain for internal consumption\(^{157}\) and for export.\(^{158}\) Warehouse receipts are registered by the Junta Nacional de Granos and delivery is guaranteed to purchasers in case of loss of grain, theft or failure to comply with warehouse regulations. The strength of the warehouse law protects farmers with grain in commercial storage, but other losses are handled under general bankruptcy regulations.\(^{159}\)

B. Grain Grades and Standards

Perhaps the best illustration of the role of regulation in creating incentives can be found in the application of grading standards to domestic and international grain trade.

Grading standards for any product have the objective of enabling buyers to specify a numerical grade and know the quality they will receive without personally inspecting and analyzing every lot sold.\(^{160}\) Standards also eliminate the necessity of exchanging samples in widely separated geographical markets.\(^{161}\) U.S. grain grading standards affect the international as well as the domestic markets; first, because the U.S. supplies a major share of world trade in coarse grains\(^{162}\) (sixty percent in fiscal 1983)\(^{163}\) and, second, because many grain producing nations have patterned their standards after those of the United States.\(^{164}\) The U.S. grain standards developed out of a need for increased marketing effi-

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\(^{156}\) Interview with Tom Jennings, Division of Agricultural Industry Regulation, Illinois Department of Agriculture, in Springfield (Jan. 4, 1984).

\(^{157}\) Telephone conversation with Eduardo Regunaga, Junta Nacional de Granos, Buenos Aires (discussing Argentina Resolution 37).

\(^{158}\) Id. (discussing Argentina Resolution 1825).

\(^{159}\) Law No. 19.550 (Argentina).

\(^{160}\) Cramer & Heid, supra note 6, at 120.

\(^{161}\) Id.

\(^{162}\) Coarse grains include feed grains (corn, barley, oats, grain sorghum) and rye, plus millet in some foreign countries.


\(^{164}\) South Africa, Brazil, Canada, and Argentina have grain grades similar to those of the United States—numerical grades with factor limits. See Regulations for Regulating the Requirements in Connection with the Export of Maize from the Republic of South Africa, No. R 1070 (June 17, 1977); Canadian Grain Commission, Grain Grading Handbook for Eastern Canada (Aug. 1980).
ciency over a period of several centuries and a description of the issues and their resolution demonstrate the effect of regulations on incentives and efficiency.

1. History of Grain Grading

Grain grading and quality standardization dates back at least to thirteenth century London when town ordinances prohibited the mixing of moldy corn with good corn. Ordinances from thirteenth-century records also specified that the quality of corn was to be regulated in cities of medieval France. With the development of more formal marketing systems, additional regulations were needed to facilitate handling an increasingly large volume of grain traded over an ever larger geographical area. To satisfy their trading needs, dealers prepared samples of the grain to be sold and exhibited or exchanged them in establishing price. As trade volume continued to grow, they began issuing statements to describe the general quality or character of the grain. The terms “sweet, dry, and merchantable” trace to a proclamation issued by the Lord Mayor of London in 1511. The use of descriptive terms became widely adopted and by the eighteenth century were common throughout the grain trade. In 1846, the Buffalo market reported the sale of “forty-nine hundred bushels, Massillon wheat, a beautiful sample, the berry being plump and of a bright yellow hue.”

As production in the United States increased in the beginning of the nineteenth century and grain exports became an important source of foreign exchange, the various exporting agencies, port authorities and boards of trade began to establish more formal quality standards in each market. In 1856, the Chicago Board of Trade (CBT), a volunteer organization of businessmen organized in 1848, formally adopted a system of grain grading using descriptive terminology. In the following year, inspectors were appointed to grade grain received in Chicago using those standards. International trade was an important influence in this de-

167 Id. at 71 n.4.
169 Id. at 2.
170 N. GRAS, supra note 166, at 78 n.1.
172 C. PHILLIPS, HISTORY OF GRAIN INSPECTION IN THE UNITED STATES, 1838-1936, at 51-54 (U.S. Dep't of Agriculture, Bureau of Agricultural Economics, Grain Division, 1936).
174 Id. at 227-28.
development of grading by descriptive term. Chicago tradesmen started shipping grain directly from Chicago to Liverpool and by 1856 the United States exported nearly 500,000 tons of corn and wheat into the United Kingdom. This export trade required descriptive terms on official documents and the CBT grading standards provided the early language. The standards were refined in subsequent years and by 1860 they were being applied to all grain received into Chicago warehouses. One of the earliest attempts to specify numerical grades was introduced by the Chicago Board of Trade in 1857; spring wheat was classified into “club spring,” “No.1 spring,” and “No. 2 spring.”

