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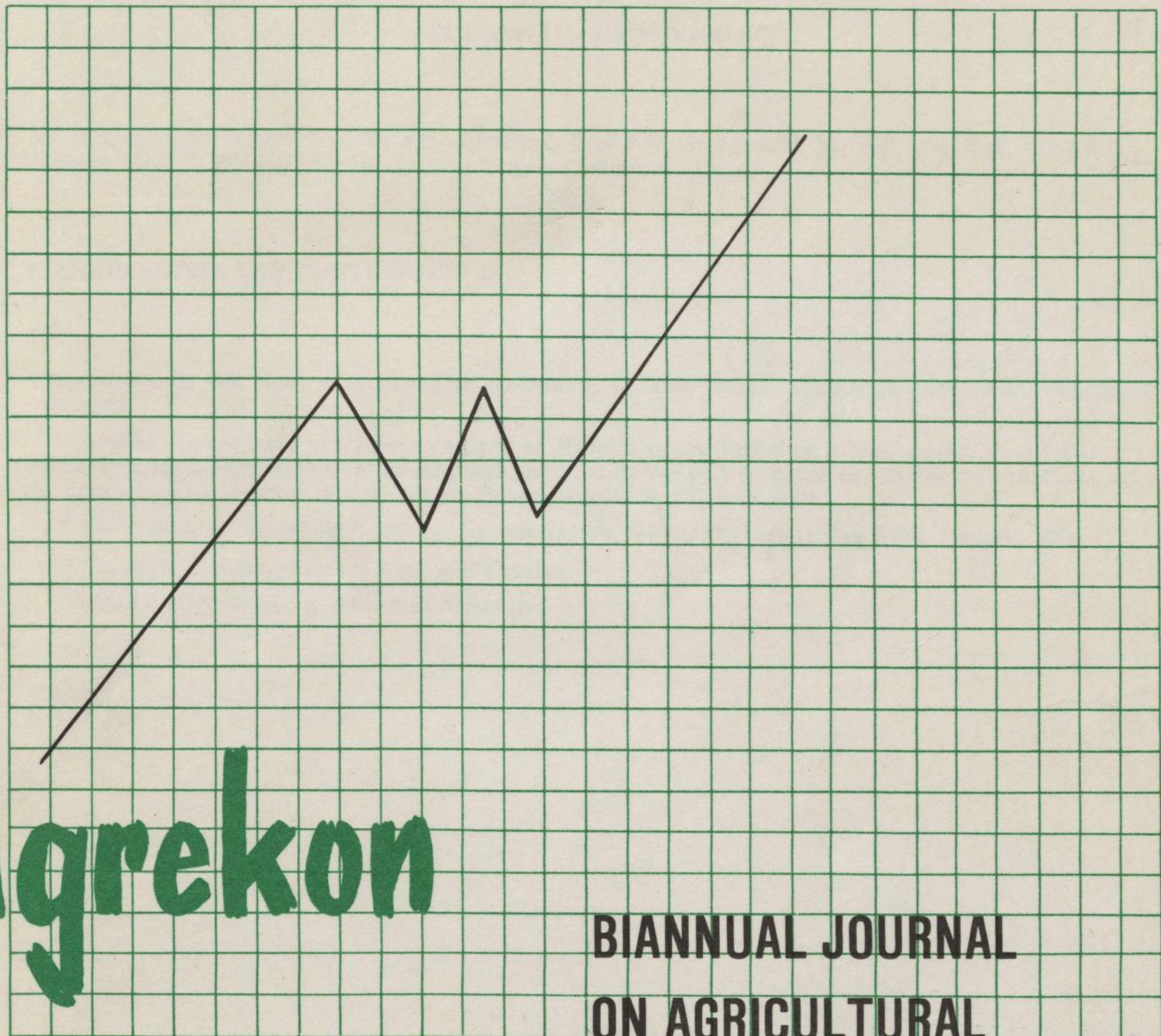
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# 945 AGRICULTURAL PRICING AND STRUCTURAL POLICY III. INSTRUMENTS OF STRUCTURAL POLICY

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## 1. INTRODUCTION

It is important that greater priority should be given to income goals in the formulation of an agricultural pricing policy. To obtain these goals greater attention should be paid to the following additional policy instruments, which take the form of a structural policy to supplement the pricing policy.

