Political Economy of Agricultural Distortions in Transition Countries of Asia and Europe

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Abstract

The paper analyzes the political and institutional factors which are behind the dramatic changes in distortions to agricultural incentives in the transition countries in East Asia (China and Vietnam), Central Asia (Kazakhstan, Kyrgyz Republic, etc), the rest of the former Soviet Union, and in Central and Eastern Europe. The paper explains why these changes have occurred and why there are large differences among transition countries in the extent and the nature of the remaining distortions.

Keywords: Political economy, agricultural distortions, transition economies, China

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Scott Rozelle and Johan Swinnen

Until in the late 1970s, a large share of the globe—from the centre of Europe to the southeast reaches of Asia—was under Communist rule. The lives of more than 1.5 billion people were directly controlled by Communist leaders. Under this rule, agricultural incentives were massively distorted. The leaders of the Soviet Block and China were committed to Socialist ideology, and designed their economies to be insulated from the world and its markets.

Since then, there have been dramatic changes in these countries. Yet there are large differences between these transition countries in the extent and the nature of their remaining price distortions. In 1978 China embarked on its economic reform path by introducing the household responsibility system (HRS) in agriculture. A few years later, Vietnam followed. Both countries reduced price distortions and reallocated key land rights from collective farms to rural households. In the initial years, however, market forces played little role, and only became important later on. Other communist regimes did not follow this path in the 1980s. Only a series of timid reforms were tried out in the former Soviet Union during the 1970s and 1980s. However, in the 1990s many nations of Central and Eastern Europe (CEE) and the former Soviet Union (FSU) implemented a series of bold policy reforms that often went far beyond the reforms that had been implemented in China and Vietnam.

While the record on what happened and the effects of those reforms are now fairly well understood (Macours and Swinnen 2002, Roland 2000, Rozelle and Swinnen 2004), it is less clear why the decisions were made in the ways that they were. If price changes, rights reforms and market emergence led to growth, why did leaders in many transition nations not choose to follow such a comprehensive prescription? More explicitly, why was it that leaders in China decided to implement their reforms gradually while those in CEE did so all at once? Why was it that leaders in CEE undertook a broad spectrum of reforms while those in many nations of the

FSU did not? Even more fundamentally, why is it that the policies were implemented by the leaders of some Communist regimes while in others it took a major regime shift for policies to gain momentum? More generally, there is much less of an understanding of why decisions were made in the way that they were.

The goal of this chapter is to explore these questions. The chapter draws partly on our previous work on the political economy of the general reforms from a Communist system to a market-based system (Swinnen and Rozelle 2006) and partly on our contributions to a World Bank research project (Huang et al. 2009 on China and Anderson and Swinnen 2008 and in particular Ciaian and Swinnen 2008 on CEE and FSU). In what follows we also generate a set of additional new arguments.

A summary of changes in distortions to agricultural incentives

There have been dramatic changes in the agricultural and food policies in almost all transition countries since the 1980s, albeit with important differences among nations.

In the FSU, agriculture was subsidized under the Communist regime. After the fall of the Berlin Wall in 1989 and the disintegration of the Soviet Union in 1991, many of the region's trade and price distortions were removed. Price, exchange rates and trade policies were all liberalized, subsidies were cut, hard budget constraints were introduced, property rights were privatized, and production decisions were shifted to companies and households.[1] As a result, on average, support to agriculture fell to low levels in the early 1990s (see figure 1) — as it did also for industrial production. Between 1992 and 1996, direct assistance to agriculture averaged just 8 percent in the CEE countries, while in Russia and Ukraine the averages were below zero.

In the mid-1990s, support to agriculture increased again in some of the ECA countries. In the CEE region this was driven by the introduction of new support policies. In Russia, by

[1] While most of the FSU and CEE followed more a big bang approach, there were important variations within the region. In Europe, the Central European countries moved first and most rapidly towards market-based systems. The reforms in the Balkan countries, such as Romania and Bulgaria, were more half-hearted and involved many inconsistencies during most of the 1990s, with government interventions continuing to distort incentives. In the large FSU countries (Russia, Kazakhstan and Ukraine), governments continued important controls of the agricultural economy through a variety of interventions such as regional trade controls, input supply controls, and the continuation of soft budget constraints. The slowest reform progress was in Belarus and in some of the Central Asian countries. While the Kyrgyz Republic relatively quickly liberalized, the other Central Asian countries have restricted reforms and liberalization. In particular, major controls remain in place in such countries as Uzbekistan and Turkmenistan today.

contrast, it reflected primarily exchange rate developments in the presence of institutional mechanisms which constrained the pass-through of border prices to farm-gate prices. Between 2000 and 2004, average rates of assistance to agriculture were around 20 percent in CEE countries, about one-third of the level in the EU-15. In Russia the average support level was positive, but only around 10 percent, while it appears to have been close to zero in Kazakhstan and Ukraine and probably negative in the rest of Central Asia.

China's reform differed fundamentally in its pace. Certainly China's first move was bold—it decollectivized agricultural production and replaced it with a system of household-based farming (Lin 1992)— but in the initial years after reform it made no move to continue to radically change its economy (Sicular 1995). There were more favorable agricultural prices in the early reform days, but these prices were administratively raised by officials in the planning bureau who retained control over the economy. It was not until property rights had been fully reformed in the mid-1980s that the leadership decided to begin to move to marketing and other reforms. Vietnam closely followed China in the pace of its reform. McMillan and Naughton (1992) describe this process as one that is gradual and deliberate but unplanned.