Other commercial organizations, including the Boards of Trade at Milwaukee, Detroit, Toledo, Cleveland and St. Louis, followed the lead of the Chicago Board of Trade in establishing grades and inspection procedures, but each agency selected its own set of standards and terminology. The diversity of descriptive terminology and grading practices soon created inefficiencies and disputes within the grain markets. The standards adopted often represented the regional practices in a fairly local market. Moreover, inspection equipment was crude and inspection procedures varied from inspector to inspector as well as between markets. The grades themselves made objective and uniform interpretation and application difficult. Most had no quantifiable factors attached to them and descriptive terms were subject to the interpretation of each inspector.

When the trade changed from the use of submitted samples to the use of numerical grades in domestic trade, European grain buyers had to rely upon the certificate of inspection rather than on visual inspection of a sample. Variations in grading and the quality of grain received gen-

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175 J. SHANAHAN, C. LEIGHTY & E. BOERNER, AMERICAN EXPORT CORN (MAIZE) IN EUROPE 1-5 (U.S. Dep't of Agriculture, Bureau of Plant Industry Circular No. 55, Mar. 26, 1910).
176 A. ANDREAS, HISTORY OF CHICAGO FROM THE EARLIEST PERIOD TO THE PRESENT TIME 243 (1884).
177 ANNUAL REPORT OF THE BOARD OF MANAGERS OF THE NEW YORK PRODUCE EXCHANGE 415, 417 (1873).
178 CHICAGO BOARD OF TRADE, THIRD ANNUAL STATEMENT OF THE TRADE AND COMMERCE OF CHICAGO, FOR THE YEAR ENDING DECEMBER 31, 1860, at 13 (1861).
179 Taylor, supra note 173, at 227.
180 C. PHILLIPS, supra note 172, at 26.
182 Id.
183 Phillips, Supervision of Grain Inspection, Grain Dealers J., Apr. 25, 1918, at 654.
184 Uniform Rules, supra note 181, at 549.
185 GRAIN GRADING AND INSPECTION AND INTERSTATE AND FOREIGN COMMERCE IN GRAINS, S. Doc. No. 116, 60th Cong., 1st Sess. 1 (1907) [hereinafter cited as GRAIN GRADING].
erated dissatisfaction on the part of the European buyer. In 1906, USDA investigations of grain shipments in U.S. and European ports demonstrated that the quality upon arrival in Europe was sometimes far below that shown on the certificate issued at origin ports. On January 1, 1899, the incoming President of the Chicago Board of Trade reported that English merchants found the method of certification unreliable, and the CBT had received bitter complaints from individual exporters. Importers from Marseille, France, sent a cable to CBT stating that because of the low quality received they would handle no more U.S. wheat except by sample. Inequities and inefficiency resulting from the grading of grain, both at home and abroad, prompted members of the trade to search for more uniform and consistent methods for grading.

Some members of the industry turned to state government for solutions to these problems. The Illinois Constitution of 1870 gave the General Assembly power to pass laws governing the inspection of grain and in 1871 a warehouse act took inspection out of the control of the private inspectors and placed it in the hands of the State Railroad and Warehouse Commission. Other states adopted state wide standards, but state control did not solve the problems of subjectivity and the variation among grading standards and procedures from market to market and state to state.

Industry and government spokesmen and trade associations working for voluntary uniform national standards were unable to obtain acceptance by the industry. Even standards that were tentatively accepted by the various inspection agencies could not be enforced. Although the Grain Dealers National Association (GDNA) made major strides towards reconciling differences within the industry and developed a set of grades based on a more scientific approach and more objective

