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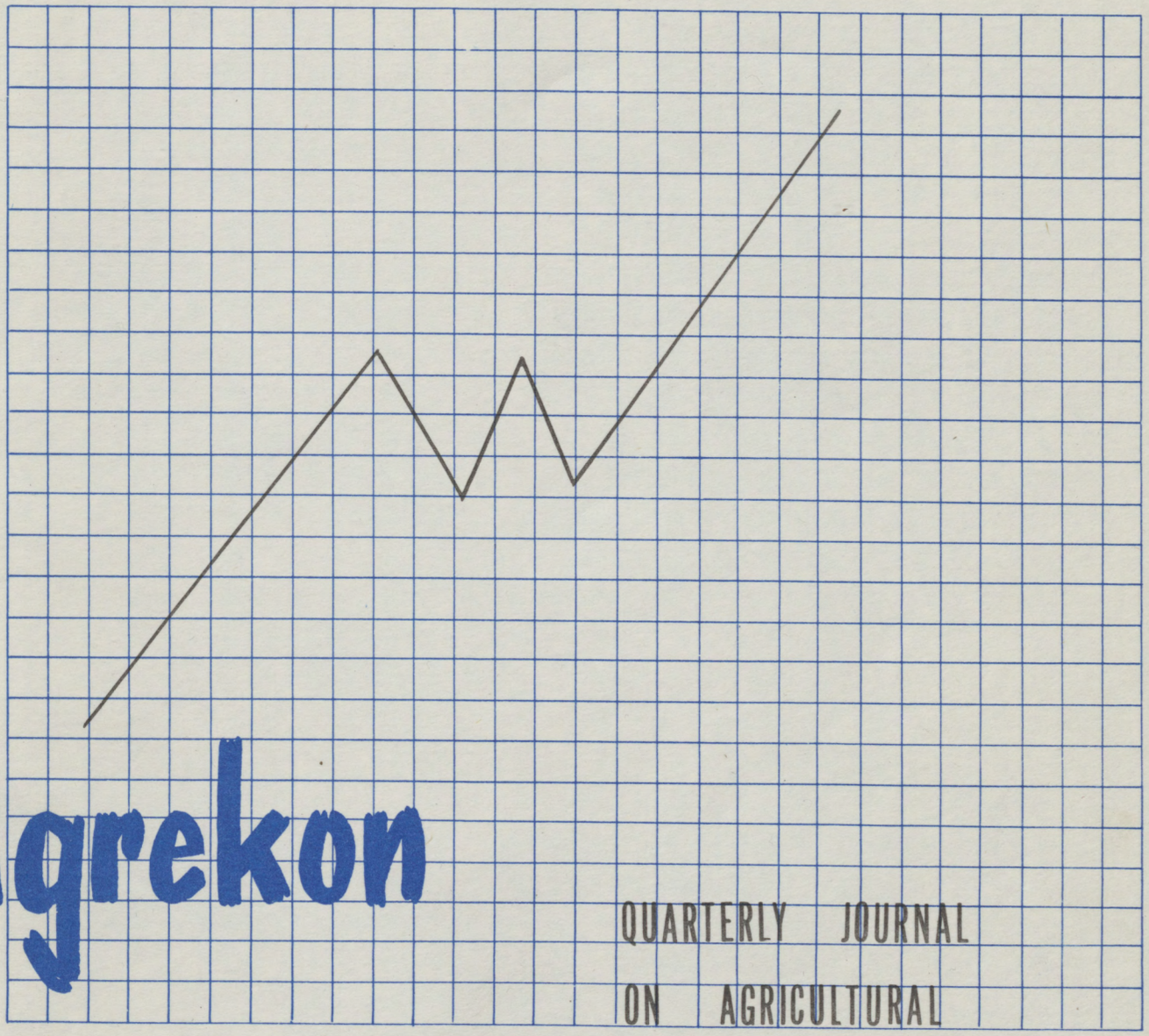