The pace of liberalization and the rate of elimination of the distortions in agriculture are linked. With the gradual dismantling of China's state-run agricultural marketing, the level of distortion also gradual diminished. The reforms increasing allowed farmers to sell their output to private traders (Park et al. 2002). Entry by non-state entities and individuals was allowed. Ultimately, competition forced the entire state-owned marketing system to be disbanded. It took 20 years, but China's planned agricultural marketing system of the early 1980s had been replaced by a system of competitive markets by 2000. Although a large share of the distortions had been eliminated by the mid- to late 1990s (by the time market liberalization was complete), it took tariff reductions and trade liberalization to finish the process (Huang et al. 2009). Pingali and Xuan (1992) describe largely the same strategy in Vietnam.

Despite this gradual approach – unlike the Big Bang in CEE and FSU – the impact on distortions has been very important. Huang et al. (2009) show that in China between the mid-1980s and 2000, the Nominal Rate of Assistance (NRA) to agriculture fell (in absolute value terms) from -50 to nearly zero (Figure 2). The shift from high distortions in Vietnam followed the same path as that in China (Figure 3). Although highly negative in the early 1990s, by 2000 the rate of assistance to producers of farmers relative to that for producers of non-agricultural tradables in Vietnam was around zero.

Political economy 1: regime change and distortion reductions

As explained above, dramatic reductions in distortions occurred throughout the former Communist countries of Asia and Europe. Although the nature of the changes differed among countries (reduction of farmer taxation in East Asia and reduction of farmer subsidization in East Europe and the FSU), changes in political regimes played an important role in triggering these changes in all countries.

From Mao to Deng in China

The reductions in distortions were part of the transition from Socialism to Reform in China. This economic transition followed the political transition from Mao Zedong to Deng Xiaoping. China before 1980 was fully a product of Mao. The influence of his politics is inescapable. Mao's fear of the outside world, his commitment to Socialism, and his skepticism of markets helped produce the pre-reform economic system. It was a system that was fundamentally closed to trade, run without markets, and administered by a controlled pricing system that discriminated against agriculture. It was a system that also failed to raise per capita income and to produce rises in total factor productivity.

While there was no dramatic overthrow of the Communist Party or outward change in the political system after Mao's death, the shift from Mao to his successor, Deng Xiaoping, nonetheless signaled the start of a new age. Committed in part by a self-learned belief in incentives and pragmatism, and also attracted by the rapid growth that was transforming most of the rest of East Asia outside its borders, Deng's policy approach could not have been more different than if there had been a revolution. Deng believed in an Open Door. Deng believed in technology wherever it came from—from foreign direct investment or an investment into domestic science and engineering. Deng wanted to incentivize the economy. It is no wonder that the beginning of the Reform Era is so clearly marked by a rise of Deng in the wake of Mao's death.

However, while Deng's fundamental ideology was radically new, China did not experience a sudden revolution, for several reasons. First, Deng assumed power from within the system. The Communist Party was in control both before and after Deng's accession to the position of supreme leader. Moreover, while Deng had a number of bold ideas, he also was essentially committed to the same system that had been built during the previous three decades.

Even if he wanted to move more rapidly (which is not at all clear), Yang (1996) describes how there were many factions that were embedded deep in the system that were fundamentally reluctant to change. All of this guaranteed that change would move—at most—gradually.

From Stalin to Brezhnev in the Soviet Union

Interestingly, the distortions under Mao in China resembled much more the distortions under Stalin in the Soviet Union than the distortions in the Soviet Union in the 1970s. As with Mao, Stalin's desire to modernize fast and his commitment to heavy industry – and his distrust of farmers – led to his policy to use his centrally controlled economic system to tax the countryside to finance industrial development. This system, as in Mao's China, reduced incentives for farms to invest and produce and left agriculture stagnant.

Soviet agricultural policy changed after the Second World War. When Kruzhnev took over as Soviet leader following Stalin's death, he initially continued Stalin's agricultural policies. However, gradually he introduced important changes. He reduced taxes on agriculture and started to provide substantial assistance from the state, both in terms of investment support and in terms of higher prices for its products. This pro-agricultural policy was continued and reinforced under Brezhnev's Soviet leadership in the 1960s and 1970s.

The fall of the Berlin Wall and the collapse of Communism in East Europe and FSU

While the Soviet Union reduced taxation of agriculture through its pricing policy after the Second World War, what was different from China is that the Soviet leadership never let go of its centrally imposed collective and state farm system – which was a dramatic reform in China under the Communist regime at the end of the 1970s. It took a much more dramatic political reform (the fall of the Communist regime) in the Soviet Union (and in Eastern Europe) to trigger these fundamental changes, which were then also accompanied by changes in price and subsidy regimes.

The fall of the Berlin Wall in 1989 signaled the beginning of the collapse of the Communist regimes throughout Eastern Europe and the (former) Soviet Union. This in turn caused dramatic changes in the economy: prices and trade were liberalized, subsidies cut, property rights privatized and production and trade organizations restructured (Rozelle and Swinnen 2004). As documented in Anderson and Swinnen (2008) this lead to a dramatic

reduction in distortions to agricultural incentives: agricultural support fell, on average, to very low levels in many countries of the region.

Importantly, political changes did not occur everywhere in the former Soviet Union. Even now, twenty years after the changes, some of the leaders have not changed. This is the case, for example, in countries such as Belarus, Turkmenistan and Uzbekistan. In other countries, such as Russia, political freedoms have been reduced again. The relationship between political reforms and agricultural reforms is illustrated in figure 4. This relationship is consistent with the idea that the lack of political reform (in particular in the least reformed countries) has constrained the progress of economic reforms—and on reducing distortions in agriculture—in these countries.