186 42 CONG. REC. 4074 (1908) (letter to the President of the United States from Robert Patterson, Chm. of the European Int'l Comm. on American Grain Certificates).
187 42 CONG. REC. 4074-50 (1908).
188 C. PHILLIPS, supra note 172, at 42.
189 Id.
190 See GRAIN GRADING, supra at 185, at 1, 4.
191 ILL. CONST. art. XIII, § 7.
192 1871 Ill. Laws 762.
193 W. Combs, How the U.S. Grain Standards Originated and How They Facilitate the Marketing of Grain at Country Points 5 (February 21, 1945) (U.S. Dep't of Agriculture paper delivered at Oklahoma City).
194 See Address by J. Shanahan, supra note 20.
195 Duvel, Grain Standardization, 6 CANADIAN MILLER AND CEREALIST 139-41 (1914).
factors, it failed to obtain voluntary nationwide adoption of the standards. An alternative approach of federal control was suggested in Congress as early as 1890, but these early efforts conflicted with the GDNA’s efforts to generate voluntary standards and without industry support the bills made little progress. When the GDNA admitted failure in their attempt to obtain voluntary cooperation, they shifted their support to federal legislation. The GDNA assisted in writing the U.S. Grain Standards Act of 1916, and their support was essential to its passage.

The legislation that finally passed was a compromise between those groups demanding complete federal control over all aspects of grading and inspection of grain and those preferring federal grades of a voluntary nature. The Grain Standards Act of 1916 gave the Secretary of Agriculture authority to establish a single set of standards and to enforce exclusive use of standards for grading all grain moving in interstate and foreign commerce. Inspectors were to be licensed by the U.S. Department of Agriculture but were not to be employees of the federal government. A system of appeals was established whereby dissatisfaction or disputes could be resolved by federal employees using the standards and procedures established. In 1916, under the authority of the Grade Standards Act, the USDA adopted the 1914 preliminary grades for corn that the industry had been using on a trial basis for two years. Standards for other grains were developed as market volumes increased.

Establishing federal standards, however, did not resolve the conflicts

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197 New Inspection Rules Adopted, Grain Dealers J., Oct. 25, 1908, at 558-60.
198 In 1890 Senator Algernon S. Paddock of Beatrice, Nebraska, introduced S4027, a bill to provide for both federal grading and inspection of grain. S4027, 51st Cong., 1st Sess., 21 CONG. REC. 5674-75 (1890).
201 Id. at 7043.
202 Id. at 7044 (1916).
204 Id. §§ 2, 4.
205 Id. § 7.
206 Id. § 6.
207 OFFICE OF MARKETS AND RURAL ORGANIZATION, U.S. DEP’T OF AGRICULTURE, SERVICE AND REGULATORY ANNOUNCEMENTS No. 11, OFFICIAL GRAIN STANDARDS OF THE UNITED STATES FOR SHELLED CORN (1916).
208 The USDA prepared and promulgated grades for winter wheat in July, 1917 and for other wheat in August, 1917. These were followed by standards for feed oats in June, 1919, grain sorghum in December, 1924, barley in August, 1926, and flaxseed in August, 1934. Grades for soybeans were promulgated in November, 1940 after an amendment to the Grain Standards Act assured its applicability to soybeans. FEDERAL GRAIN INSPECTION SERVICE, U.S. DEP’T OF AGRICULTURE, HISTORICAL REVIEW OF CHANGES IN THE GRAIN STANDARDS OF THE UNITED STATES (May 1980).
between the various buyers and sellers who sought the maximum competitive advantage or attempted to determine those rules that would provide increased efficiency or profits. The debates and disputes prevalent in the 1800’s resurfaced many times over the next century despite numerous regulatory changes in the standards and seven legislative changes in the Grain Standards Act. The recurrence of these issues reflect concern over the incentives created by the regulations and their effect on grading, pricing and operational efficiency in the industry.

Many of these issues are unresolved, in part because of lack of agreement among the parties on the purposes of grading standards. While the USDA accepts the principle that the purpose of grading standards is to provide information from which buyers and sellers can determine value, grain merchandisers are more concerned with obtaining uniform, interchangeable quantities to facilitate transactions with a minimum of description. It has been argued that grading standards are in principle neutral and that market forces establish value and discounts. However, in practice the neutrality principle is subject to question. For example, the market places price differentials only on those grade factors included in the standards even though other factors are economically important. Conversely, price differentials are generally put on all factors in the standards even though some of these factors have little relevance to value in feeding or processing.

