MINIMUM INCOME POLICY: ELEMENTS AND EFFECTS OF AN ALTERNATIVE INSTRUMENT OF FARM POLICY OF THE EUROPEAN COMMUNITY

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Introduction

Price support for farm products through import restrictions still represents the main instrument for raising farm sector incomes within the Common Agricultural Policy (CAP) of the European Community (EC).

The objective of this paper is first to analyze the effects of the traditional price policy of the CAP. Next, an alternative type of farm income policy will be discussed which seems to be more consistent with the general principles of income policy outside agriculture, and which should be able to avoid, or at least reduce, most of the negative effects of the present price policy of the EC.

The Present Agricultural Income Policy of the EC

The Instruments of Agricultural Income Policy

Price support instruments differ to a certain degree according to the specific supply and demand conditions of the product in mind. However, almost all types of price support fall into two basically similar categories; namely, (1) levies on imported goods which refer to the difference between world market prices and fixed minimum import prices; and (2) guaranteed minimum prices for farm products within the Community in order to maintain a minimum level of prices and income if internal supply should exceed internal demand.

Every year the Council of Ministers of the member countries has to make unanimous decisions on the level of common prices for farm products. Due to differing economic conditions among the member countries, these unanimous decisions have become more and more difficult, and these difficulties will increase with the future enlargement of the EC. The national prices for agricultural products differ, however, since changing exchange rates of currencies are compensated by the monetary compensatory amounts (MCAs) (Schmitt, 1977 and 1978; and Heidhues, Josling, Ritson, and Tangermann).

The Effects of the Common Price Policy

It is quite obvious that the CAP results in prices above the world market level and that production in nonmember countries is lower than without such a policy, while production in member countries is higher. For important agricultural products there is even excess supply. Furthermore, the system of variable levies has accentuated the instability of world market prices of the products concerned (Johnson). Potential welfare gains of the Common Market are probably decreasing new trade barriers within the Community via MCAs. Due to the supported prices, the EC suffers welfare losses because of a suboptimal intersectorial factor allocation and a suboptimal structure of consumption (Koester and Tangermann). Finally, it has to be mentioned that in the long run, high income farmers who, strictly speaking, do not need income support measures benefit absolutely and relatively more from price supports than those with low incomes (von Witzke, 1979b).

Minimum Income Guarantees

An Alternative Concept of Farm Policy

Various proposals have been put forward in the past in order to substitute the present price support policy with alternative instruments of income policy. The alternative concept to be discussed in this paper is different from those proposals, because it would not only avoid most of the negative effects mentioned above, but could also resolve the existing problem of low incomes in agriculture without inhibiting necessary structural adjustment of the farm sector, and it is also consistent with the general principles of income policy.

The System of Minimum Income Policy

A system of a guaranteed minimum income is characterized by two essential elements: (1) the level of guaranteed minimum income; and (2) the marginal decrease of income transfers in relation to increasing income. Various types of minimum income guarantees (negative income taxes) with respect to these elements have been suggested (Wille). The efficiency of a minimum income policy depends (among other factors) on the level of minimum income. If it is fixed too low, there might be an insufficient income support. If it is fixed relatively high, there might be negative effects on the incentives for structural adjustment which cannot be ignored.

The marginal decrease in income transfers depending on increases in market income should be such that there are sufficient incentives for farmers to increase their market incomes. There will probably be no special income tax rates for farmers. The marginal rate of decrease in transfers, therefore, has to take into account that farmers above a certain market income level have to pay income tax (BMF).

Each member country has already installed a different system of income policy which contains income guarantees in one form or another (Kaim-Caudle). The main objective of these minimum income guarantees is to avoid the standard of living of a household falling below a given minimum level. There is no reason, from the point of view of income policy, why the systems which guarantee a minimum standard of living for the nonagricultural population should not be applied to agriculture and should not enable agricultural households to realize at least this minimum standard of living. Compared with the present agricultural income support via price policy, the income support via minimum incomes guarantees, as proposed here, is relatively low, but it is the same income as that guaranteed for all other households which do not earn a sufficient market income.

It is obvious that the level of minimum income has to be different among member countries not only because there are different systems of minimum income support but also because of different opportunity costs of labour in each country. This is also in conformity with the Treaty of Rome which states that the agricultural policy of the Community has to take into consideration the fact that the agricultural sectors are closely linked with the economy of each of the member countries. For a detailed analysis of this point, see von Witzke (1979a). It cannot be concealed that there might be administrative problems concerning the ascertainment of the true farm income. As far as we can see, rural income maintenance programs in different states of the United States indicate that these problems can be overcome (Palmer and Pechman).

Minimum income payments are normally granted if households have both very low income and no assets which could be sold or used to obtain loans. If the same criteria were applied, farm households would not get income transfer payments unless they sold their farm or could not get any more borrowed money for consumption and investments. As far as we can see, this is consistent with the general principles of income policy, but would be unacceptable to politicians, specially because of the capital losses farmers have to suffer before being eligible for income transfers. Hence, the minimum income policy for farmers should be oriented along the general principles of national income policies of each of the member countries, but it should not be necessary to count all their capital when applying for minimum income grants.