Why was reform possible with the Communist Party in China and not in the FSU?

The previous discussion raises the interesting question why radical reforms of the agricultural economic system was possible in China but not in the Soviet Union under the Communist regime. In Swinnen and Rozelle (2006) we argue that radical reforms under the Communist regimes could only occur when there was simultaneously strong grassroots support for the reforms and support at the top of the Communist Party. If support from both above and below is not there, it is likely that the policy efforts will succumb to inertia, foot-dragging and resistance from those that are not in favor of reform. For example, reform failed in China in the 1960s because there was no support by the top leadership for radical decollectivization demanded by households at the grassroots level (Lardy 1983). Reform failed in Russia in the 1970s because there was neither grassroots nor leadership support for radical changes (Brada and Wadekin 1988). Agricultural reform failed in the 1980s in Russia because the reform proposals from the top of the Communist leadership under Gorbachev were not supported at the farm level (Gray 1990). Only in China at the end of the 1970s and the early 1980s was there a confluence of interests in favor of radical reforms at the top and at the grassroots, from both farm households and local officials.

Paradoxically and ironically the radical, though partial, economic reforms in the Chinese countryside did much to reinforce the Communist Party's hold on power (Oi 1989). The opposite was true in the Soviet Union where the lack of significant reforms ultimately contributed to the fall of the Communist leadership.

The radical reform actions in China, which looked like moves away from Socialism, probably did more to consolidate the rule of the Communist Party than any other measures taken during this period. Although it is well-documented that the decisive changes directly affected the

incomes and livelihood of more than 70 percent of the population in the rural areas, the agricultural reform also had a tremendous impact on the urban economy. The rise in food production and increases of food supplies to cities took a lot of pressure off the government. Urban wages, when raised, became real gains to income, since food became relatively cheaper. In addition, the rise of rural incomes created an immediate surge in the demand for non-food products. Many of the same dynamics occurred in Vietnam (Wurfel 1993, Pingali and Xuan, 1992).

Causes of differences in grassroots support in China and the Soviet Union

Why were the attitudes towards decollectivization of farm workers and local officials in China and the Soviet Union so different? One factor sometimes suggested as an explanation for the difference in farmers' motivation is the historical legacy of Socialism. Rural households in the Soviet Union had been working under the collective system for much longer than in China, and there was no memory of family farming. While this factor no doubt affected the attitudes of rural households, this is unsatisfactory as an explanation because it cannot explain why attitudes in many rural households in East European countries (who had been under Communism as long as China) were equally unenthusiastic about decollectivization.

A more convincing argument is the differences in distortions which contributed to differences in standard of living offered by pre-reform collective agriculture. In rural China more than 30 percent of households lived in utmost poverty (Lardy 1983, World Bank 1992). In contrast, farm workers in CEE and FSU benefited from large government subsidies and high wages, and were covered by social welfare benefits. Despite low farm productivity, workers in the Soviet Union's state farms and collectives lived at standards of living far higher than those in China's rural sector. In several countries rural incomes were actually higher than urban incomes (Ellman 1988). With the reduction of distortions, farm incomes would fall, effort by farm laborers would need to increase, and risks would have been higher. Moreover, with over-employment and soft budget constraints, agricultural reform would trigger lay-offs. Not surprisingly, many farm workers in the Soviet Union and CEE resisted agricultural reforms.

Differences in technology and in bureaucratic organization reinforced these differences in attitudes. Farmers in China purchased few of their inputs. Supply channels were simple. They sold relatively little of their output into the market. Almost no farmers interfaced with processors. Most importantly, given the high labor factor share, the potential for effort efficiency-enhanced output would mean significantly higher incomes for farmers. In contrast,

farms in the Soviet Union and Eastern Europe were much more integrated into an industrialized production system and a complex network of relations with input suppliers and processors (Johnson and Brooks 1983). Moreover, they were much more capital- and land-intensive. Under these conditions, farms were less likely to get a large boost from incentive improvements, and more likely to face serious disruptions.

The support of officials for reforms in China was sustained by reforms of the bureaucracy and by rural industrialization and fiscal reforms (Qian and Weingast 1997). The fiscal reform policies were shown to be beneficial to local leaders, and they secured support for the overall reform agenda. These changes also stimulated interest of bureaucrats in local economic growth. In the Soviet Union, little change took place in the bureaucracy (Shleifer 1997) and, since the interests of local officials were also here aligned with those of farm managers, the rational response of both was to resist, not support, reform.

Crises, political change and reforms during transition

General political and economic crises have continued to play an important role in inducing changes in agricultural distortions. The most obvious example is the fall of the Communist regime and the disintegration of the Soviet Union – and of the central directives coming from Moscow. Also, more recently there are several examples where more general crises have triggered changes. Most often the policy reforms come only after new elections lead to a change in government, reflecting changed electoral preferences. For example, in Romania and Bulgaria, important progress in market reforms and the removal of distortions only occurred in the late 1990s after electoral change brought reform-minded governments to power. In Ukraine, reform progress was made in the years after the 1999 election in which the large farm lobby fell out with President Kuma, who consequently introduced a series of important reforms which the farms had successfully opposed previously.

However, democratic political change is not a sufficient condition in itself for better agricultural policies. For example, in both Ukraine and in Kyrgyz Republic, the important political changes (the “Orange Revolution” and the “Tulip Revolution”, respectively) in the early 2000s did not contribute to better agricultural policy. In fact the Ukraine government seems to have reversed. In Kyrgyz Republic, change has mostly resulted in more instability, while relatively little distortions remain in agriculture.