The role of standards in generating incentives can be illustrated through a comparison of grading standards in the U.S. and Argentina. Blending of high and low moisture corn in the U.S. has been blamed for some of the moisture problems in the export market. In U.S. standards and marketing practices, 15.5 percent moisture is used as the basis for price. Much of the corn is stored at lower moisture levels and the standard of 15.5 percent is attained in the market by blending high and

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211 S. Bermingham & L. Hill, A Fair Average Quality for Grain Exports 6 (Dep’t of Agricultural Economics, University of Illinois at Urbana-Champaign, July 1978).
212 Numerical grades are determined by comparing test results with minimum or maximum values on each of several quality factors specified in the grading standards. E.g. No. 1 soybeans must contain not more than 13.0 percent moisture, 10.0 percent split beans, 2.0 percent total damage, etc.
low moisture corn. Argentina, however, experiences few problems with moisture. First, because base moisture is set at 14.5 instead of 15.5 percent,\textsuperscript{216} corn can be safely stored and shipped at the base moisture content. Second, because moisture is not a grade determining factor, there is no incentive for blending wet corn with dry corn. Regulations related to grades thus influence the cost of marketing and the value of the product delivered to the buyer.

U.S. corn standards combine broken corn and foreign material into a single factor, with maximum limits for each numerical grade.\textsuperscript{217} Argentine corn standards classify broken corn and foreign material as separate factors.\textsuperscript{218} This distinction reduces the amount of dirt or weed seeds that can be included in any grade. U.S. corn\textsuperscript{219} and soybean\textsuperscript{220} standards also include test weight as a grade factor despite the lack of scientific evidence relating test weight to economic value. The standards for corn and soybeans in Brazil and Argentina, and for corn in South Africa and USSR, do not include test weight. Test weight in U.S. standards has generated an incentive for farmers to select high test weight varieties in order to avoid price discounts for low test weight.

The factors included and excluded from grading standards, as well as the limits placed on each factor to determine numerical grade, create incentives which are viewed as beneficial to one group or another. The search for rule changes in grading standards that will alter the economic opportunities and distribution of profits has generated a debate over grading that has continued for over one hundred years.

2. The Issue of Moisture in the Grading Standards

One of the issues that has surfaced many times and in many forms throughout the history of grain grading is the question of moisture. Clearly, grain with different moisture levels must also have different intrinsic value\textsuperscript{221} since soybean meal or pounds of beef cannot be produced from water.

Overall marketing efficiency is decreased if grading and pricing practices motivate farmers and elevators to incur costs that generate income but do not increase the intrinsic value of the grain. For example, if water can be added to grain without reducing its price per weighed quan-

\textsuperscript{216} Resolucion No. 20.275, supra note 51.

\textsuperscript{217} FOREIGN GRAIN INSPECTION SERVICE, U.S. DEP'T OF AGRICULTURE, OFFICIAL UNITED STATES STANDARDS FOR GRAIN 2.3 (Jan. 1984) [hereinafter cited as OFFICIAL U.S. STANDARDS FOR GRAIN].

\textsuperscript{218} See Resolucion No. 20.275, supra note 51.

\textsuperscript{219} OFFICIAL U.S. STANDARDS FOR GRAIN, supra note 217, at 2.3.

\textsuperscript{220} Id. at 8.4.

\textsuperscript{221} Intrinsic value of grain is the value of the grain after it has been converted to products through feeding or processing.
tity then, while income to the seller is increased, no additional value is obtained since it is only the dry matter in the grain that generates the final product. The standards established in 1916 require moisture to be less than 15.5 percent for No. 2 corn. Over time, the market established No. 2 corn as the basis for price bids and any corn with moisture above 15.5 percent receives less than full price. Corn with moisture below 15.5 percent receives an implicit discount because of a loss of weight not compensated by increased price. Thus, the regulation establishing standards has determined that 15.5 percent moisture corn provides the seller the maximum returns. However, 15.5 percent moisture corn cannot be safely stored during warm weather and cannot be safely shipped in closed ocean vessels. Moreover, it is not the optimum moisture content for processing. In short, almost no one in the grain industry prefers corn at 15.5 percent except for purposes of meeting an arbitrary moisture standard established for No. 2 corn.

Although the yield of dry corn per acre is fixed at the time of harvest, the weight delivered to the elevator varies with moisture content. Excess water in the corn (above the 15.5 percent price base) receives a price discount because there is less dry matter per ton or per bushel. However, the market does not pay a premium for corn below 15.5 percent even though drier corn contains more dry matter per ton or per bushel. When corn is dried to safe storage moisture, the farmer will deliver less total weight to the elevator and be paid the 15.5 percent moisture price, thus reducing the farmer's income.

