AGRICULTURAL COMPETITIVENESS: MARKET FORCES AND POLICY CHOICE

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I am greatly honoured to have been asked to deliver the seventh Elmhirst Lecture in a series begun by my teacher, colleague and friend, Theodore W. Schultz, and to follow him and the other distinguished scholars who gave the intervening lectures.

Revolutionary changes have recently occurred, and are continuing, in many countries in the role of governments in rural communities. Much the most successful of the striking reductions in governmental intervention has been in China. The process of change now under way in Central and Eastern Europe is equally dramatic but much more amorphous and confused, and with a great deal of uncertainty concerning its potential outcome, though it seems certain that, whatever the specific policy choices will be, the degree of governmental intervention in agricultural production and marketing decisions will be much less in the future than in the past. It is to be hoped, however, that the positive and essential roles of government will not be neglected as they have been, to some degree, in China.

The role of government in agriculture in North America and Western Europe today remains similar to what it was two decades ago, contrasting with the transition economies and China. Yet change is occurring, with New Zealand’s being the most dramatic. Two forces have favoured change. The unilateral one has been the increasing recognition that the price support and subsidy policies of the industrial countries have become too costly to taxpayers to be sustainable, and reform is required. The multilateral one has been that achieving further opening of markets for industrial products and services required some reduction in the protection of agriculture. The Cairns Group made it clear in a forceful way that there had to be some reduction in protection for agriculture in the industrial countries if they were to participate in a GATT agreement.

Consequently, it is a good time to consider anew the appropriate roles for government in agriculture and rural life. Perhaps it is now possible to approach the subject analytically with some expectation that lessons will be learned from recent experiences in so much of the world.

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SOME PERSONAL REFLECTIONS

It is exactly 50 years since my first journal paper was published, though its main theme serves as the basis for this lecture. The title of the paper was ‘Contribution of Price Policy to the Income and Resource Problems in Agriculture’ (Johnson, 1944). A major point was that price policy could be used to improve the efficiency with which agricultural resources were used if price policy served to improve the accuracy of price expectations and was not used to raise the average level of farm prices. More accurate price expectations would improve resource allocation by farmers by minimizing excess resource use when price expectations erred on the high side, or minimizing the underuse of variable resources when price expectations erred on the low side. The reduction of price uncertainty would be beneficial, as well, through reducing capital rationing in agriculture. At the time, with the Great Depression still vivid in my memory, I believed that limited access to credit was a major source of inefficiency in the use of agricultural resources. It was my view that agriculture in the United States employed too much labour and too little capital, in part because it did not have sufficient access to credit, given the alternative returns to those resources elsewhere in the economy.1

A second major point was that price policy, at best, could make only a very minor contribution to modifying the distribution of income within agriculture in a socially acceptable direction in reducing inequality, or in reducing income differences between farm and non-farm families. Increasing farm prices above market equilibrium levels would increase income inequality within agriculture while doing little or nothing towards reducing the differential between the returns to farm and non-farm labour.

The sources of low incomes and low returns to labour in agriculture were three. First, there were excess labour resources in agriculture, depressing the marginal product of labour; second, there was a low level of investment in the human agent (nutrition, health and education) in rural areas; and third, the costs and barriers to mobility of resources to the non-farm sector impeded the necessary adjustment to the excess labour resources existing in agriculture. These reasons are equally powerful in explaining the relatively low earnings of farm labour in developing countries today. Nor could price policy contribute significantly to increasing the level of investment in human capital or to reducing the costs of mobility (Johnson, 1944). It is in these areas that developing country governments must act if farm people are to make their maximum contribution to, and share fully in, the benefits of economic growth.

In spite of what some may assume from what I have said so far, my paper is not an argument for laissez faire as that concept is often mistakenly understood (Viner, 1960). It is an argument for finding those activities for government that markets cannot adequately perform and where, if government adopts appropriate policies, the welfare of rural people will be enhanced. Unfortunately, there is now a tendency in a number of developing economies to ‘leave everything to the market’ (including research and education) and to ignore the role of government in supplying public goods. Yet it is an argument – I hope a powerful one – for government not to intervene in product and factor markets in ways that adversely affect the interests of farm people, a very common form
of governmental market intervention in developing countries (Schiff and Valdés, 1992).