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AGRICULTURAL PRICING AND STRUCTURAL POLICY I: MACRO-ASPECTS OF PRICING POLICY

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South African Agricultural Union

1. INTRODUCTION

Agricultural policy in South Africa, of which agricultural pricing policy constitutes an integral part, is largely based on the following five basic principles: (1, p.125)

(a) Firstly, the best use must be made of the country's natural resources, including its manpower potential. This means that the general balanced economic development of the country must be kept in mind at all times when taking any measures in respect of agriculture.
(b) Secondly, private initiative and industrial freedom should be respected in so far as this is in accord with the interests of the country as a whole. Intervention in the free functioning of the economy should take place only when this is considered necessary in the interests of the country.
(c) Thirdly, agriculture should be established as a highly efficient industry. The objective is to ensure that soil, capital and manpower are optimally utilised. One of the most prominent objectives is therefore technical and economic efficiency.
(d) Fourthly, agriculture must adapt continually to changing circumstances in both the technical and the economic fields, taking overseas and domestic events into consideration.
(e) Lastly, the human aspect should never be lost sight of - farmers and their families must be able to make a decent living.

In terms of Agricultural pricing policy the Marketing Act is concerned largely with that part of general agricultural policy which has to do with the marketing of agricultural produce with the following aims: (2, p.6)

(a) To promote stability in the prices of agricultural products; and
(b) to reduce the gap between the producer and consumer price through rationalisation.

Here the aim is to increase the productivity of the agricultural industry and the efficiency of related marketing, processing and distribution industries, to the general benefit of the producing and consumer community. To achieve these objectives, the Marketing Act provides for marketing schemes which may apply to one or more of the following aspects:

(a) Arrangements for the marketing of a product,
(b) arrangements for the exportation of a product for sale,
(c) promotion of the demand for a product, and
(d) promotion of research on a product and matters related to such product.

These objectives underline the fact that the primary objective is the stabilisation of prices within the framework of "orderly marketing", and that there is no specific objective in respect of income stability. (3, p.57)

The Jacobs Committee (3, p.56) holds the view that in the formulation and application of a country's agricultural pricing policy, one should give thorough consideration to-

(a) the general economic objectives of the country and
(b) the agricultural objectives evolving from these economic objectives, with which they are largely reconciled.

The general primary economic objectives of a national economic strategy for the country as a whole have already been spelled out (4, p.3) and (5, p.13) as-

(a) economic growth;
(b) provision of employment;
(c) greater self-sufficiency;
(d) an increase in and acceptable allocation of income;
(e) an acceptable distribution of economic activities between the various areas of the country;
(f) sufficient strengthening of the economy against economic measures from overseas which may have an effect on our economy;
(g) a minimum acceptable provision of Government services, and
(h) a stable price level.

In pursuing its objectives, as has already been explained, agriculture has also to play an important role in the pursuit of the objectives of a national economic strategy.

2. PRICE CONTROL POLICY

2.1 Various views

There are various views on price control.

One opinion is that price control should be abolished as it has, with certain exceptions, in many cases been unsuccessful in keeping the increase of relevant prices below the level of uncontrolled prices. The most important reason given for the abolition or phasing out of price control is that it should be one of the measures

which form part of the long-term policy in the fight against inflation. It is particularly important in the agricultural sector that the existing legislation, rules and regulations of price control be revised regularly to ensure that they are still in the national interest and do not push up food prices unnecessarily, to the detriment of the consumer. (6 p.1)

A similar view is that statutory price control is probably the worst method of preventing price fluctuations and the problem with controlled prices is that they may rise even more rapidly than the inflation rate. Price control normally results in a chain reaction of price rises and encourages marginal production, which is less profitable, i.e. production in areas which adjoin the natural production borders. (7, p.105)

As the production costs of the producers in these less suitable or marginal areas must also be taken into account when determining prices of agricultural products, this could keep the price of the relevant product at too high a level, since the price is based on average production costs, which should be normally distributed. (8, p.51)