Political economy 2: big-bang versus gradualism

A fundamental difference between China and many CEE and the FSU states was in the pace of market liberalization. This raises the question: why did the FSU and CEE not also opt for the gradual process of market liberalization? We believe that there are a number of differences that explain the choices for the alternative approaches.

Once China had successfully implemented property rights reform and restructured its farms (as well as adjusted prices to reduce the implicit tax on farmers), liberalizing markets became less imperative (Rozelle 1996). The early pricing changes (which were not done through markets, but by the planning bureaucracy) and the household responsibility system helped the reformers to meet their initial objectives of increased agricultural productivity and higher farm incomes and food output (Sicular 1988, Lin 1992). The agricultural reforms fuelled China's first surge in economic growth and reduced the concerns about national food security. The legitimacy of leaders of being able to run a government that could raise the standard of living of its people was at least temporarily satisfied. A new set of radical reforms might have exposed the leaders to new risks, in particular regarding the impact on the nation's food supply (Putterman 1993). Decollectivization had erased the worst inefficiencies. With the urgency for additional reforms dampened for top leaders (since their goals were met) and for farmers (since their incomes and control over the means of production both had improved), there was less policy pressure from both the top and grassroots.

The situation was very different in the Soviet Union and CEE states in the late 1980s. Communist leaders had failed to substantially reform for decades, not only in agriculture but in the entire economy. Once they lost power, the anti-communist political forces that came to power were determined to get rid of the Communist system and to introduce democracy and a market economy. Reforms were launched despite resistance by farm managers, workers and local officials (Swinnen 1997). Reformers chose to push through as much of the economic reform agenda as possible at the time that they were (still) in charge – using their "window of opportunity." Hence, for both political and economic reasons, a comprehensive set of radical reforms were pursued. Since the previous reforms had failed to result in efficiency improvements with marginal and slow policy shifts, in the view of the reformers a more radical and broad-based reform approach was necessary.

These dynamics applied to reform programs across the economy. Within the agri-food system, reforms extended beyond land reforms. The post-communist policy shifts needed to be

sufficiently radical to have a significant impact on productivity of the entire food system. This required a broad and encompassing reform strategy that needed to address several key issues. First, the more industrialized nature of the Soviet agricultural production system and the inefficiencies imbedded in the agro-food supply chain required an approach beyond the confines of the farming sector. The organizational inefficiencies in the supply chain would have severely limited the potential impact of farm-level reforms in the Soviet Union. The supply chains inefficiencies were an important cause of low agricultural efficiency (Johnson and Brooks 1983). As a result, solving the problems of Soviet agriculture would require policy reforms beyond the farms.

Second, in terms of administrative feasibility, the more complicated technologies in Soviet agriculture and in CEE meant a more complex set of exchanges between a larger number and greater variety of firms. China's farming sector was largely based on small mostly subsistence farmers selling grain and oilseed commodities to a trading system that in turn only had to re-transfer the stocks to urban sales outlets or at the most rudimentary processing firms (such as oil crushing mills). By contrast, in the Soviet Union and in the CEE the food economy was dominated by livestock products, dairy and other products that were part of an agri-industrial complex, including agribusiness, food processing and retailing companies. To design an optimal sequence of policy in a gradual reform strategy, policy makers would have been required to have access to extensive information on a vast number of processes. This information had not been available for planning, so there is no reason to believe it would have been available for a gradual reform program.

Third, the overall importance of agriculture in the economy (measured as the share of GDP or employment) also was an important feature that helped determine the pace of reform. Unlike in China, where agriculture made up such a huge share of the economy at the outset of reforms, agriculture in the Soviet Union and the CEE was much less important in the economy. Reformers took several decisions which had a major impact on agriculture and on the sequencing of the agricultural reforms as part of a broader reform agenda. Hence, for all of these reasons, the same factors that kept reform from occurring in the Soviet Union and CEE in the pre-reform era made it imperative that, once the decision to reform was made, the reforms happen all at once.

Political economy 3: domestic pressures and structural conditions

Now that the transitions are well advanced, there is more scope for explaining policy evolutions using standard political economy theory. In this section we consider just domestic forces at work.

Development and anti-trade patterns

Several political economy stylized facts that are widely observed in market economies (Anderson, Hayami and Others 1986, Swinnen 1994; de Gorter and Swinnen 2002) are also found in the post-transition CEE and FSU countries. On average, the data indicate that farmer assistance tends to be higher in higher-income countries, and higher for import-competing enterprises than for export-oriented ones. For example, Slovenia, the richest country in the region, has the highest level of agricultural protection. In many CEE and FSU nations we also observe the same correlations. It is likely that these reflect similar political-economic interactions and mechanisms as in other parts of the world. Anderson and Swinnen (2009) estimate these effects and find that the same correlations apply.

These exact same dynamics have occurred in the case of China (Huang et al. 2009). Whereas China's farmers were taxed heavily in the past, in recent years they have begun to receive greater assistance from the state. In 2007, for example, farmers received up to US$20 per acre (in RMB equivalents) in production subsidies (Rozelle, Huang and Otsuka 2008). While it is unclear if the new subsidies are distorting, there is the tendency in China to begin to support agriculture as the nation's economy grows.