Effects of a Minimum Income Policy on Agriculture

If the present price support policy were replaced by a minimum income policy, restrictions on imports of agricultural products from nonmember countries could be reduced, as well as the minimum price guarantees for such goods within the EC. Farm prices could then be reduced to the world market level or a level which still guarantees regular supplies of farm products according to Article 39 of the Treaty of Rome. Price policy would then only aim at stabilization of world markets prices and at the desired level of self-sufficiency.

It is obvious that a partial substitution of price support policy by minimum income guarantees would (1) reduce the rise of agricultural production within the EC, (2) remove the EC barriers to international trade in agricultural goods, and (3) avoid any excess supply. Most of the negative effects on income distribution in agriculture, factor allocation, and international trade of the present price support policy would thus also be reduced.

Minimum Income Guarantees in the EC

Although the negative effects of the CAP are quite obvious, the member countries of the EC have up to now resisted any basic change in the agricultural price support system. It has to be assumed that they will behave so in future too, so that they will not agree to any sudden and fundamental change in the CAP like the minimum income guarantees proposed in this paper. An abrupt and fundamental change in the present system, however, is not desirable either, because this would not be consistent witht the general principle of a stable economic policy, and would surely cause high private and social costs of adjusting to the new policy. Any alternative measure of income policy would have to be introduced gradually to have any chance of being realized.

On the other hand, continuing the present policy of price supports as a vehicle for increasing farmers' incomes as much as nonfarm incomes within the Community is becoming increasingly difficult. These difficulties are exaggerated by the economic recession since 1973--the process of structural change has slowed down, population and income growth are extremely low, technological progress and thereby growth in farm output is still rather high, and, in the near future, the Community will be enlarged by developing countries, such as Greece, Spain, and Portugal, which will very probably accelerate the surplus situation of the EC. Together with the difficult economic problems, especially as far as the balance of payments levels of most present and future member countries are concerned, the present policy of relatively high producer prices cannot be continued over a long time period in order to support producers' incomes.

A minimum income policy can indeed gradually reset the system of price support. For this, each member country first has to introduce a system of minimum income guarantees which is consistent with its general national income policy and which takes into account the special situation of farmers as discussed above. In this situation, relatively few farmers will be able to apply for an income transfer, because farm incomes are still supported by the price policy. After introduction of such a system, the real level of price support can be gradually reduced to the average long run world market prices, which is a level of price support which guarantees the desired rate of self-sufficiency. Average farm income will probably also decrease but none of the farm households will have less than the income guaranteed to all other households in each of the member countries. The substitution of the price support policy by minimum income guarantees, however, requires politicians to have the courage to cut off the privileges of the present agricultural income policy and to apply the principles of the general income policy to both nonagricultural and agricultural households.

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OPENER'S REMARKS--Per Lundborg

The authors have identified important problems associated with the current income support policy of the European Community. But the questions are very complex and need more exhaustive treatment. Their proposal is vague and not original. I agree that a guaranteed minimum income is essential for a minimum income policy, but I cannot see that a marginal decrease of income transfers in relation to increasing income is necessary. It is more a question of how progressive the income tax is and how the social transfer system works. Thus, I must conclude that the authors have suggested a minimum income policy combined with a system of other direct income transfers, without explicitly recognizing this point. Direct income payments have for a long time been considered the alternative to the present price policy, and minimum incomes are widely used within the frameworks of the social security systems of the member countries.

There is a large number of aspects that are not discussed or that are commented upon too briefly, such as the effects of the minimum income policy on farmers' incentives. It is claimed that a minimum income policy would not inhibit structural adjustment. There is, however, no extensive discussion of this.

Any minimum income high enough to substantially improve the welfare of farmers may very easily inhibit structural change. It is not very easy to find a minimum income level that has no negative effects.

A totally neglected question is the political implications of exchanging the present system for the one suggested by the authors. We know that farmers tend to regard direct income payments as socially demeaning charity. Therefore, political difficulties of implementation may arise.

The authors stress the need to lower the rate of production increases within the Common Market and to increase the import share of consumption. Assuming that productivity increases at an unchanged rate, this will require that labour leave agriculture even faster than otherwise. There will be political resistance to reducing the rate of production increase, and it is doubtful whether farmers will regard the suggested policy as helpful.

The paper points out several important problems with the present EC price policy, as have several other papers presented during this conference. The purpose of the paper is therefore to be appreciated and commended. However, I am very sceptical about the proposal presented. A minimum income policy can at the most be a complementary tool for the Common Market. But it can hardly be a substitute for the present policy, even in the long run.

RAPPORTEUR'S REPORT--Sylvestre Ndabambalire

The participants agreed on the social character of the direct income payments which are supposed to be an alternative policy instrument. However, almost all rejected the authors' assumption about the supply and cost curves as well as about domestic and world market conditions. The administrative, political, and social problems (eligibility criteria and perception of the direct income payments as socially demeaning) which impede the applicability of the minimum income policy and neutralize its presumed positive effects were repeatedly emphasized. The generally expected but also questionable advantages of the minimum income policy are trade expansion, enhanced social welfare, optimal factor allocation, desired structural changes and adjustments, and equitable income redistribution, among others.

Contributing to the discussion were Harold F. Breimyer, Michael Haines, Ulrich Koester, and John R. Raeburn.