Other views (9, p.2) are that price control is an unnecessary evil and even that the economic system of South Africa is socialistic, among others owing to the control of the prices of products and means of production. (10, p.37)

The fact of the matter, however, is that price control has certain inherent dangers if applied according to the control board system and the various related marketing and pricing arrangements, particularly if it does not succeed in giving an accurate representation of the free market in the medium and long term. As soon as the price created by a control measure deviates from the price which would have been formed through the interaction of supply and demand on the open market, a misallocation of production factors arises and consequently a surplus or shortage of certain products. (5, p.10)

2.2 Price as an instrument of policy

In a capitalistic system it is essential that price retains its function as a regulator of economic activities. In agriculture failure to appreciate this fact will not only have an adverse effect on this sector, but will also be detrimental to the economy as a whole, so that no-one will benefit. It is otherwise unacceptable to allow prices of agricultural products to fluctuate freely and it is generally accepted that intervention is necessary. However, intervention should be of such a nature that it does not interfere with the long-term trends in supply and demand.

Owing to the important function of prices in the economy it cannot be recommended that the objectives of growth in the per capita income and the maintenance of parity towards the rest of the economy should be pursued only via a pricing policy. The task of a pricing policy is primarily the elimination of short-term fluctuations which give rise to irregularities owing to the special circumstances that prevail in agriculture. (11, pp. 192-193)

Stable prices - and even high price levels - are not a permanent solution to the problem of unstable farm income, particularly when this is caused by farming units which are too small, production systems which are not optimally adapted to environmental conditions or natural resources which have been abused or have deteriorated. An increase in producer prices to a level higher than that justified by prevailing circumstances will not assure the farmer of a higher income in the long run. This creates a higher cost structure, an increase in land values and marketing problems which could lead to lower incomes in the long run, unless recourse is had to radical measures such as production and marketing quotas and control over land prices. These measures cannot be supported because they entail a greater degree of intervention in the freedom of the farmer as independent entrepreneur. (12, p.32)

The problems of uneven distribution of income and rural proverty experienced in South African agriculture cannot be solved through pricing policy. It is inevitable that the greater part of the benefits of an indulgent pricing policy will go to those who already obtain a high income from their farms under the current pricing system. (15, p.4)

Other economists maintain that even the present policy of determining the prices of agricultural products in South Africa cannot succeed in eliminating the problem of instability and uneven distribution of agricultural income and suggest that more attention be given to price measures to correct these deficiencies and promote structural adjustments. (16, p.22)

Unrealistic prices, especially when judged by circumstances prevailing on farms run at an average efficiency level, will keep farmers on small units or units that are poorly managed. This does not solve the problems of a skew distribution of income and low farm incomes, but promotes the continuance or even aggravation of these problems. Such units consequently engage a great deal of the manpower which should really have been available to other sectors.

A system of product price differentiation in favour of farming units with low incomes, i.e. uneconomic farming units, cannot be supported. This will result in dissatisfaction and discourage such farmers from making essential adjustments and improvements, and uneconomic production on such farms will only be perpetuated. It is not easy to put an end to temporary differentiation and it is doubted whether this will be to any avail. As far as a system of support prices on a uniform basis is concerned, the opinion of specialists, as quoted, indicates that this will only be of limited benefit to the farmer with a low income; the greatest benefits will be derived from this system by the farmers with high incomes. (12, p.32)

In addition to their function of rationing the consumption of various goods and services which

are produced, prices also determine the share of each production factor in the national income, and in the process serve as a guideline for the application of the various means of production. Seen in general, the price level of agricultural products determines, commensurate to that for other goods and services, the share of agriculture in the national product. In the same manner the commensurate price levels for the separate products determine the allocation of income between the various branches of farming. To ensure the most efficient application of the various production factors and enable agriculture to continue making the maximum contribution towards the prosperity of the country, this allocation, ideally seen, should give an accurate representation of the underlying relationships between the supply and demand of each product. Seen from this point of view, the role of prices as regulator of the economy is surely the more important function. (7, p.153)

