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AGRICULTURAL TRENDS AND GENERAL ECONOMIC POLICY

A. G. LLOYD
University of Melbourne, Parkville, Vic. 3052

In Chapter 3, entitled 'The Agricultural Sector in the 1980's—Some Influences and Trends', the Group provided a broad-brush but clearly-drawn account of the main directions of change in Australian agriculture and in its markets. The general mood conveyed is one of optimism and, as regards future productivity growth, it verges on complacency. Possible problems of capital formation were ignored. The Group reproduced (p. 23) the quite dramatic Stoeckel-Miller (1982, p. 171) graph which depicts a watershed for Australian agriculture in the late 1960s. Around that time, the annual growth of farm output halved, from 3.3 per cent to 1.7 per cent, and the growth of farm inputs reversed, from plus 2.6 per cent to minus 2.2 per cent. Arithmetically, this suggests an increase in 'productivity', but this gain occurred under suspicious circumstances.

Powell (1982, 1983) had pointed out that, in hard times, input savings by farmers may take the form of capital depletion. This can occur through deferral of repairs and maintenance, particularly of land and associated improvements such as fertiliser use, weed control, soil conservation and maintenance of fences, buildings and plant. Asset depreciation, as the BAE has been measuring it, may have been understated. Furthermore, in hard times there is likely to be a diminution of 'on-farm capital formation', which makes use of inputs that are recorded mostly as 'current' rather than capital, including labour. (Rapid labour-shedding occurred in the early 1970s.) These and other points led Powell (1982, p. 282) to ask whether the surge of development based on pasture improvement had run its course and whether recent productivity increases can be sustained, given the fall in investment.

There may also be a touch of complacency in the discussion of market prospects. The Group apparently gave little weight to the concern expressed by Harris (1982), especially about the failure of multilateralism and the dangers to Australia of the consequent global trends to bilateralism.

In Chapter 4 the Group concentrated on adjustment to change, protection policy, intersectoral competition and the exchange rate, and set the scene for the review of government assistance to the agricultural sector in Chapter 5. The general policy stance, and most of the individual recommendations support 'market forces', but the advocacy was pragmatic rather than evangelical. The message to governments can be paraphrased as: 'Wherever possible reduce government intervention in agriculture and other sectors, but where pressures for intervention cannot be resisted seek measures which minimise the adverse effects on efficiency'. At the same time, the Group favours increased financial assistance for farmers.

Many of the Group's specific suggestions have aroused some hostility in farmer organisations, in particular the call for more market orientation, reduced assistance to the heavily-protected farm industries, higher

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levies on farmers for research, reform of income tax averaging and more rational allocation and pricing of irrigation water.

It is true that these suggestions, and nearly all of the many other sensible points made by the Group, have been made before and most are in the literature of the profession. But, if the recent improvement of farm policy is to continue, these points must be made repeatedly. Further, they must be made by people whom politicians and public servants regard as being 'sensible' and 'sound', especially in the sense of their having some appreciation of the political and administrative difficulties faced by decision makers. The members of the Group were such people: they cannot be dismissed as being too academic or innocent, Jarrett notwithstanding.

We should remember that most of the sensible changes in farm policy which have occurred since the early 1970s took place after decades of prodding and repetition by critics, mainly academics. By a process of attrition, these suggested reforms worked their way up the political agenda. Good reports by periodic committees of inquiry can speed that process of attrition.

As regards the Group's recommendation of more agricultural assistance, I have some sympathy 'in principle' for the conclusion, but none for the method by which it was reached, and little for the methods of disbursement suggested in later chapters. This requires me to raise again the topic of tariff compensation. The Group came to the judgment (para. 4.57) 'that there is insufficient evidence to conclude that tariff compensation should be provided to agriculture on the grounds of improving resource allocation'.

Unfortunately the Group failed to explain exactly what they meant by tariff compensation, which would have enabled us to understand more clearly why it was rejected. Some meanings of 'tariff compensation' are such that the proposal cannot be accepted; other meanings are such that it cannot reasonably be rejected. For example, if tariff compensation means that in determining how much assistance an activity should be given, one takes into account how much assistance it enjoys compared with competing activities, disagreement seems difficult. The Group's failure to define and discuss the various forms the tariff-compensation argument can take is shared by most of the economists who have published on the issue (Lloyd 1978).

Whatever its implied meaning, the Group's explicit rejection of the resource allocation argument for tariff compensation does leave it in a bind when it goes on to say (para 4.64): 'The Group therefore proposes the provision of assistance to raise incomes in the agricultural sector as an option less preferred than the one advanced in para 4.49,' namely, reducing disparities in assistance by general reductions in protection from the top down. They added, 'In meeting this objective the Group believes Australian agriculture should receive more assistance than it currently obtains'.

The difficulty is that the Group does not really say why additional assistance is justified, beyond advancing a vague and unconvincing *equity* argument, namely, that farmers have lost money because of tariffs. Had para 4.64 included the term 'lightly-assisted agriculture' in place of 'Australian agriculture' (the former makes up four-fifths of the latter) the Group would not have found itself relying solely on an assertion about 'justice'.