There is an interesting question whether this "development pressure" is also behind the remarkable switch from agricultural taxation to agricultural subsidization in the Soviet Union over the period 1930-1970. Table 1 presents data on the relationship between income and the shift from taxation to subsidization comparing the shift in the Soviet Union and the current policy developments in China. The data suggest that the change in the Soviet Union occurred when GDP per capita was around US$3500 which, intriguingly, is roughly the current level of income in China. Hence, these observations are consistent with the interpretation that the pressure to start subsidizing agriculture is real in China and would lead to a net subsidization of agriculture in the future – in the absence of strict constraints, such as WTO may provide.

Concentrated benefits and distortions

One of the reasons that protection has not risen more in China as its economy has grown may be related to the observation that protection is greatest when the benefits are most concentrated.

Since China has around 200 million farmers and production of many of its commodities (rice, wheat, maize, soybeans, cotton, fruits, vegetables and livestock products) is spread out over many provinces, the benefits from protection might be said to be less concentrated than in any other country in the world.

There is an important exception, however. Sugar production in China is highly concentrated. More than 50 percent of its production is in Guangxi province, most of the rest of China's sugar production is in two other provinces. When looking at protection of different commodities—both assessed rates and those negotiated under the WTO accession agreement – it is clear that sugar is an outlier. Its in-quota tariff is above 25 percent, higher than any other major commodity. Moreover, the execution of sugar border policy is strict in the sense of custom officials have been exceptionally fastidious in collecting all duties.

Also in other transition countries, opportunities for rent seeking from distorted policies inhibit reductions in distortions, as the few who benefit disproportionately from the existing distortions lobby strongly for their continuation. This applies to various policies, such as cotton regulations in Central Asia, grain trade regulations in Bulgaria, Ukraine, and Russia, and water policies in Central Asia. But it also applies to several policies in countries in which benefits go a specific group of farms. For example, the continuation of soft budget constraints in the large FSU countries, and the failure of governments to enforce bankruptcies and enforce strong land rights, all disproportionately benefit large farming companies while smaller family farms are often hurt by these policies.

Exceptionally heavy government intervention is associated with policies that tax agriculture rather than subsidize it. Heavy negative government intervention in the form of depressed incentives tends to be concentrated on commodities that have the potential to provide export tax revenue for the government. This is especially the case in the cotton sectors of Uzbekistan, Turkmenistan and Tajikistan (Pomfret 2008). There, as in a number of African countries (Baffes 2009), the government controls the cotton chain so as to extract rents, thereby depressing farmers' prices and production incentives.

The grain (and oilseed) export sectors of Ukraine, Bulgaria, and (surplus regions of) Russia are similarly characterized by heavy government regulation and interventions. In traditional grain-exporting countries such as Ukraine and Bulgaria, the grain sector has disproportionate political significance – for historic and psychological reasons. For example, in the mid-1990s in Bulgaria, ministers of agriculture had to resign regularly following reports of grain shortfalls or unregulated exports threatening the local grain supply (Swinnen 1996). In Ukraine, ad hoc grain market interventions continued in recent years (von Cramon et al. 2008).

Causes of increases in support during transition

The increases in agricultural support in Europe's transition economies – in the second half of the 1990s in CEE and more recently in the FSU – are the result of the interaction of domestic political forces with international events. For example, the increase in farmer assistance in CEE countries was likely caused by the 'normal' domestic internal pressures that are brought to bear in a contestable political environment which result in rises in agricultural protectionism as per capita income increases and as agricultural comparative advantage declines. In this period it was a case of reversing somewhat the overshooting in reform during the first few years of transition.

Another factor that is playing a role is the overlay of the EU accession process, which is encouraging CEE governments to target the levels of support expected in the EU by the end of the phase-in period of accession, so as to maximize the transfer of benefits from Brussels. However, it appears that in the years before accession, the EU accession process had more impact on the introduction of new support instruments than on the overall level of support. This is probably because all the cost of that support has to be borne within the national economy prior to EU accession (Swinnen 2002).

In addition, improvements in the government's budgetary situation, which allowed more subsidies to be given to farmers than was possible in the early years of transition, also appear to play a role. While this is common throughout the ECA region, it is particular important in Russia and some of its neighbors, such as Kazakhstan, where recovery from the post-1998 fiscal crisis has been aided by windfall gains from the dramatic rise in the prices of their exports of oil. China's nascent use of subsidies coincides with the rebound of fiscal revenues under the control of the central government.

Political economy 4: impact of international agreements

In addition to national political forces, there have also been several sets of international pressures influencing policy choices in the transition economies.

Regional integration agreements

EU accession, both prospective and then actual, has had obvious and profound influences on policy choices in the CEE region. The eight countries that joined the EU in May 2004 have raised domestic agricultural and food prices up towards EU15 levels. An important part of the EU farm subsidies are in the form of direct payments. EU8 farms receive considerably less of these subsidies than those received by EU15 farmers. The EU8 subsidies will gradually increase, reaching EU15 levels by 2010. Another important difference is that these subsidies in the EU15 will be given earlier than in the EU8 on a per farm (single farm payment) basis, which means they are less coupled with production and therefore less distortive and more efficient.

The EU8 countries have also been induced to undertake major regulatory improvements to stimulate their markets, including private investments in the food chain and public rural infrastructure investments. Their trade policies have likewise changed so as to allow free access for all products from other EU25 member countries and, in most cases, also freer access for non-agricultural products from non-EU countries (the latter because the common external tariff typically was lower than that previously applying in acceding countries).