## 2. INSTRUMENTS OF STRUCTURAL POLICY

### 2.1 Stabilisation funds

The building up of a strong stabilisation fund during favourable years seems to be one of the best supplementary measures for controlled price flexibility to provide for less favourable years. This applies particularly to those industries where the export market forms an important marketing channel and the domestic industry can do little to influence fluctuations in world prices.

It has already been recommended that the National Marketing Council collaborate with the various control boards concerned on a co-ordinated basis to formulate clearly defined guidelines in respect of the sources from which and the manner in which these stabilisation funds should be built up and the purpose for which and the way in which these funds should be applied, and determine floors and ceilings for these funds. (1, p. 73)

### 2.2 Insurance

The risks to which modern commercial farming is subject increase as farming becomes more specialised. Mechanisation and other modern technological developments will result in an increase in capital investment in agriculture and the prices of farming requisites will increase more rapidly in most years than the prices of agricultural products, with a subsequent drop in the profit margin.

In view of all these factors, crop farmers in particular will be unable to bear individually the continuous and enormous risk inherent in agricultural production. (2, p. 9)

From the outset there should be clarity about the exact aims of a crop insurance scheme - otherwise it could be used as a kind of

subeconomic Government scheme for supporting farmers requiring assistance after crop failures caused by more general reasons than those the scheme was initially intended to cover.

Crop insurance should be based strictly on business principles and the main objective should be to enable modern farming entrepreneurs to spend large amounts of cash with a reasonable degree of confidence to produce a crop which will be grown and reaped only over a period of six months or more and which will only produce an income once a year. This refers to a crop whose production is accompanied by calculable risks against which it is possible to insure.

The insurance scheme must assure the agricultural entrepreneur who does not have large capital reserves of a minimum income if his crop should be affected by certain events over which he has no control but against which he can insure. Certain urban entrepreneurs and professional persons are protected through similar assurance schemes. Such crop insurance should largely be aimed at preserving the farmer's operating capital in the case of a poor crop.

The system of crop insurance should meet these conditions and should be set up in such a way that it is able to serve as a supplementary instrument in promoting sound farming practices. (3, p. 155)

### 2.3 Finance

Financing as a policy instrument can perform two important tasks. In the first place it can enable the deserving farmer to run his farm as rationally as possible in the midst of high capital requirements and great instability. Secondly, financing policy can play an important role in the consolidation and prevention of uneconomic farming units.

Unfortunately financing as a policy instrument in South Africa is hampered by a lack of co-ordination. A large number of institutions provide credit, most of which is provided by private institutions and co-operatives. This places a distinct restriction on the efficacy of this instrument.

It is essential that sufficient credit be made available in accordance with sound financing principles. When credit is granted to farmers they should also be advised on how to apply the funds

purposefully and in accordance with the principles of profitability, liquidity and solvability.

While financing policy could undoubtedly play an important role on the farm, it could also be a strong instrument in the consolidation and prevention of uneconomic farming units. When credit is granted the first consideration should be whether the farmer wishes to buy a farm or consolidate his own farm. Hence financing would not only prevent the creation of other uneconomic farming units, but also aid the consolidation of existing economic farming units.

In this respect, however, it is also important to point out that it is only reasonable to expect farmers to contribute to the financing of their farming operations from own savings. The larger this contribution, the more it will be to the advantage of the farmer concerned. That part of agricultural financing which comes from other sources must be obtained on the basis of business principles, taking into account the problems peculiar to agriculture.

This warning cannot be over-emphasised, especially in times when high interest rates are required.