A similar situation exists for soybeans, although moisture levels below the base of thirteen percent often occur in the field before harvest is completed. Soybean processors prefer soybeans at ten percent moisture. Again, however, farmers who deliver at this moisture level receive an implicit discount through less total weight. With no price or quantity adjustment for moisture level below the base, farmers who deliver grain

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222 OFFICIAL U.S. STANDARDS FOR GRAIN, supra note 217, at 2.3. Number 2 is a numerical grade in the standards for corn. To be graded No. 2 the sample of corn tested must contain not more than 15.5 percent moisture, 3.0 percent broken corn and foreign material, 5.0 percent total damaged kernels, and .2 percent heat-damaged kernels and test weight must be 54 lb/bu. or greater.

223 Cramer & Heid, supra note 6, at 126-36.


225 Shove, Wet Grain Aeration for Holding and Drying Shelled Corn, in ALTERNATIVES FOR CONDITIONING AND STORING CORN AT FARM AND ELEVATOR 7 (Proceedings of a Regional Conference, University of Illinois at Urbana-Champaign, Feb. 1970).

226 G. AYERST & H. LENIGER, REPORT ON HEAT DAMAGE TO ARGENTINE MAIZE DURING SHIPMENT TO EUROPE 46 (Dec. 1967).

at optimum moisture levels are penalized.\textsuperscript{228} For any grain below the base moisture, the standards and pricing methods create an incentive to increase the moisture content in order to avoid implicit discounts. Many farmers and elevator managers have discovered several methods to increase the moisture content of soybeans and corn which is below the base moisture level.\textsuperscript{229} One method is to blend high moisture grain with low moisture grain, permitting moisture to move from wet kernels to dry kernels until they reach an equilibrium. Another alternative is the use of aeration fans to force high moisture air into stored grain. Moisture from the air is absorbed by the kernels and moisture content increased. Water may also be added directly to the grain. All three methods achieve the same end result. When research describing techniques for adding water directly to corn, soybeans or wheat was published in 1980,\textsuperscript{230} the United States Food and Drug Administration (FDA) offered the opinion that any method of adding water to grain constitutes adulteration of food as defined under section 402(b)(4) of the Federal Food, Drug and Cosmetic Act.\textsuperscript{231}

The regulations in the grade standards that establish moisture levels for each grade in each grain are translated into incentives through the pricing practices of an industry that has accepted these moisture levels as a basis for price discounts. Sellers who respond to these incentives by rewetting grain to the moisture levels the market has established, however, are in violation of the FDA regulations. Thus, while moisture may be removed to reach base moisture levels in grain, the same moisture may not be returned without violating federal regulations. The grain quality, however, is the same whether grain is dried to the base moisture or rewetted to the base moisture.

These conflicting incentives result in inefficiencies. First, market incentives encourage storing grain at moisture levels above those recommended for safe storage. Losses from spoilage are frequent. Second, market incentives encourage the addition of moisture to meet grade standards. Rewetting and blending in response to the arbitrary moisture levels dictated by the standards involve an additional cost without any real increase in value. The inefficiency is one of creating economic incentives for uneconomic actions.

Removal of moisture as a grading factor is one step toward rationalizing these inconsistencies. In the United States, on September 12, 1984, regulatory action by the USDA removed moisture as a grade determin-

\textsuperscript{228} P. Bloome, supra note 224, at 1-2.
\textsuperscript{229} Hill & Shove, What are Farmer's Alternatives Concerning Moisture Content of Grain Going to Elevator?, 10 SOUTHWEST FARM PRESS 14, 14-15 (Jan. 13, 1983).
\textsuperscript{230} Bloome, Moisture Shrink in Stored Wheat May Be Biggest Loss Factor, 7 SOUTHWEST FARM PRESS (May 15, 1980).
ing factor for corn, soybeans and grain sorghum, to become effective September 9, 1985. However, an additional step is required before the market will make the necessary adjustment. The quantity of grain should be defined in terms of the dry matter it contains rather than the present "legal bushel" definition based on weight of water and grain combined. As early as 1916, the USDA published recommendations that grain be priced on the basis of the dry matter it contained, not on its wet weight. Redefining the legal bushel would remove the incentive for altering moisture content except to obtain the optimum storage and handling moisture levels. The quantity of grain would be determined by its weight, adjusted for differences in moisture. The weight of grain at various moisture contents would be adjusted to the equivalent weight of grain at the base moisture content. This change in the rules and regulations would resolve several problems. It would: (1) remove incentives for rewetting; (2) eliminate the conflict between the FDA and general practices in the trade; (3) eliminate the need for and the cost involved in blending diverse moisture contents solely for the purpose of meeting the USDA standard; and (4) pay sellers on the basis of the quantity of dry matter delivered regardless of the moisture level.