A further and somewhat erratic influence has been the regional trading arrangements among the ECA countries. These include the Eurasian Economic Community (EAEC), the Central European Free Trade Area (CEFTA), and the Baltic Free Trade Area (BFTA). However, the impact of these agreements on reducing agricultural policy distortions has generally been limited because the agreements include many exceptions for agricultural and food products, and especially for so-called “sensitive products” which make up a substantial share of production. Moreover, Central Asian countries such as Kazakhstan and Kyrgyz have been reluctant to join the EAEC, as it would impose Russia’s trade and customs preferences on them.

The World Trade Organization

The impact of the WTO is mixed. Some of the transition countries, such as the Czech Republic, Slovakia, Hungary, Poland, Romania, and Slovenia were members of the GATT and thus have been members of the World Trade Organization (WTO) since its creation in 1995. China, Bulgaria, Estonia, Lithuania, Latvia, Kyrgyz, Armenia, Georgia, Albania joined the WTO later. As of 2009 Ukraine, Russia and Kazakhstan were at different stages in their negotiations for WTO accession.

WTO accession has not strongly disciplined those countries that were founding members in 1995. For example, the applied tariffs are significantly below bound tariffs in many CEECs.

This suggests that these CEECs have not been constrained by the WTO agreements (Bacchetta and Drabek 2002).

For the CEECs that joined early, their commitments were based on the high support levels of the 1980s and therefore caused little constraints on their policies in the 1990s; for the others the restrictions were more severe. However, for those that had to negotiate their entry in the latter 1990s, the constraints on introducing or maintaining distortions are more serious. Perhaps more than any other acceding country, the accession process has led to a fall in distortions in China (Huang et al. 2009). China's desire to enter the WTO (which probably was motivated by non-agricultural trade issues more than anything—e.g., textiles) led to two phases of adjustments in protection. Huang and Chen (1999) demonstrate that even before China's accession, leaders aggressively reduced protection on a number of commodities (including many importables, such as soybeans and cotton) in anticipation of the negotiations. On accession, protection fell even further. However, according to Huang, Rozelle and Chang (2004), while protection did fall after 2001, the rate of fall was not faster than the reductions that had begun in the early to mid-1990s in preparation for entry into the WTO. Being a newly acceding country, the constraints imposed on China by international agreements have been real and have led to falling rates of positive protection, especially for a significant number of importable commodities (Huang et al. 2008).

For the CEE countries, the most important WTO impact has been indirect: in anticipation of eastward enlargement, the EU was forced to introduce major changes to its Common Agricultural Policy, which in turn has affected post-accession agricultural distortions in the EU8.

Influence of international financial institutions (IFIs)

The role of other international institutions was very important at the start of transition, as it provided policy reform guidance in all these countries. However, in more recent years this advice has been less effective. For those countries joining the EU, policy advice from Brussels was perceived as more relevant than that from Washington DC (World Bank and IMF) or London (EBRD). This is especially, but not only, the case for the EU accession countries. Also for those countries aspiring to join the EU (such as most of the Balkan countries, and even those further east such as Ukraine), or those seeing the accession countries as models for their own development strategies, policy advice from Brussels is taken seriously. Another reason is that in many of the other ECA countries their improved fiscal and macroeconomic situations have made them less beholden to those international financial institutions requiring reforms as a condition of providing loans or financial assistance.

Conclusion

In this chapter we provide a series of hypotheses to explain the political economy of the dramatic changes in distortions to agricultural incentives in the transition countries of Asia and Europe. Until the late 1970s, all these countries were under Communist rule, and agricultural incentives were massively distorted. The leaders of the Soviet Bloc and China were committed to Socialist ideology and designed their economies to be insulated from the world and its markets. Since then, there have been dramatic changes in the distortions to agricultural incentives in these countries. Yet there are large differences between the countries in the extent and the nature of their remaining distortions.

We have identified four sets of political economy arguments to explain why these changes have occurred and why there are very large differences between the countries in the extent and the nature of the remaining distortions. The first set of arguments discusses how the change in political regimes has induced a change in policies. In some cases, particularly in China, this regime change was within the Communist party, while in many other countries the economic changes only occurred when the Communist regime itself collapsed. We have tried to explain why this was the case.

The second set of arguments is about why some countries have taken a gradual road to market liberalization and others a big-bang approach. We argue that these differences are related to regime change and whether a broad approach to reforms was needed to introduce irreversible changes to the entire political system.

As in many other countries, structural characteristics of the economy also influenced agricultural policies – and hence distortions – in the transition countries over the past 20 years. In particular we observe that subsidies to agriculture are positively correlated with economic development and have a negative correlation with exports. These patterns have been observed widely and explained by a variety of political economy models. Finally, we argue that international agreements have influenced agricultural distortions in the transition countries, but that the impact varies importantly across agreements and across countries.