When credit is granted the following basic principles should therefore be borne in mind:

- (a) The granting of credit should be rational;
- (b) credit should be recoverable;
- (c) farming enterprises should be planned;
- (d) credit should be granted subject to certain provisions. (3, pp. 58-59)

In respect of the contribution to be made by a farmer to the financing of his farm from own savings, the Jacobs Committee recommended that farmers be allowed to build up a tax-free reserve fund in favourable years and that they only be assessed on the income deposited in this fund in the year in which it is withdrawn. (1, p. 240)

However, the Government has not yet approve this recommendation. Such a reserve fund is regarded as one of the most important steps towards stabilising agriculture in respect of farming income and the contribution to own financing. (4, p. 13)

## 2.4 Subsidies

It is undoubtedly true that direct and indirect subsidies and other Government assistance to agriculture amount to millions of rand every year.

The use of subsidies as a supplementary policy instrument should, however, be questioned on a number of counts. As soon as long-term subsidies are introduced farmers automatically take them into account in their planning, which result in a misallocation of production factors. Subsidies contribute to the unequal distribution of income among farmers, since the large farmers benefit the most.

The subsidies which are paid in the case of certain food products are primarily consumer subsidies, although the producer benefits indirectly and, under certain circumstances, directly as well.

Subsidies were initially introduced under conditions of inflation and shortages and the aim was to absorb to some extent the inevitable rises in the cost of living. With the aid of subsidies consumer prices can be kept at a lower level than would otherwise have been the case and a subsidy which is to the benefit of all consumers does have certain advantages as an anti-inflationary measure. During times of surplus production and when products are exported at a lower realisation than the domestic price, subsidies also act as an effective support for producer prices.

The producer benefits directly to the extent to which subsidies contribute towards increasing the more profitable domestic consumption. There are, however, also certain disadvantages to the payment of subsidies. One such disadvantage is that subsidies could disturb the optimum utilisation of production factors. The subsidisation of prices and transport costs, tends to stimulate consumption artificially, and marginal production which would otherwise have been submarginal is encouraged. This could eventually disturb the balance between the industry concerned and the rest of the national economy and involve production factors which could have been put to better use in other sectors.

Another disadvantage is that a general subsidy on total sales is an exceptionally expensive method of assisting consumers in the lower income groups and supplementing the personal income of the smaller producers. Producers benefit directly in proportion to their production and consequently the smaller producer will benefit less from a general subsidy. The same applies to consumers who purchase limited quantities of the commodity.

Attention must also be drawn to the fact that the subsidising of staple foodstuffs does nothing to relieve the serious structural problems being experienced in the agricultural industry. The question arises whether, in the agricultural industry, these funds could not be put to better use, for example, whether the subsidy on butter should not be used to modernise the dairy industry. A similar subsidy was withdrawn fairly recently in Australia and to solve structural problems in the industry larger amounts were made available, for example interest-free loans to deserving dairy farmers to assist them during the transition from cream to whole-milk production, and assistance to factories to accommodate producers making the transition.

The general opinion is that our future policy should be to reduce the subsidies on food production gradually and this was intimated by the Government. (5, p. 673)

Although it appears that no serious fault can be found with the short-term subsidising of products or inputs in order to achieve certain objects, it does not seem possible to justify a long-term subsidy policy, about the value of which there is some scepticism.

Food prices as such should not be kept at unrealistically low levels by subsidising the consumer or expecting the producer to produce the required commodities at unrealistically low prices.

Food prices should therefore follow the normal trend of cost increases and this should be accepted by all as inevitable. (6, pp. 3-4)

Subsidisation as a supplementary policy instrument should therefore be aimed largely at those cases where progress is essential but where the farmer does not derive any immediate benefit, such as soil and water conservation. Distress and drought assistance may be necessary, but otherwise subsidies and other Government aid should only be granted on the basis of certain qualifying standards.