How have the ideas concerning the effects of price policy on the level and distribution of farm incomes put forward in the 1944 article stood the test of time? Nothing has transpired in the past half-century that casts doubt upon the propositions relating to the limitations of price policy in solving the income problems of agriculture. Actual experience of price policies in the industrial countries has shown that the concept of forward prices was not attainable in actual practice, something I subsequently had to accept (Johnson, 1951). No government believes that the appropriate role of price supports is to provide the best available forecast of equilibrium prices.

Another basic idea of the forward price concept was that there should be emphasis on measures other than market price interventions in implementing the price guarantees implicit in the forward prices. The proposal was that supplementary payments be made when market prices fell 10 per cent or so below the forward prices (Johnson, 1947). Such payments are now called ‘deficiency payments’ and are used in the United States and the European Community to minimize some of the adverse impacts of high market support prices on production, consumption and international trade. Storage was also proposed as a technique to be used with forward prices, but the objective was to duplicate as nearly as possible what storage would be in a private market if there were no capital restraints. In other words, the objective was to maximize the expected value of a storable commodity, taking into account the joint interests of producers and consumers.

WHAT HAVE WE LEARNED FROM EXPERIENCE?

Recent research

Research has greatly advanced our knowledge of the regularities that exist in governmental interventions in the markets for agricultural inputs and outputs. While there was general knowledge of the rough pattern of the price interventions in the developing countries and the contrasts between the developed and developing prior to 1980 (Schultz, 1978), the first systematic empirical exploration of the patterns of agricultural protection was undertaken by Binswanger and Scandizzo (1983). Subsequent work, especially Gardner (1987), Anderson and Hayami (1986), Miller (1991) and Swinnen (1994), introduced explicit theoretical frameworks and extended the earlier empirical analyses.

Several empirical regularities were found (Miller, 1991). These relate to government intervention in markets, measured by nominal protection coefficients, and to important characteristics of an economy and its agriculture. The nominal protection coefficients, which measure the difference between border prices and the returns to domestic producers, can be negative as well as positive. The most important regularities are that there is a significant negative relationship between the level of nominal protection and:

(1) the percentage of the labour force engaged in agriculture;
(2) the amount of arable land per capita;
(3) the percentage of a farm product that is exported (with imports counted as negative exports);
(4) the percentage of the product produced by small farmers;
(5) the product being a tropical beverage.

The negative relationship between the level of nominal protection and the percentage of a nation's labour force engaged in agriculture could be stated differently with equal accuracy, namely that there is a significant positive relationship between the level of nominal protection and real per capita national incomes. As is well known, there is a close negative relationship between the percentage of the labour force engaged in agriculture and national real per capita incomes. This relationship holds over time for each country and across countries at a given time. The cross-over from negative to positive protection occurred in East Asia when per capita incomes (1980 dollars) were approximately $2000. For any given country the per capita income at which protection becomes positive depends on the other factors affecting protection, such as arable land per capita or the degree of self-sufficiency.

There are significant limitations to the use of nominal protection rates. Schuh (1968, 1974) showed that overvalued exchange rates and protection of the manufacturing sector can have very harmful consequences for agriculture, with those effects not being reflected in nominal protection rates. In their pioneering study, Cavallo and Mundlak (1982) empirically estimated the devastating effects of the full range of economic policies (macroeconomic, trade and exchange rate policies) on the development of Argentina's agriculture.

The World Bank comparative study of governmental policies affecting agriculture, ably directed and summarized by Krueger, Schiff and Valdés (Krueger, 1992; Schiff and Valdés, 1993), significantly extended our empirical knowledge of the effects of government policies on agriculture in developing countries. Based on the analysis of 18 developing countries, it is clear that in the majority of the cases studied (16 out of 18) farmers are taxed, and exports are taxed more heavily than imports.