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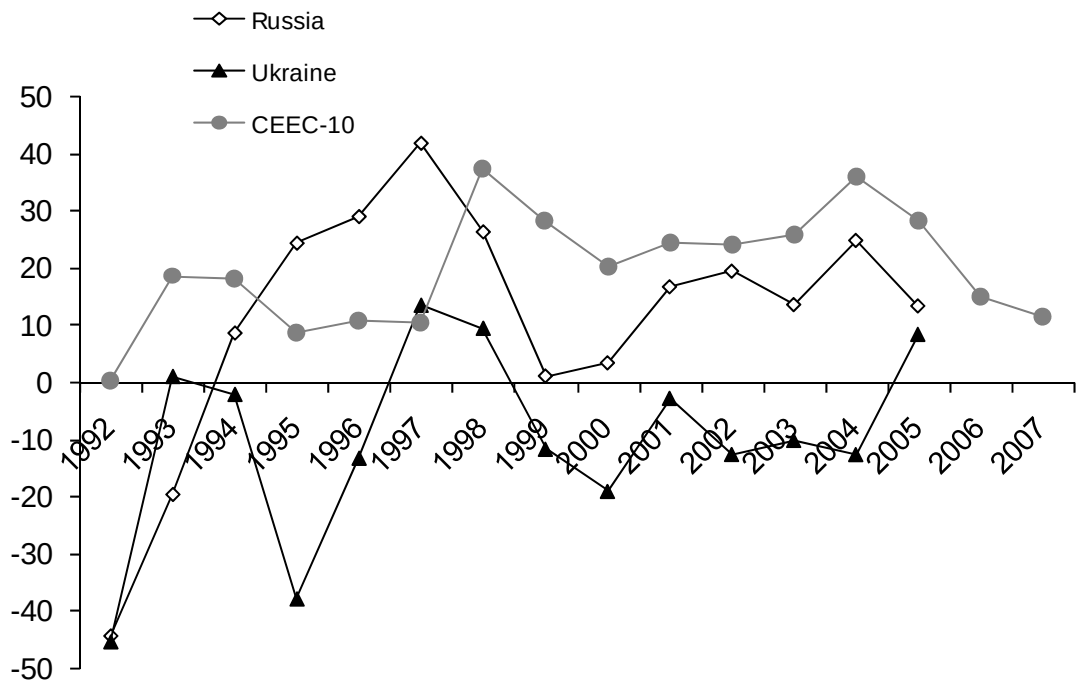
Figure 1: Nominal rates of assistance to agriculture, European transition countries,[a] 1992 to 2005

(percent)

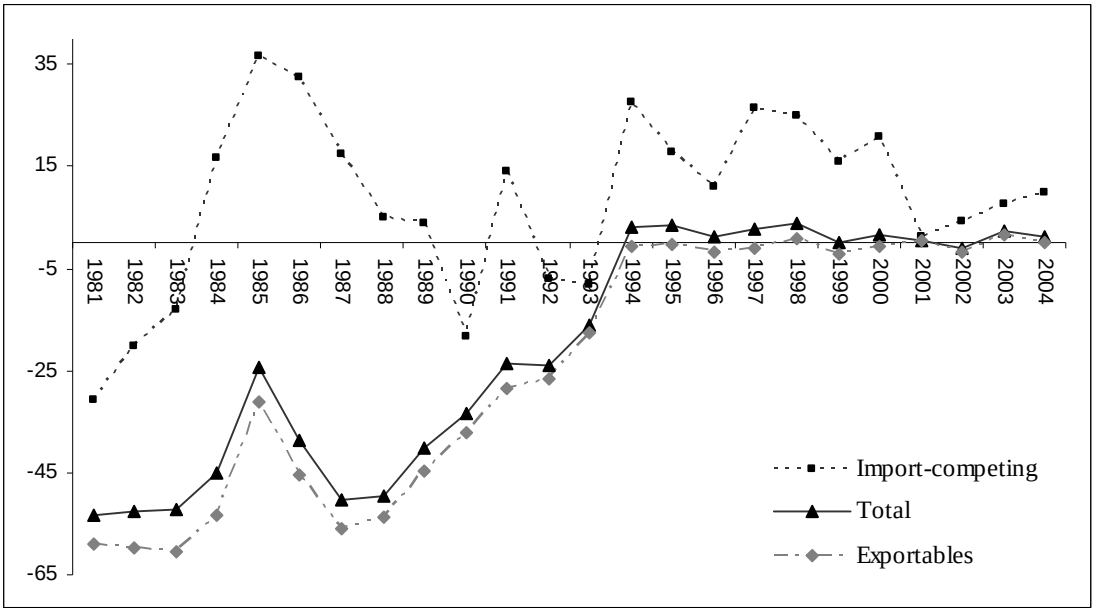


[a] CEEC-10 refers to the eight Central and Eastern European countries that joined the European Union in May 2004 plus Bulgaria and Romania (who joined in January 2007).

Source: Anderson and Swinnen (2009)

Figure 2: Nominal rates of assistance to import-competing and exporting sub-sectors of agriculture, China, 1981 to 2004

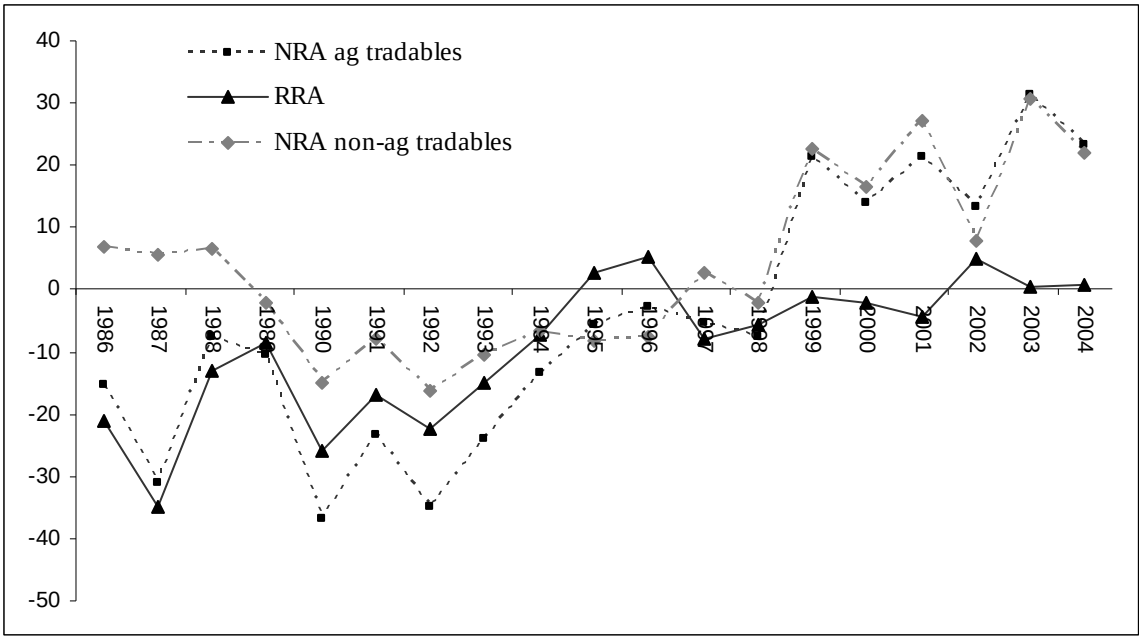
(percent)