Here we think particularly of criteria such as economic farming units, adapted farming practices, record-keeping and the financial position of the farmer.

It has, for example, been recommended that a subsidy be introduced which will be payable to farmers for a farm book-keeping system which meets the standards laid down for such systems by the former Department of Agricultural Economics and Marketing to improve the managerial abilities of farmers as far as possible. (3, p. 119)

## 2.5 Production control and marketing quotas

Provision is made in the Marketing Act for the regulation of agricultural production but this Act contains no stipulation according to which direct production control, through a restriction on the quantity of means of production employed, can be introduced. Provision has been made for the allocation of marketing quotas to producers and the prohibition of the sale of certain grades of a product. (7, p. 82)

Owing to problems experienced with price as an instrument to regulate the supply, producers have on various occasions put forward the idea that direct control over production could present a possible solution to the problem of protecting the prices of their products. Direct control could be applied by means of area restrictions, marketing quotas or other similar methods.

The use of such direct measures to regulate production is not supported in principle by the Department of Agriculture. This view is upheld by the Maize Board Mission, which made a thorough study in 1962 of production control measures in the United States of America. There may be certain circumstances in respect of specific industries which necessitate and even justify some degree of production control and the application of a quota system.

Although this type of arrangement certainly means a greater degree of price and income stability to producers who are already established in the industry, it is also subject to serious drawbacks:

- (a) It limits the freedom of choice of individual producers.
- (b) In practice it is difficult to find a fair and reasonable basis according to which quotas can be adjusted on merit, not only initially but also from time to time.

(c) Existing production systems on both good and less suitable soil - and applied by efficient and less efficient farmers - are largely protected and adjustments which may be necessary owing to changing circumstances are impeded. This tends to curb efficiency in agriculture and increases costs.

(d) The investment structure of the industry is increased to the extent to which the advantages for the producers concerned are gradually capitalised. This will inevitably have a curbing effect on small-scale or young progressive farmers who have not yet fully developed their farms.

(e) The effective application of such regulations often requires extended and strict control measures which are accompanied by high costs.

(f) Production control by means of quotas opens the door to practices which are irreconcilable with the spirit and aspirations of controlled marketing. (8, p. 127)

## 2.6 Protection or import replacement measures

The major organisations in the private sector launched a successful campaign some years ago which was aimed at import replacement with a view to the elimination of unnecessary imports and the saving of foreign currency, which is exceptionally important in the present economic period.

While the agricultural sector as a whole imports exceptionally small quantities of commodities, an appeal was nevertheless made to the farming community to support local industries wherever possible and within the normal bounds of quality and price. (8, p. 47)

It has been realised that in certain fields local manufacturers are unable to compete with manufacturers overseas and that this may justify protective customs duty.

It was also realised that the competitiveness of South African industries vis-à-vis overseas suppliers could improve if tariff relief were granted, where justified, on imported materials and components used in manufacturing. For this reason a purposeful customs tariff protection policy was formulated in order to encourage rapid and diversified industrial development. (9, p. 2)

In this respect, for example, the Government decided to manufacture diesel engines locally with the introduction of the necessary protection measures for the local industry.

Previously, for example, all tractors, of which agriculture is the largest consumer, were imported. Because of this a large amount of foreign exchange flowed out of the country every year and South Africa was very sensitive to any possible trade boycotts. It was therefore in the interests of South Africa to reduce this dependence on overseas countries for the provision of tractors. South Africa is vulnerable not only to possible boycotts on the supply of tractors but also to boycotts on the supply of spares for existing tractors. The opinion

of the Union was that the manufacture of diesel engines for use in tractors was a step towards making South Africa less dependent on overseas countries.

The manufacture of diesel engines in South Africa could bring about greater rationalisation of the whole tractor industry. At present various engines are used and these are manufactured together with various ranges of spare parts. Engine parts will therefore be standardised, causing a considerable saving.