The World Bank study is important because it has provided systematic and consistent empirical estimates of the effects of macroeconomic and exchange rate policies and industrial protection, as well as the sectoral policies affecting agriculture, on the incentives for agricultural production and the incomes of farm people. It has all too often escaped the notice of agricultural policy officials that protection of industrial products and overvaluation of the exchange rate act as taxes on agriculture, and in most cases impose heavier burdens on agriculture than direct interventions such as export taxes, price ceilings and state procurements. On the average for the 18 countries the net negative effect of direct price interventions was 8 per cent of the value of output while the indirect taxes amounted to 22.5 per cent and together they totalled 30 per cent (Schiff and Valdés, 1992). This meant that, on average, farmers received 30 per cent less for their output than they would have received had there been free trade and an equilibrium exchange rate. In many developing countries the direct protection is positive – domestic prices exceed world market prices at the official exchange rate – but when the indirect
measures are taken into account the total protection becomes negative, and significantly so. Schiff and Valdés summarize the magnitude of the taxation (1992, p. 7): ‘On average the net effect of direct and indirect interventions has been an enormous income transfer out of agriculture – averaging 46 per cent of agriculture gross domestic product (GDP) a year during the period 1960–84.’

Obviously these enormous rates of taxation affected the growth of agricultural output. In the three countries with the largest adverse price effects of both direct and indirect intervention (−52 per cent), it was estimated that after two decades output was reduced by 36 per cent; in ten countries with lesser but substantial intervention (−36 per cent), output was depressed by 24 per cent, while in three countries with modest adverse price effects (−14 per cent), output was reduced by 14 per cent (Schiff and Valdés, 1993).

There is, of course, ample evidence that the developed countries provide high rates of nominal protection for their farm products (Webb et al., 1990; OECD, 1987, 1993). The levels of agricultural protection in the industrial countries have increased sharply since the mid-1950s (Johnson, 1991).

Agricultural protection in the industrial countries increased exports and/or decreased imports, depressed international market prices, increased their instability and limited the market opportunities for farmers in the developing economies compared to a situation of free trade (Tyers and Anderson, 1992). In most industrial countries high market prices for farm products increased agricultural production and depressed domestic consumption. The resulting excess production was then disposed of through export subsidies, with no concern for the effects on the international markets. I challenge anyone to show that either the United States or the European Community ever limited the amount of their export subsidies because of effects on the export earnings of unsubsidized low-cost producers.

Most OECD member countries give a relatively high priority to price stability for their domestic producers and consumers, yet none has either recognized or expressed any concern that their pursuit of price stability has increased price instability in international markets (Johnson, 1991; Tyers and Anderson, 1992). A country which achieves internal price stability by controlling imports and exports forces the rest of the world to absorb the effects of whatever domestic instability in demand and supply exists. In effect, rich countries achieve domestic price stability at the cost of increased instability for the developing countries who depend on either imports or exports for the functioning of their economies. Schiff and Valdés (1992) note that many developing countries also follow policies to stabilize consumer and producer prices, thus also contributing to international price instability.

Divergent effects in developing and developed countries

On the basis of the overwhelming evidence of the characteristics of governmental price interventions in developing and developed countries, it is clear that, in the former, governments exploit farmers (generally for the benefit of a minority urban population), while in the latter governments attempt to be the benefactor of the farmer. It should, it seems to me, strike us as rather odd that
we live in a world that is so constructed that, when farm people are relatively poor, as they are in all developing countries with urban incomes much higher than farm incomes, farm people are heavily taxed, and in countries where farm people are relatively wealthy, as they are in the industrial countries, they are the recipients of charity, even though they like to call it something else. Is our world as topsy-turvy as this implies?