The South African Agricultural Union endorses the approach that price fixing should be subject to the supply and demand position in the long term, but objects to price fixing based on the symptoms of a situation which only develops after the desired equilibrium has been exceeded beyond one point or another. The Union stresses the necessity for intelligent advance estimates of long-term trends, in addition to which a serious attempt should be made to take into account the elasticity and movement in the supply and demand curves. (12, p.127)

Owing to inflexibilities in respect of both the production and the consumption of agricultural products, exaggerated price movements are often experienced in agriculture under highly changeable circumstances - exaggerated in the sense that the price fluctuations are generally larger than may seem justifiable in giving direction to the application of production factors for optimal effective production.

It also appears that a bigger fluctuation in prices is often unable to bring about an adjustment much sooner than a lesser one would have. In fact, it is possible that the disruption caused by exceptional fluctuations may even curb the adjustments. Besides this, co-incidental short-term fluctuations in production, and to a lesser extent also in demand, if fully reflected in prices, may disguise the underlying longer term tendencies and also temporarily confuse the regulatory function of prices. Certainty regarding the meaning and duration of a price change may, under certain circumstances, be more useful in promoting adjustments than the mere extent of the change. For these reasons attempts at a rational arrangement of agricultural product prices are justified, but only as long as the objective is to eliminate that part of the price fluctuation which is exaggerated or, which may be irrelevant or confusing in regard to the required adjustment of supply and demand. Such a "stabilisation" of prices should be handled very carefully so that it does not help to reinforce the inflexibilities which already exist.

Ideally agriculture should be informed in advance of possible tendencies so that the necessary adjustments can be made timeously. This will help to minimise the losses which usually accompany such adjustments. It should be conceded, however, that with the data currently available and methods and techniques developed to date, the controlling authorities are generally not in a position to venture much in this respect.

Conditions in South Africa tend to vary so much from farmer to farmer that the maintenance of a stable income level for an industry as a whole is no assurance that this will also apply to the individual producer.

2.3 Price ratios

Price ratios and the subsequent changes in price ratios are, in the nature of things, of great importance in respect of the position of agriculture in relation to the other sectors of the economy and also in so far as this affects the relationship of the various branches of farming within agriculture. In this respect it is firstly important to bear in mind the terms of trade relationship between agricultural products and those products which agriculture purchases from the rest of the economy in the form of inputs. The rate at which agricultural producer prices change in comparison to the prices of the products purchased by agriculture from the rest of the economy (largely means of production) is an indication of the competitive position of agriculture in the economy. During a period of stagflation, as at present, this ratio is not so favourable to the various branches of the agricultural industry.

It is also important to heed changes in the price relationships among agricultural products, especially taking into account changes in the underlying factor costs. These price relationships influence the relative profitability of the various branches of farming and thus the future volumes of production. (3, p.58)

What are referred to here are various branches of agricultural production where, on a biological physical basis, the ideal would be equilibrium with other branches, but where such a condition, for various reasons, mainly of an economic nature, does not exist. Although the latter aspects have not been analysed more closely, it would seem as if the relationship between prices which may be fetched by the various products is one of the deciding factors regarding production trends of individual commodities and their relation to one another.

These badly motivated production tendencies have for some time been an obstacle to many agriculturists who have come up against the adverse effect of certain price relationships between products, to such an extent that the lack of success in propagating the correct farming systems in many cases should not be attributed to technological deficiencies or misconceptions regarding

agricultural production policy, but to the hampering effect of existing price relationships.

The net realisation depends partly on the price fetched by the product and where prices of products are fixed according to controlled marketing and several of these products have to compete with one another for the same means of production, price fixing may have an effect on the farming system in an area.

If the premise is that in any area the desired farming system is that which is best suited to the natural circumstances and is constituted in such a way that in the long run the greatest economic benefit can be derived from this system, it goes without saying that in considering the prices of competitive products the promotion of the desired farming system should be thoroughly taken into account.