Although the rationalisation of the manufacturing industry is accompanied by the standardisation of spare parts, which will result in large-scale simplification and improved maintenance of tractors and should therefore later save on costs (10, p. 18), the general opinion is that in the short term this will have a cost-raising effect on agriculture.

It is felt, however, that the long-term benefits for South Africa of the rationalisation and strategic goals of the Atlantis project will outweigh the possible short-term disadvantages.

It should be remembered that there is a possibility that certain industries in South Africa will be able to manufacture or develop certain agricultural inputs less expensively and therefore export at higher prices owing to a comparative advantage over the same industries in other countries. In other words, if these industries are not protected to some extent when imports can be obtained at lower prices than the locally manufactured product, this could disrupt the local industries and these inputs may later have to be imported at higher prices because they are no longer available locally.

## 2.7 Export incentives

The important contribution of agricultural produce towards the position of South Africa as an exporter is well known and has already been referred to, and similarly the problems experienced with the exportation of agricultural products to world markets have also been mentioned.

Export incentives may constitute one of the more significant policy instruments to supplement a pricing and marketing policy.

The Government decided last year virtually to double the export incentives with a view to the fact *inter alia*, that the agricultural sector is an important earner of foreign exchange. (11, p. 44)

While the exporters of processed agricultural products may come into consideration for all the various forms of export assistance, where applicable, this is not the case with unprocessed agricultural products. Special lower railage tariffs, for example, are only granted for the export of citrus and deciduous fruit. The limited assistance under the export incentives regarding the exportation of unprocessed agricultural products can be attributed to the fact that exports are handled by agricultural control boards, which are not subject to tax, and to the opinion of the

Direktorate of Agricultural Economics and Marketing that assistance to the agricultural sector should not be fragmented.

In view of the important role played by agricultural products in total South African exports, and in order to enable the agricultural industry to compete more effectively on the overseas market, it has already been recommended that -

- (a) agricultural products (processed and unprocessed) should not be excluded from the export incentives;
- (b) the exportation of unprocessed agricultural products on a non-discriminatory basis should also qualify for the applicable benefits; and
- (c) the packaging allowance should be re-instituted at least in cases where the Government prescribes the domestic and export packaging standards. (1, p. 203)

The increasing problems with which producers of agricultural exports have to contend owing to factors such as rising production, transport and other marketing costs and problems in respect of competition on protected overseas markets - which problems have been added to by the upward adjustment in the value of the commercial Rand - are requiring more and more attention.

## 2.8 Uneconomic farming units

The problem in respect of uneconomic farming units or those which are too small has long been realised and is regarded as one of the major causes of the variable and unequal distribution of individual farming income and rural poverty, as well as a strong contributory factor to the misuse of land and the abuse of grazing.

The problem can be solved in four ways. Firstly, measures that will prevent the further subdivision of agricultural land are necessary. Secondly, it is essential that existing uneconomic farming units be consolidated and thirdly, as a result of this, some farmers will have to withdraw from agriculture. Fourthly, the question of part-time farming operations and the existence and expansion of plots around cities and the larger towns has still to be settled.

That there is an awareness of the problem of the uneconomic subdivision of agricultural land and the dangers involved speaks for itself in the legislation passed on the matter. Agricultural statistics do not lend themselves to a precise estimation of the extent of the problem as it exists today. The fact that the number of White farmers is still declining does not necessarily mean that the number of uneconomic units is also declining. It is possible that the size of the larger units is increasing. (12, p. 157)

The withdrawal of farmers from agriculture must be approached with caution, since it is in conflict with economic, social and strategic political forces, which dictate that attempts should be made to retain the White population in rural and border areas.