The taxation of agriculture in developing economies has been justified by those who favoured import substitution policies and to finance industrial development (Johnson, 1993). All too many developing countries followed import substitution policies during the 1950s and 1960s, based on the expectation that both real and financial resources could be transferred out of agriculture to more productive sectors, such as manufacturing, with little or no adverse effect on agricultural production. If this justification were valid, there would be a positive relationship between the rate of taxation of agriculture and economic growth. The World Bank study makes it very clear that such has not been the case. For 1960–85, there was a strong negative correlation between the rate of taxation of agriculture and growth of national GDP. The countries that provided mild positive protection of agriculture grew almost exactly twice as fast as the extreme taxers (Schiff and Valdés, 1992), while the representative and mild taxers grew by 55 per cent and 61 per cent, respectively, more rapidly than the heavy taxers. Even if it were possible to make a theoretical case that government interventions that transfer resources from agriculture to the industrial sectors could increase the rate of economic growth, the sad fact is that developing country governments have not found the mix of policies required to achieve that result. Even if it were true that there is a particular market intervention that would increase welfare, it should not be assumed that this would be the intervention chosen. Experience, most of it very painful for farmers, proves that other outcomes have a much higher probability. The benefits of the positive protection to agriculture in developed countries do not go to farm labour, capital and management (Johnson, 1944, 1991). How can it be that in the developing countries farm people are harmed by negative protection and in the developed countries the benefits for farmers of positive protection (except for land owners) are nil? It is due to different conditions of the supply of factors of production other than land – the supply conditions for labour, management and capital. As economic growth occurs, the elasticities of supply of resources devoted to agriculture, other than land, increase. In countries with low incomes, when farm employment makes up a large percentage of national employment, the elasticity of supply of farm labour and management is low and capital is largely self-supplied. In these circumstances all resources, and not land alone, share in the income losses from depressed prices. The elasticity of supply of land may not differ much from that of farm labour. The taxing of agriculture in a developing country cannot be justified on the ground that all, or most of, the loss in agricultural income will be absorbed by land owners; labour and capital will suffer losses as well.

Why is it that the elasticity of supply of labour, management and capital increases as economic growth occurs? The growth of real per capita incomes and the decline in the relative importance of agriculture are associated with a host of factors that increase the ease of transferring resources between agricul-
ture and the rest of the economy. Increases in real per capita incomes are associated with increased education in rural areas, improvements in communication (telephone, radio, television), sharp reductions in the costs of personal transport (improved roads, buses, trucks, cars) and an increase in the share of a nation’s jobs that are non-agricultural in both urban and rural areas. The evidence that the elasticities of supply of labour and management to agriculture increase as real per capita incomes increase is the gradual reduction in the differences in returns to comparable human capital in rural and urban areas as the percentage of the nation’s labour force in agriculture declines.

A mistaken expectation of agricultural policy makers in developed countries is that high rates of positive agricultural protection will slow the exodus from the farm. The high protection for agriculture in Western Europe and Japan did not result in slower rates of reduction in the farm labour force from the mid-1950s to the mid-1980s than in other industrial countries with much lower rates of protection. The slowest rates of reduction in the farm labour force were in North America, Australia and New Zealand (Johnson, 1991). I am not arguing that there was a causal relationship between the high rates of protection and the rapid exodus of labour from agriculture, though the late Pierre Lardinois, former Commissioner of Agriculture in the European Community, made a plausible case for such an association. ³

My point is simply that very high rates of nominal protection have not reduced, let alone stopped, the flow of labour out of agriculture. History makes it clear that farm employment will continue to decline whether protection is high or low. This is true because high rates of protection are not sufficient to increase significantly the returns to labour and management engaged in agriculture. Policy makers everywhere have failed to recognize that once agriculture is well integrated into the rest of the economy the elasticity of supply of labour to the sector becomes very large, and that the return to farm labour is primarily determined by labour supply functions rather than by demand factors. Farm output prices can only affect the demand for farm labour, not the supply conditions. If you look across the OECD countries national differences in the relative earnings of comparable labour in agriculture and non-agriculture are very small compared with the differences in real output prices.

Why do policy makers wish to slow the transfer of labour from agriculture to other employment? A reason may be that too rapid transfer may destroy the vitality of rural communities. However, there is ample evidence that there need not be a definite relationship between farm employment and the farm population. In 1965, 46 per cent of Taiwan’s labour force was engaged in agriculture; in 1990, just 13 per cent. Yet the number of farm households in 1990 was nearly the same as in 1965. The fate of rural communities no longer depends on agriculture in middle- and higher-income countries but turns on the attractiveness of those communities as a place to live and work. That attractiveness is a function of the success in achieving approximate equality between the variety, quantity and quality of rural and urban infrastructures.
Credit

Interventions in credit markets have been as pervasive as interventions in product markets. In all rural societies there are three groups of people who are considered to be rapacious – landlords, marketers, and bankers and money lenders – and it is nearly universal that one or all of these groups has been regulated or made subject to subsidized competition.