The promotion and maintenance of a sound price relationship among products with a view to promoting farming systems adapted to the natural conditions in the various regions are one of the most difficult tasks under controlled marketing. (12, p.125)

This task is made even more difficult by the considerable degree of unco-ordination with which the prices of agricultural products are determined.

It was also recommended that the prices of products which are fairly interdependent be fixed simultaneously and that due consideration be given to the economic relationships between products - i.e. substitution and complementarity relationships in both supply and demand, price elasticities and cross-elasticities of supply and demand.

It was therefore also recommended that a further in-depth study be made to identify and quantify the causal relationships within agriculture and between agriculture and other sectors of the economy - farming income studies and analyses of branches of farming should all be part of any thoroughly planned and comprehensive study programme. Modern statistical and econometric techniques make it possible to do more accurate intersector analyses and to determine the relationships between branches of farming within an industry. The ratio between supply and demand, price elasticities, profit analyses, size analyses and variance analyses can be determined more significantly and used to make policy decisions.

The price-fixing function is of such fundamental importance to agriculture and even to the national economy that the Government and other institutions concerned should be well equipped to undertake this task. Reliable information of the nature indicated above is indispensable in the formulation and application of a rational, reasonable long-term pricing policy. (3, p.79)

2.4 Production costs

During the war and the post-war years when general shortages were prevalent and the authorities followed a strict anti-inflationary pricing policy, the most important consideration in fixing the prices of products such as maize, wheat and industrial milk was that of production costs and the response of production to the prices fixed on this basis from time to time. The idea of stabilised prices on a cost-plus basis was strongly approved by certain producers. However, such a fixed formula cannot be applied indefinitely without seriously disturbing the balance between production and consumption. Under conditions of perfect competition, prices will in the long term be equivalent to the average costs, but it must be remembered that costs and prices both influence one another. If, for example, the demand and subsequently the prices should drop, the marginal producers will gradually drop out, causing a drop in average costs. A price policy which is only based on production costs must eventually collapse when the supply continues to exceed the demand at the particular price levels. The same applies to the opposite. The changing world in which we live continually demands adjustments which do not necessarily have anything to do with costs in the short term.

Besides these economic considerations, the determination of costs in agriculture in itself also presents exceptional problems. Because of the variety of activities carried out on most farms and the general lack of complete records, it is often impossible to obtain reliable cost data. Production costs also vary considerably from farm to farm, from area to area and from season to season. It would be impossible to obtain cost data from all producers and consequently the average costs of regional trials have to be reduced, which under the circumstances will not be an accurate reflection of the average costs in that particular industry. Problems are also created by the handling of items such as farm values and managerial remuneration, which must be added to the total costs and which may easily start a cost-price spiral.

Although the absolute costs of production cannot serve as a satisfactory basis for the determination of producer prices, cost studies can be of value in indicating changes. All the circumstances which could have an effect on supply and demand should also be considered during price fixing. As a cost increase could mean the same to a producer as a price reduction, this will inevitably influence his production decisions - another factor to be taken into account. In practice such cost changes can also be determined more accurately than the absolute level of costs. Another purpose for which production cost studies are important is the determination of tendencies in the general commensurate level of net income of the producer. One of the objectives of control is, in so far as this is allowed by the long-term supply and demand position, to try to maintain the net income of the farmer at a level which is in line with the rest of the national economy. It is therefore important that the relevant institutions have access to applicable economic studies in this respect. (12, pp. 122-123)

An important aspect to bear in mind is the view that the price of a product will determine the

production costs and not *vice versa.* 21, p.17) (22, p.4)

It was also found that the method of determining prices on the basis of production costs is both impractical and unjustifiable. It is thought that this approaches the problem from the wrong side and that the only realistic and economic basis for price fixing is the demand and supply price. (23, pp. 179-185) (25, pp. 99-105)

The international opinion is that although realistically regarded, a stabilisation scheme will never be a complete substitute for the market or be able to guarantee total security to farmers, price fixing on the basis of production costs is the most beneficial to the farmer. (24, p.5)

2.5 Strategic importance of industries

It has already been recommended that the strategic importance of agriculture in the realisation of the national goal of self-efficiency in particular, should be given greater recognition and that the Government's goals for agriculture in this respect should be clearly spelled out. Only then will it be possible to take this aspect thoroughly into account when deciding on pricing and other stabilisation measures.