With regard to farming conditions in South Africa, we are specifically referring here to the view that everything possible should be done to prevent the decline in the rural population and excessive urbanisation, and to the contrary view that for the sake of economic development it is inevitable and even essential that a decline should take place in the rural population. (3, pp. 33) (13, p. 39)

It has already been indicated that larger and larger quantities of food can be produced with less and less human labour through the substantial technological progress in agricultural production. This, together with the tendency towards lower percentage spending on food while income in the rest of the national economy is increasing, makes a decline in the number of people in agriculture inevitable. For this reason it is inevitable that if the *per capita* income of agricultural entrepreneurs is to rise or even simply be maintained, many farmers will be compelled to leave agriculture, despite the improvements which could come into effect in the production and the marketing of agricultural products. The acceptance of this as a natural migration trend does not, however, offer a problem-free solution. (14, p. 4)

Against the background of the social, political and strategic forces in particular, it has already been requested that positive steps be taken to curb this tendency, with specific reference to -

- (a) the proper identification of problem areas, especially border areas, with the view to retaining existing farmers and establishing new farmers in such areas; and
- (b) the need to establish and retain the necessary public infrastructure, facilities and services, such as electricity, water, transport and communications, to make economic development possible and to ensure a reasonable standard of living and quality of life in such areas.

This means that uneconomic farming units cannot be retained, which is in accordance with the previous recommendation that the Department of Agriculture should deliberately apply itself to facilitating the withdrawal of owners of particularly uneconomic farming units. Special attention should also be paid to financing methods to support farmers who are remaining on uneconomic units and who qualify for such support. Assistance to such farmers will enable them to enlarge their uneconomic units so that they become economic by purchasing other uneconomic units which become available through evacuation under such circumstances. (1, p. 34)

The establishment of an autonomous body with corporate personality which can purchase and consolidate such land and make it available to selected persons has also been advocated. The unwillingness of financial institutions to finance the purchase of uneconomic units may necessitate the formation of such a body.

As far as part-time farming is concerned, it has already been requested that an inquiry be instituted into the nature and extent of the farming

operations of part-time farmers and their contribution to agriculture in order to establish how Organised Agriculture can help promote the image of the part-time farmer so that he can be recognised as a fully fledged farmer in all fields, and to establish whether all the benefits offered to full-time farmers should also be at the disposal of part-time farmers. The Department of Agriculture is at present carrying out such an inquiry. (13, p. 49)

In the case of smallholdings, the question should be asked whether it is desirable that agricultural land be further subdivided and whether this process should be stopped in future?

## 2.9 Deficiencies in agricultural production systems and practices

Besides assuring farmers a reasonable living, the agricultural industry also produces food for the population of the country, raw materials for industry and agricultural commodities for marketing or export markets. If this is to be achieved it is of fundamental importance that the natural resources be put to best use in agricultural production under local environmental conditions and in such a manner as to ensure the continuance of the industry on a sound basis and a good living to both the present and future generations of farmers.

Optimum utilisation of the potential does not necessarily result in personal or temporary gain only, and it is intended to meet the needs not only of the present generation but also of the future. The most important basic requirement which an optimum utilisation system should meet is that agricultural production should take place in harmony with the natural environmental factors. Each agricultural region has a certain inherent agricultural potential, i.e. production possibilities emanating from the natural environmental factors, of which topography, temperature, rainfall, wind, soil and vegetation are the most important. These factors will determine the success of a specific crop, or breed of cattle or sheep in a certain area. A prerequisite for an optimum utilisation system is therefore that the branches of farming should be practised within the limits provided by the potential of these natural environmental factors. (15, pp. 43-44)

Physical stability appears to be a prerequisite for economic stability.

The temporary success of exploitation systems which probably appeared injudicious in the long run during a period of high prices or favourable seasons created the notion that where the natural environmental factors are not altogether unfavourable, practically any farming system can be practised, provided the farmer is competent enough and "the prices are right" - a notion which is totally unrealistic.

In addition, the principles involved in the application of capital, labour and machinery as well as technology, especially in respect of

yield-improving practices, have not yet been fully mastered.

## 2.10 Deficiencies in respect of farm business management

Modern agriculture is characterised by increasing commercialisation. In the process farming concerns are increasingly becoming business concerns which apply bought inputs in the production of marketable products. Increasing amounts of inputs are being used and bought inputs are replacing home-produced inputs.