Rural people have long believed that bankers and other lenders have too much power over their lives. But when governments directly supply subsidized credit this power is shifted to a bureaucrat. If the subsidized credit is supplied through private credit institutions, the power of a private functionary is increased. When there is private profit in a credit transaction, the availability of credit to a given individual is determined largely by profit expectations. But when credit is subsidized, and the losses due to failure to repay the loan and/or the interest are covered by the government, decisions concerning which individuals receive loans become arbitrary, since demand will exceed supply. The evidence is that in all too many cases it is the larger and better off farmers who benefit from subsidized credit.4

Other input subsidies

A case can be made that input subsidies may be an effective way of increasing the rate of adoption of new and more productive technologies. Subsidies of one or more of the inputs associated with the new technology, say fertilizer or insecticide or seed, could increase the profitability of early adoption and reduce the risk at the same time. In such cases there could be a net welfare gain from encouraging early and rapid adoption of a very profitable new technology. The input subsidies would serve to reduce the cost to farmers of acquiring knowledge.

This is the same line of argument that can be used to justify tariffs or subsidies for infant industries. It could well be a valid argument – net welfare gains could be realized in the case of either input subsidies associated with a new technology or a tariff for an infant industry – but the dangers are also similar; experience indicates that the subsidies or tariffs will be continued long after there is a positive welfare gain. The infant industry never quite reaches maturity and the new technology is never quite secure. Vested interests arise in both cases. In the case of input subsidies in agriculture, the interest of producers of the inputs is quite obvious and may well dominate (Krueger, 1992).

Getting prices right

In recent years there has been considerable controversy over the importance of 'getting prices right'. In some cases a false dichotomy appears to have been created, namely that, since the short-run elasticity of supply of farm output is quite low, agricultural output growth is more dependent on productivity change and the supply of inputs, such as fertilizer, than on real output prices (Narain,
1976). Leaving aside that the availability of fertilizer is primarily a matter of ‘getting prices right’, it is evident from the World Bank study that a failure to get prices right can have enormous adverse effects on agricultural output growth over a period of two decades when the price distortions are as large as those that have existed. If prices are sufficiently distorted, as they have been in many developing countries, they can dominate everything else – education, research, adequate input supplies – by destroying incentives. Obviously, a productive agriculture requires much more than getting prices right. It is to what government needs to do to complement markets that I now turn.

WHERE GOVERNMENT ACTION IS NEEDED

It is important in considering the appropriate role for governments to recognize, especially in developing countries, that people with the human capital required to be effective analysts, administrators and civil servants are in extremely scarce supply. Such skills need to be economized and used only where they have the highest marginal social product. An important question that has not been answered is the extent of the damage done to developing economies by the allocation of so large a share of scarce human administrative skills and analytical abilities to parastatals, and other forms of market interventions and controls, from the 1960s to the 1980s.

Provision of public goods

It has long been recognized that the efficient use of a nation’s resources requires that a number of very important activities and services be provided by government; there are some goods and services that a competitive market would not supply at all or would provide in less than optimal amounts. These include public goods where consumption is not exclusive, such as maintenance of law and order, protection of civil rights, national defence, public parks, agricultural research and some forms of communication, such as radio and television. It has been common to treat other goods and services as public goods even where exclusivity of consumption could be realized, such as roads. But the nearly universal decision has been that the cost of relying on tolls for all roads would greatly diminish the net contribution of roads to the national welfare and so toll roads are the exception rather than the rule.

Competitive markets may not be optimal

There is a third area of goods and services for which governments have generally accepted a major role, either as a regulator or as a supplier. These are goods and services that societies believe will either not be provided in adequate amounts by competitive markets owing to economies of scale (public utilities), or not be utilized in socially optimal amounts by certain segments of the population. The latter is the argument for providing free primary and
secondary education: if the family must pay all or most of the costs of education poor families, on average, will invest less in education than richer families, contributing to greater income, political and social inequalities. A similar argument has been made for universal access to health care.