In the general perspective, it is felt that what is important, at this stage is not that the Republic should at all costs produce all its requirements of agricultural and other products, but that, where the country is dependent on imports and supplies can be obtained from overseas, South Africa should have the necessary foreign exchange to pay for such supplies.

It is important to remember in this regard that agriculture is traditionally one of the most important earners of foreign exchange and also makes an important contribution on a net basis to the current account of the balance of payments. The extent to which agriculture will be expected to maintain or extend this position will have direct price implications.

In view of the changing position in which the Republic finds itself at present, particularly as a result of the current international political and economic relations, it is regarded as essential that the Government thoroughly reconsider its agricultural policy and also its agricultural pricing and support policy. In the formulation of the latter it may be useful to classify the relevant agricultural products broadly according to the relative importance of the export or domestic market, as described below:

(i) Products which are largely produced for the export market (e.g. wool). In such cases it is considered that the producers should adapt to the export prices. Unless exceptional considerations arise, Government assistance should be restricted to the normal forms of agricultural export incentives and the provision of temporary assistance to overcome these problems should the stabilisation fund of the industry be insufficient to support producer prices in a certain situation.

(ii) Products which are largely produced for the domestic market (e.g. wheat, dairy products and red meat). In cases where consumption exceeds domestic production, the Government should indicate what degree of self-sufficiency it is aiming at. The higher the degree of self-sufficiency aspired to, the greater the incentive margin for producers will have to be and the closer the consumer price will have to be to the maximum he is able and prepared to pay. If complete self-sufficiency is not the objective, the producers alone should accept financial responsibility for the turnover of the surplus production which exceeds domestic consumption. If complete self-sufficiency is a goal and surpluses do arise sporadically, for example owing to exceptionally favourable climatic conditions, the Government, consumer and producer together should accept the financial responsibility for the turnover of such surpluses.

(iii) Products which are produced partially for the domestic market and partially for export (e.g. maize and sugar). Normally the domestic market is fairly important in such cases and the stability of the domestic market could be significant for this production field. Market differentiation should be applied and domestic price levels should be such that they are reasonable to consumers and also provide producers with a reasonable return. The effect of fluctuations on the export market should be isolated and handled separately by means of stabilisation funds. When export prices are favourable, a portion of this yield should not be used to subsidise domestic prices and, similarly, the domestic market should not be burdened to supplement low export prices. Should once-profitable exports become permanently unprofitable, the Government may render temporary assistance to facilitate adjustments in production but long-term export subsidies or sporadic contributions by the Government to support temporarily low export prices cannot be justified under normal circumstances. (3, pp. 76-78)

2.6 Different nature of agriculture

Economic policy is applicable to the economy as a whole. In principle all sectors are of equal importance and there should be no discrimination between the various sectors - the economic process of a country forms an inter-dependent entirety.

Without detracting from the above-mentioned principle, it is considered that a sectoral policy could sometimes be essential owing to certain features of a specific sector which demand that more emphasis be placed on policy aspects of one sector than on those of another (26, p.91)

One of the sectors referred to in this respect is agriculture. This sector is characterised by

exceptional features which make special action completely understandable. Although such a view may be justified, in the application of policy aspects attention will always have to be given to the position of the relevant sector in relation to other sectors.

It is a fact that a sectoral policy may be followed in respect of one or other sector (agriculture), but then we must be certain of the relative importance of that sector.

The question which should now be answered is which exceptional *features* and problems in agriculture necessitate a specific sectoral policy?