However, managers in the grain industry object to this proposal on the grounds that: (1) the equivalent bushel concept would eliminate the income elevators now receive from blending wet and dry grain; (2) moisture meters are not accurate enough to use as a basis for determining equivalent bushels; (3) measuring moisture on all grain purchased would require additional expense; and (4) separate bins would be needed for each moisture level. There is a response to each of these concerns. First, elevator income is determined by competitive forces setting prices for services performed. Elimination of elevator profit opportunities from blending may require higher charges for other services, but the total income from all sources

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233 Quantities and prices for grain in the U.S. are generally quoted in terms of bushels. However, the bushel is determined by weight without regard to volume. The weight per bushel specified for each grain is called the "legal weight per bushel" and was established for purposes of estimating duties by the 39th Congress. In subsequent years individual states moved toward uniformity in setting legal weights for each grain based on a Winchester bushel of 2150.42 cubic inches in capacity.
235 Hill, The Standardized Bushel—Solution to the Grain Moisture Debate, in EVALUATION OF THE ISSUES IN GRAIN GRADES AND OPTIMUM MOISTURES 25, 25-29 (Dep't of Agricultural Economics, University of Illinois at Urbana-Champaign, No. AE-4548, Dec. 1982).
236 Id. at 27.
237 Irmen, Grain Moisture and Dry Weight Matter Marketing, National Grain and Feed Association Newsletter, Aug. 25, 1983.
will be limited only by competing elevators. Second, commercial meters have been sufficiently accurate for measuring moisture above the base and have been used to determine discounts.\textsuperscript{238} It seems illogical that the industry accepts the current degree of meter accuracy for discounting farmers but not for establishing premiums. Third, the only time moisture is not measured on farm-delivered corn is when the manager knows the moisture will be below the base and he will receive a bonus of extra bushels. Again, the expense is readily justified when farmers are being discounted, but the argument asserts that the same procedure is too expensive to measure moisture when farmers may receive extra value. Fourth, grain is already segregated according to moisture. The equivalent bushel approach would eliminate the need to separate moisture for purposes of standards and permit blending and segregation according to good storage practices. The number of separate bins required might even be reduced because all moisture levels would be priced on the basis of dry matter and, whether separated or blended, their price and quantity would remain unchanged.

Resolution of this debate between buyers and sellers of grain is only possible if the justification for changing regulations is shifted to efficiency rather than a redistribution of total value between buyers and sellers. If rewetting grain is illegal and inefficient, but current marketing institutions provide economic incentives to add water, then a change of incentives through changes in policy is a more viable solution than policing farmers and elevators to prohibit blending, rewetting and aeration. Changing the "rules of the game" (i.e. regulations) can alter the distribution of income among the players, but it may also increase the total income available for distribution.

\section*{C. Marketing Practices in International Trade}

Quality loss and the condition of grain at foreign destinations has been a constant concern throughout the history of grain exporting.\textsuperscript{239} The chief complaints from foreign buyers are:

1. A high percent of broken kernels and foreign material at destination.\textsuperscript{240}
2. Excessive moisture at the time of unloading.\textsuperscript{241}

\begin{thebibliography}{99}
\bibitem{238} L. Hill & M. Paulsen, \textit{Shrink Factors for Corn Using Recalibrated Moisture Meters} 4 (Dept of Agricultural Economics, University of Illinois at Urbana-Champaign, No. AE-4542, Sept. 1982).
\bibitem{239} J. Shanahan, C. Leighty & E. Boerner, \textit{supra} note 175, at 3-4.
\bibitem{241} J. Shanahan, C. Leighty & E. Boerner, \textit{supra} note 175, at 21.
\end{thebibliography}
3. Low yields of final processed products from U.S. origin grain.\textsuperscript{242}