Source: Huang et al. (2009)

Figure 3: Nominal rates of assistance to agricultural and non-agricultural tradable sectors,[a] Vietnam, 1986 to 2004

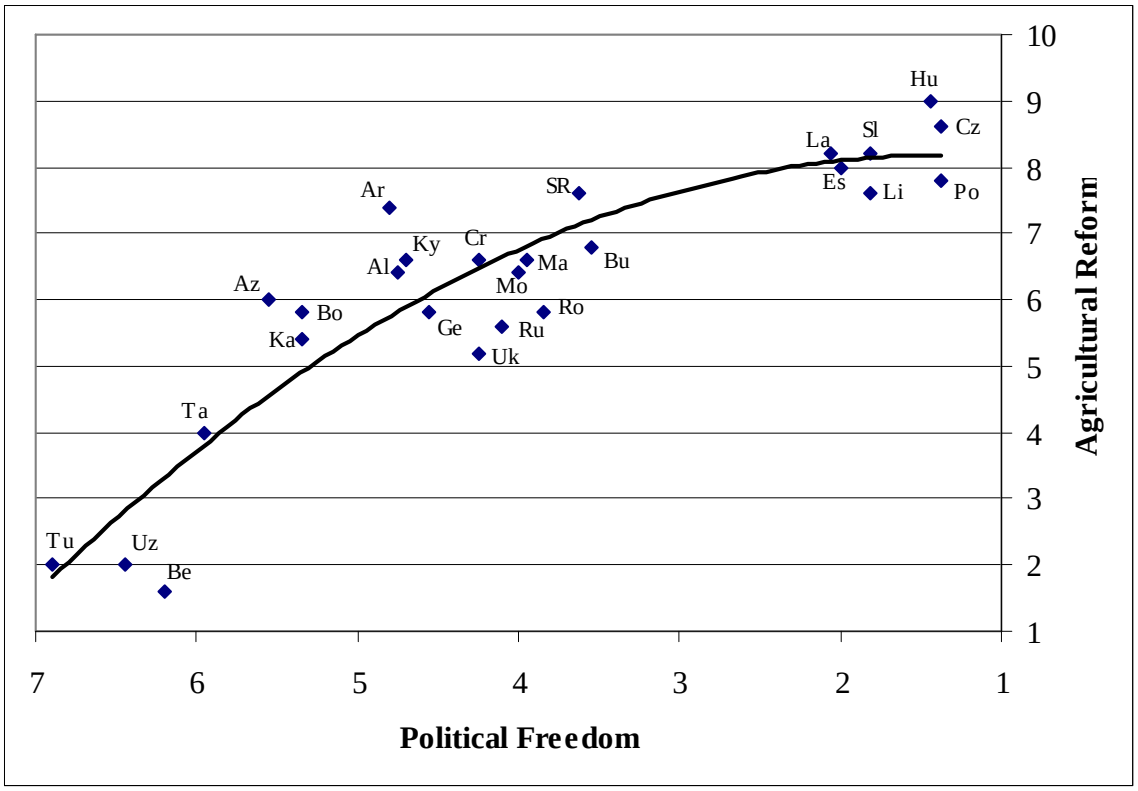
(percent)



[a] The Relative Rate of Assistance (RRA) is defined as 100*[(100+NRAag^t)/(100+NRAnonag^t)-1], where NRAag^t and NRAnonag^t are the percentage NRAs for the tradables parts of the agricultural and non-agricultural sectors, respectively.

Source: Athukorala, Huong and Thanh (2009)

Figure 4: Correlation between agricultural reforms and political reforms in Europe's transition countries



Source: Swinnen and Heinegg (2002)

Table 1: History of taxation and subsidization under Communist regimes in the Soviet Union and China

year	*GDP/capita*	*Country*	*Ag distortions*	*Ruler*
1930	1450	Soviet Union	Tax	Stalin
1940	2150	Soviet Union	Tax	Stalin
1950	2850	Soviet Union	Tax (less)	Kruzhnev
1960	3950	Soviet Union	Subsidy (less)	Brezhnev
1970	5570	Soviet Union	Subsidy	Brezhnev
1980	6420	Soviet Union	Subsidy	Brezhnev
1970	780	China	Tax	Mao
1980	1070	China	Tax	Deng
1990	1860	China	Tax (less)	Jia
2000	3425	China	Tax (less)	Jia
2010	?	China	Subsidy?	H

Source: Maddison (2003).

Note: GDP per capita is measured in 1990 international Geary-Khamis dollars (for more details see http://unstats.un.org/unsd/methods/icp/ipc7_htm.htm).