(a) Historically it is true that the agricultural sector in a young developing country is very important. As the country becomes industrialised the relative importance of agriculture diminishes and gives rise to difficult adjustment problems which necessitate a special sectoral policy.

(b) The economic planning of a farm is probably more difficult than that of an ordinary production industry. This can be attributed to the fact that the production unit is relatively small, making it impossible for each unit to obtain the services of specialists on the same basis on which comparable specialist services are obtained in other production industries.

(c) The instability and disproportionate allocation of income for individual farmers as well as individual agricultural industries owing to-
   (i) the relatively inelastic demand for and supply of agricultural products;
   (ii) the economic cycle;
   (iii) overseas variability;
   (iv) the variable climate.

(d) Structural problems such as-
   (i) deficiencies in agricultural production systems and practices;
   (ii) uneconomic farm units;
   (iii) deficiencies in the management of farming enterprises.

(e) Marketing problems such as-
   (i) dependence on nature and fairly long production periods;
   (ii) unco-ordination of a large number of relatively small production units;
   (iii) poor inherent bargaining power of agriculture.

These characteristics undoubtedly indicate the different nature of agriculture which necessitates a sectoral policy specifically for agriculture. Farming is different from most other enterprises in which products are produced. In a purely capitalistic economy where prices are determined solely by the demand for and supply of goods, farming generally experiences a price-cost squeeze and farmers often find themselves in a less favourable financial position than is the case with industries in other economic sectors where goods are produced. (13, p.1)

2.7 Income stability

As we have already seen from the objectives of agricultural pricing policy, no specific goals are set in respect of income stability. (2, p.6)

However, the Jacobs Committee recommended in this respect that in the formulation of an agricultural pricing policy greater priority should be given to income goals. These goals are normally expressed as follows:

(i) That agriculture should receive a fair share of the national income. This also means that agriculture will in the long term share in the increasing national prosperity derived from the economic growth.

(ii) That the share of agriculture be divided among farmers on an equitable basis.

(iii) That sharp fluctuations in farming income, which emanate from the inherent unstable supply/demand ratio in agriculture, be kept within reasonable limits.

Despite the basic merit of maintaining price stability, to which priority has been given so far, it seems as if a more flexible system with limited annual price fluctuations could make an effective contribution to income stability. (3, pp. 71-72)

The opinion of the South African Agricultural Union is that price as an instrument in stabilising income will be more effective in the case of normal fluctuations in the income of a branch of farming. The premise of the Union is briefly that, subject to the *per capita* income of the farmer, prices should be stabilised at a level which is in keeping with the rest of the national economy. To reach this goal it is recommended that-

(a) prices be adjusted to normal fluctuations in production to eliminate the impact of such fluctuations on income;

(b) further adjustments should be made to the gross growth rate in the *per capital* national income for the country as a whole in order to maintain the parity between the growth rate of income in the agricultural sector and that of the rest of the economy. (12, p.123)

Although the fixing of producer prices cannot always be determined from year to year according to a set formula, the income position of producers in the branches of farming concerned should, within limits, be taken into account during price fixing. To this one can add changes in production costs, the price and income elasticity of supply and demand as well as the expected long-term changes in the supply and demand curves, production and consumption tendencies, prices of substitutes, importation and exportation possibilities and general agricultural policy.

The stabilisation of the income of the various branches of farming therefore cannot be seen in isolation from the rest of the national economy or take place without meeting certain important biological-physical production requirements.

To share in the increasing prosperity of the country, agriculture must meet certain basic structural requirements and the farmer should

contribute his fair share towards increasing this prosperity. The expression "fair share" in this respect means especially that the long-term increase in the productivity per unit production factors of the farmer should be in line with that of the rest of the community. This principle, if strictly applied, should help promote the balance between the various production branches in the sense that it will send the utilisation of land and other production factors in agriculture in the direction of those branches with the highest productivity. (12, p.124)

To give greater priority to the set income goals in respect of income stability rather than to price stabilisation, *greater attention should be paid to additional policy instruments in the form of a structural policy to supplement pricing policy.*

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