These complaints often take the form of recommendations for producers to grow better varieties, for grain exporters to load better quality, for grain marketing firms to avoid blending and for export elevators to clean grain just before loading.\textsuperscript{243} But these complaints generate little action on the part of producers or grain marketing firms because they are not accompanied by any economic incentives. When foreign buyers specify No. 3 yellow corn in their contract, they are permitting a maximum of seven percent moldy kernels and four percent broken corn and foreign material.\textsuperscript{244} The economic incentives are very strong for the exporter to load as close to that quality as his equipment and technology will permit. Most corn received by the export elevator contains less than seven percent moldy kernels, thus providing an opportunity for the elevator to purchase badly damaged corn at a discount, blend it into the corn as it is being loaded at a rate to achieve seven percent and receive full price for the moldy kernels. This obviously decreases the total "value" of the corn for most uses, but it does not affect "price." Therefore, it enhances the income of the exporter and reduces value to the foreign buyer. Maximum limits on foreign material generate incentives for the same type of blending practices.

Breakage could be reduced at foreign destinations if producers would select varieties and drying practices that would generate corn able to stand up better under export handling.\textsuperscript{245} However, no economic incentives exist for producing this corn. If farmers incur a yield loss or additional cost in producing the better quality, the lack of premium would have the effect of penalizing farmers for producing good quality corn for the foreign market.

Uniform grades, terminology and measurement devices contribute to efficiency in international grain markets. Despite the progress over several centuries of grain trading, uniformity has still not been achieved in some areas. For example, the United States is one of the few nations not using the metric system for measuring grain quantity and quality. Moreover, moisture is one of the more objective factors in the standards and its accurate determination is essential to establishing value. Yet, no uniform measurement method has been accepted by all countries in-

\textsuperscript{243} Wichita Eagle Beacon, Oct. 7, 1984, at 9C.
volved in international trade,\textsuperscript{246} basic reference methods differ among countries\textsuperscript{247} and calibration validation in the United States is left to individual state agencies, often with the result that moisture meters in different states do not give comparable readings.\textsuperscript{248} The lack of uniformity and the confusion created by inconsistent moisture readings among points in the market channel generate inefficiencies in marketing. In general, it will require changes in international institutions in order to reduce these inefficiencies.

Perhaps the most dramatic quality problem in the international markets is that many quality factors important to the foreign buyer are not included in the U.S. standards.\textsuperscript{249} Consequently, there are no incentives at any point in the market channel for improving quality on those characteristics. Thus, farmers are not encouraged to choose varieties or technology that would increase the yield of starch or flaking grits\textsuperscript{250} or even nutritional value because current grading standards include very few factors that relate to value for processing or feeding. Farmers producing soybeans with higher protein or oil content do not receive higher prices. Improvement in grading standards requires adequate incentives at each point in the market channel. Since the procedures for changing standards\textsuperscript{251} involve public hearings and support from the grain industry, changes at the federal level are difficult to make. However, history has demonstrated that state or local grade standards lead to inequities and inefficiencies.\textsuperscript{252} The industry is best served by federal regulations that establish uniform standards for use throughout the industry.

Export procedures for most U.S. grain are based on an export certificate where origin quality and weight are final.\textsuperscript{253} This means that the sellers' responsibility ends when the required weight and quality are loaded in the final shipping bin in the export elevator above the vessel. Changes that take place in the quality of the grain during loading, transit or unloading at final destination become the responsibility of the buyer.

\textsuperscript{246} Mulfon & Martin, \textit{Méthodes de références normalisées de dosage de l'eau dans le cas du maïs: Justification des méthode ICC}, \textit{REVUE DE METROLOGIC PRATIQUE ET LEGALE} 9 (1978).

\textsuperscript{247} \textit{FOOD AND AGRICULTURE ORGANIZATION OF THE UNITED NATIONS, REPORT OF THE SECOND SESSION OF THE CODEX COMMITTEE ON CEREALS AND CEREAL PRODUCTS} 9, para. 54 (1981).


\textsuperscript{249} L. Hill, Improved Quality of U.S. Feed Grain Exports (May 15, 1978) (paper presented at a grain trade seminar in London).