Because of the path-breaking work of the first Elmhirst Lecturer, Theodore W. Schultz (1964), the important role of investment in human capital in economic growth has received increasing consideration. The evidence is now very strong that investment in human capital through universal access to primary and secondary education contributes to economic growth, while at the same time limiting or preventing increases in inequality as economic growth occurs. Taiwan and South Korea provide important lessons for developing countries in this regard. Each gave quite early emphasis to making primary and secondary education universally available. They not only enjoyed rapid growth but each achieved growth without a significant increase in inequality.

Development of infrastructure

Rural infrastructure has not received the same attention and emphasis as it has in urban areas. This was especially the case in socialist countries where the neglect of roads left a high percentage of villages and farm households inaccessible by truck, bus or motor car throughout the year, or for a large part of the year, owing to the poor quality of the existing roads. The neglect of rural roads in the former Soviet Union will continue to influence the economic viability of many rural areas for decades to come. China also neglected rural roads. In rural areas farm people are expected to contribute very directly to road construction through taxes, fees and required labour participation, while in cities roads and streets are paid for from budget funds derived from all of the people of China.

Support of research

The recent unparalleled rates of growth of food production in developing countries owe much to the provision of a public good, agricultural research. There is overwhelming evidence of the high rates of return to investments in agricultural research (Evenson et al., 1979), returns far higher than those to the more glamorous and obvious rural investments, such as dams and irrigation schemes. It is not that developing countries have had a bad record in supporting agricultural research; the rate of growth of expenditure over the past three decades (especially the first two) is a source of satisfaction. But the returns remain high and further investment can be readily justified. Unfortunately, the recent record of decreasing support of agricultural research by both developing and developed countries is a cause for serious concern.
Information

Market information is essential for the efficient functioning of markets. In developing economies and those in transition, such information is unlikely to be adequately supplied by market institutions and, unfortunately, little is being done, especially in economies in transition, to provide it systematically. The more fragmented and imperfect markets are, the more valuable is information about spatial variation in prices. With radio communication now nearly universal, the dissemination of market information is both fast and cheap. The major cost is in the acquisition of the information, though this cost is low compared to its contribution to the development of efficient markets.

Institutions

As I have argued, governments wishing to assist farm people to maximize the income from their human and physical resources must provide the appropriate amount of public goods to supplement the goods and services provided by competitive markets. Governments also must actively limit the role of monopolies, either through a positive competition policy (including liberal policies towards international trade) or by regulation where competition is not a viable alternative. A major reason for the poor performance of the agricultural sector in the socialist countries in Europe and in China until the recent reforms was that farms were confronted by monopoly everywhere they turned. The experience of the socialist economies makes it very clear that monopoly is the enemy of productivity, whether the monopolist is public or private. In fact, public monopolies can be far more powerful and damaging than even the strongest private monopolies. At least the private monopolies are motivated by the desire to make profits and this places limits on the amount of exploitation that is in their interest; there does not seem to be a similar restraint on the behaviour of public monopolies.

The clear definition and enforcement of property rights has a major role to play in creating the incentives for an efficient agriculture. Without definite property rights, investment in agriculture will be less than optimal. While I believe that private ownership of farm land is superior to public ownership, in either case it is essential that the rights to use the land be clearly defined and enforceable. The assigned rights must be enforceable against arbitrary actions of governments as well as against private entities.

Property rights need not be, and should not be, absolute if externalities are involved; for example, if run-off from my field damages your field, it is reasonable that I be required either to compensate you for the damage or to reduce the run-off to an acceptable level. Time does not permit exploration of the limitations on property rights required to achieve the appropriate level of environmental protection, or of the important role that market incentives can play in that effort.
Reform is so difficult

Perhaps the strongest argument against beginning any market intervention is that experience tells us that such interventions are extremely difficult to eliminate, even when conditions change radically and the original rationale no longer prevails. The current agricultural price policies of the United States were brought in to alleviate the real economic distress of farmers during the Great Depression. Some 60 years later, the basic framework remains, even though incomes of farm families now equal or exceed urban family incomes. That is not due to price policies but to the integration of the nation’s labour and capital markets.

Agricultural adjustment

The capacities of governments to intervene are legion, except in one area. Governments have seldom, if ever, adopted policies or programmes designed to ease the costs of agricultural adjustment as economic growth occurs. The common approaches have been either to ignore the problem or to attempt to prevent adjustment from occurring through protection. The latter has never done more than delay adjustment, not prevent it. Agriculture is a declining industry; there is no escaping that fact.