The Equity Argument

As regards the Group's equity argument, let me start with the axiomatic proposition that a Government cannot really be fair or unfair to that vague conceptual entity which we term 'an industry', though it can be fair or unfair towards the *individuals* in the industry. Then let me make the far-fetched but temporary assumption that the ownership of farm land has not changed significantly since, say, the 1920s, when we were rapidly raising our tariffs. Clearly, returns to land, and consequently land values, have been reduced since the 1920s by government actions on tariffs, but how does one demonstrate that the change has been 'inequitable', that is, that the previous income distribution is preferable to the existing one?

Generally, when relativities are disturbed by government action, opponents may argue that the change is inequitable by showing that the disadvantaged group, whether it is farmers or university professors, is more needy, or more worthy, than the beneficiaries. The Group attempted no such a justification for farmers having their relativities restored. It merely put forward its collective value judgment. I am not saying that value judgments are in some way unimportant or disreputable. I merely say that the politicians can make these, and stand or fall by them, without the help of expert committees. In this case, I suspect the Group's value judgment would be shared by only a small minority of voters.

Now let us avoid the objection I have just made by assuming that it can be demonstrated that the income transfers away from farmers, through tariffs, *have* been inequitable. Can we put this right by compensating today's owners of agricultural land? As Longworth (1977) pointed out, the answer is 'No', since they are a very different set of *individuals* from those who owned land in the 1920s and 1930s, and questions of equity are questions relating to individuals.

If a land tax had been imposed in the 1920s, reducing the earnings from land and, therefore, land values, and the tax were removed a half-century later, a windfall gain would have been bestowed on all of those who purchased land in the interim. So it is with tariffs. There may be efficiency advantages in removing the effects of tariffs on agriculture, but where are the equity advantages? There might be *some*, since there are some octogenarian owners of rural land. Furthermore, one *might* be able to make some case for compensating a son who has inherited a rural estate which was depleted by the effects of high tariffs. But it could be very rough justice.

Resource Allocation

The Group provided two dubious reasons for rejecting the resource allocation argument for assisting lightly protected agriculture. The first is that (para. 4.55) '. . . evidence suggests that the efficiency gains from reducing protection and improving resource allocation, whilst large in absolute terms, are relatively small as a proportion of the economy's total output'. The evidence is not cited, but presumably it is of the type obtained from the Evans (1972) model. This suggested gains from trade of 1.8 per cent of GNP per annum, but, according to Dixon (1978), this is an underestimate. What is puzzling, however, is that if the evidence which the Group had in mind was compelling, it would seem to dispose

not only of the tariff compensation argument, but also of the Group's first-best objective of tariff reductions. Indeed, this argument, which I will term 'the large denominator trick', is advanced frequently in support of high tariffs. The flaw in the argument is that the gain from virtually *any* policy action will be small relative to the GNP. A more appropriate denominator is the social *cost* of the policy action. A finding that tariff reform will raise GNP by 'only' two per cent per annum would be of interest, but would not provide grounds for rejecting tariff reform.

The second reason was (para. 4.56) '. . . the lack of information about how changes to existing protective arrangements, including the provision of compensation, would actually affect resource allocation'. The information argument, originally propounded by Peter Lloyd (1975) and Warr (1977), has been enthusiastically adopted by the IAC and was included in their submission to the Group and apparently accepted. It is concerned with situations in which payment of compensatory assistance to offset initial distortions could give rise to new distortions sufficiently large to reduce overall welfare. For example, if assistance were given to wheat, and it were not possible to assist more lightly-protected industries such as coarse grains with which wheat competed closely for resources, the expansion of wheat output might be mainly at the expense of the other products (the 'Cinderellas'). The net result could be a transfer of resources from less-protected to more-protected activities, and thus a larger production distortion. Peter Lloyd (1975, p. 150) argued that this 'illustrates the complications which one is up against if one attempts to engage in this kind of second-best piecemeal policy-making'.

The present author has pointed out (Lloyd 1978) that this is a valid argument against the piecemeal tariff-reform strategy as being inferior to the strategy of across-the-board adjustments. It is not an argument against partial and discriminatory tariff compensation being added to our currently operating piecemeal strategy of tariff reductions. Furthermore, under our present piecemeal system, the 'new distortions' argument applies as much to reductions in assistance as to increases in assistance. If any tariff is reduced other than the highest, the possibility exists that most of the resources displaced could go to a more highly protected activity. The information requirements of finding the appropriate level of intervention are severe, but the argument is quite symmetrical as between reductions in assistance under our current piecemeal system and tariff-compensating increases. The saving grace of the piecemeal system is that although *individual acts* of tariff reduction for high tariffs (and tariff raising of low tariffs) may actually worsen matters, the overall policy of moving toward uniformity will reduce aggregate distortions. If uniform assistance gives a result approximating free trade, a series of movements toward uniformity surely must reduce distortions.

Finally, I find it perplexing that the Group saw informational problems about additional assistance for efficient rural activities, yet went on to settle instead for across-the-board forms of assistance such as credit subsidies which are indiscriminate as regards either efficiency or welfare criteria.

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