\textsuperscript{250} Grits are segments of the hard endosperm of the corn kernel obtained during separation of germ, bran, and endosperm in dry milling. Flaking grits are those grits large enough to be used for making flakes such as those used in breakfast cereals.

\textsuperscript{251} 7 U.S.C. §§ 71, 74 (1982).

\textsuperscript{252} \textit{Uniform Rules}, supra note 181, at 549-50.

\textsuperscript{253} S. BERMINGHAM & L. HILL, supra note 211, at 1.
However, at the foreign port, the vessel is frequently allocated among as many as 50 different buyers with significant variation in the quality they receive.\textsuperscript{254} The importer's responsibility is so diffused that processors or feeders cannot obtain accountability for quality changes during unloading. The primary change that takes place after the grain is graded at the export point is one of increased breakage during subsequent handling.\textsuperscript{255} Drying techniques and varieties of grain are available that would dramatically reduce the amount of breakage taking place during this handling.\textsuperscript{256} However, no incentives exist to reward those farmers who use lower drying temperatures or select varieties that will better withstand subsequent handling.\textsuperscript{257}

The solution is to change incentives. Every firm in the marketing channel, from farmer to final processor, responds to economic incentives that currently exist. If a change is desired in marketing practices, the rules which generate these economic incentives must be changed. For example, breakage during transit could be reduced by including a test for breakage susceptibility in federal grade standards to facilitate price differentials at the point of first delivery. Farmers who are currently selecting varieties and using drying techniques to produce corn suited to the export market (e.g., resistance to breakage) would receive a higher price per bushel than those farmers producing corn not suitable for these purposes. Quality characteristics such as starch content, yield of flaking grits or measure of total digestible nutrients and protein, once incorporated in the grade standards, would become the basis for price differentials generating the incentives for an increase in quality throughout the market channel. Without such incentives, no change is likely to occur.

\textbf{IV. CONCLUSIONS}

Resolution of the issues in grain quality and grading standards requires a perspective beyond national legislation and regulation. Local, national and international laws and regulations with moral as well as legal enforcement interact in world grain markets to promote efficiency or inefficiency. Individual firms make decisions based upon incentives. Incentives are generally prescribed by marketing institutions and regulations. Therefore, any improvement in efficiency requires changes in regulations and government policies. Legislation and regulations developed to solve specific problems are seldom evaluated for their effects upon in-

\textsuperscript{254} L. Hill, M. Paulsen & M. Early, supra note 240, at 20.
\textsuperscript{255} Id. at 26.
\textsuperscript{256} Paulsen, Hill, White & Sprague, supra note 245, at 1830-36, 1841.
centives and marketing efficiency. Yet these relationships often determine total product and profits available for distribution among the various participants in the production and marketing of goods.

Few regulatory changes will receive unanimous support from all sectors of a national economy or from all nations because regulations are, by their nature, intended to help balance the marketing power of one group against that of others. Existing rules and regulations, as well as potential additions or changes must be evaluated for indirect effects upon the total available supply of goods and services as a consequence of their role in creating incentives or disincentives in the market. There are very few opportunities for decisions that make everyone better off without making someone worse off in a welfare context. For the most part, decisions of this type are spontaneously initiated by individual participants in the market. Most issues revolve around the trade-offs between individuals and groups and resolution of the issues requires regulations accompanied by legal enforcement. Changes in regulations often result in a reallocation of the total income among firms, individuals or nations. These changes can increase the total income, even though not all groups will gain. If changes increase total income and are made under conditions of economic growth, losers can be compensated to counter undesirable effects of redistribution. However, the rules of the game must be properly structured to generate incentives for increased efficiency, greater output and allocation of the total product according to socially acceptable criteria.

Efficiency in grain production, marketing and international trade is largely determined by the regulatory environment and enforcement climate within which private firms make marketing decisions. This article has reviewed only a few of the numerous regulations affecting the grain industry in order to illustrate the important influence of national and international policies on the cost and availability of grain. In order to avoid serious consequences in terms of adequacy, stability and cost of food supplies, it is essential that agencies and individuals responsible for developing, interpreting and enforcing local, national and international regulations understand the economic implications of their decisions.

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258 P. Samuelson, Economics: An Introductory Analysis 602 (1948).