The governments of developing countries should learn from the failures of agricultural policies of the industrial countries. A major role for government action is to assist farm and rural people to adjust to declining employment opportunities in agriculture. This means shifting emphasis from the commodity markets, where governments like to intervene, to that of making factor markets work more efficiently. The welfare of farm people depends far more on the functioning of labour markets than on the markets for commodities, yet governments neglect activities appropriate to such markets, such as information and education. As noted earlier, the critical neglect is that of rural education. The evidence is overwhelming that the costs of migration are significantly reduced as more education is acquired. In the long run it is only through the equalization of the education levels of rural and urban people that urban to rural income disparities will be eliminated. Only when there is a relatively free and low-cost transfer of labour (and capital) between farm and urban areas will farm people fully participate in the benefits of economic growth. For those who worry that assisting the farm adjustment process will result in inundating the cities, there is a very simple answer. If the countryside is made an attractive place to live and work, through investment in the rural infrastructure (schools, roads, electricity, communications), the flow of people to the city will not be of concern.

CONCLUSIONS

Finding the appropriate relationships between the roles of government and the market – between laws, institutions and regulations, on the one hand, and the
allocative and distributive functions of markets, on the other – is the most important task of policy analysis and policy formation. It is not only that governments have engaged in harmful interventions in markets but, all too often, they have neglected highly productive activities and investments to improve the quality of rural life that are properly the function of government. The actual mix of policies affecting agriculture has resulted in inefficient use of the world’s resources – agricultural output in the industrial countries is too large and expensive, while in most developing countries production has been adversely affected by policies that discriminate against agriculture. Let us hope that in the future governments leave to markets the functions they perform effectively, and utilize the resources of government to undertake those important activities that cannot be effectively undertaken by markets to ease the costs of rural adjustment to economic growth and to gradually eliminate the major differences between the quality and variety of rural and urban life.

NOTES

1Whatever the validity of my position may have been in 1944, it is quite clear that in the industrial countries today the commercial firms producing most of agricultural output are well served by capital and credit markets. There are numerous financial instruments available to them to reduce risk where this is desired and necessary to keep the cost of credit at a reasonable level.

2 Compared with the achievement of a price objective by altering market prices, deficiency payments, as operating in the United States, have the advantage since they can be restricted in a number of ways. The payments can be, and increasingly are, based on a past level of production or on a fixed quota. The advantage is that the payments become income transfers with minimal effects on current output decisions. The ‘compensation payments’ now in operation in the European Union grain regime are of a similar type. Deficiency payments can also be used to influence production decisions, and were so used in the United Kingdom up to 1973 to make up the difference between a ‘guaranteed price’ and the market price received by farmers. Unless the payments are truly decoupled (and relatively few are) they serve as implicit export subsidies even though domestic and export prices are the same.

3 In private conversation in the mid-1980s, Pierre Lardinois argued that the combination of high and stable output prices assured by the Common Agricultural Policy benefited the large commercial farmers much more than the smaller family or part-time farmers. Because of stable as well as high prices, commercial farmers had ready access to credit under favourable terms. Assuming either that the operators of the large farms were more productive than those on the small farms, or that there were some scale economies, the large farms found it profitable to expand, and could do so by outbidding the family farms for any land that became available. The change in the number of farms of more than 50 hectares in EC-9 between 1970 and 1990, and the increased percentage of the total farm area, are consistent with his predictions, though other factors were also important. Schuh (1974) provided the analytical basis for the same result earlier, but I am confident that Lardinois’ conclusion was based on his observation of EC agriculture, including his experience as Commissioner of Agriculture.

4 A critical analysis of subsidized rural credit (von Pischke et al., 1983, p. 10) provided the following comment: ‘The evidence shows, however, that interest rates kept low by government policy discriminate against the poor. Cheap credit is rationed: the procedures are at least in part politically determined and provide opportunities for corruption, cronyism and favouritism. A select group of relatively wealthy and powerful individuals or families tend to capture the benefits of concessional loans, making it more difficult for the weaker segments to obtain credit.’
REFERENCES