This increasing commercialisation exposes farmers to increasing commercial risks and thorough planning and management in the agricultural industry have become just as important as in any other type of business concern. The farmer of today has to be a market-oriented manager who applies bought inputs, often acquired on credit, in the production of marketable products. This requires a high business management ability. Those who do not meet this requirement will be unable to continue farming and economic forces dictate that they should leave the industry. This process may be accelerated in future.

The number of farms in South Africa has declined from 116,8 thousand in 1950 to 71,2 thousand in 1978 (16, p. 6). It is estimated that 96,5 per cent of South African agricultural production is produced by 61,3 per cent of the farmers. (17, p. 30)

The remaining 38,7 per cent therefore produce only 3,5 per cent of total agricultural production. Some of the 38,7 per cent of the producers have already or may still apply modern business methods to change their farming concerns into efficient business concerns, but the majority who do not stop regarding farming as merely a way of life will have to give up their units to efficient entrepreneurs and seek other full-time employment. Some of these producers will also discover that their lack of interest in business methods and capital will force them to accept non-farming employment to supplement their income.

As the general economic process functions selectively, the farms (or managers) with the lowest productivity will disappear first, i.e. the 38,7 per cent of the farmers who only produce 3,5 per cent of total agricultural production and who display no interest in business methods or the most effective utilisation of agricultural resources. (18, p. 177)

One is aware of the tremendous variations in farming efficiency between individual farms within relatively homogeneous farming areas (19, pp. 54-59), and it is suspected that such fluctuations can also be found between average farming groups in various areas. (20, p. 38). This surmise has been confirmed and evidence of such differences has already been furnished. (21, pp. 29-36)

Various authors have indicated that the inability of farmers to adapt to modern technological and economic conditions contributes to financial deterioration relative to earning

possibilities elsewhere and to the less than optimum use of resources. (18, pp. 158-186), (22, p. 3), (19, p. 56), (23, p. 32)

When considering this lack of economic progress it must be admitted that there is one prominent cause for most of the problems facing the agricultural industry. It should be recognised that most farming units in South Africa, seen from a business point of view, are not efficiently managed. In reality many of the basic principles for a successful business concern are not yet applied to farming.

The biggest challenge facing agriculture in future will undoubtedly be the effective integration of business principles in farming. This will result in the careful application of natural resources, the keeping of farming records and the analysis of the agricultural industry, purposeful planning of farming enterprises according to business principles, the elimination of uneconomic labour and mechanisation and more realistic land prices. (29, p. 1)

## 2.11 Research

In South Africa an amount equivalent to only 0,5 per cent of the total agricultural turnover in 1979/80 was spent on agricultural research, compared to an amount equivalent to approximately 2,5 to 3 per cent of the turnover in the agriculture of developed countries.

South Africa is behind in this respect, and the gap is increasing. In addition, our natural resources and climate are less favourable.

The addition of increasing production costs to agricultural product prices creates product prices at which South Africa cannot market its surplus production competitively overseas. Uncontrolled increases in the price of essential agricultural inputs further aggravate the situation.

An increase in the efficiency of production by extended basic and applied research and technological development, with the accompanying cost-reducing effects this will have per unit input, has long been a necessity in South African agriculture.

Urgent and purposeful action is necessary to innovate new technological developments, the following aspects of which have started to become critical:

- (a) The need for a constant flow of applicable technology through applied research;
- (b) the need for favourable pricing policy strategies which will encourage producers to accept and apply new technology to produce more at the same given input level or to produce the same at a reduced input level or to produce the same at a reduced input level per unit output;
- (c) access to agricultural credit and an incentive to self-financing in purchasing the essential production inputs;
- (d) the availability of these inputs when and where necessary at reasonable prices;

- (e) improved storage facilities and marketing
- (f) the availability of processing facilities;
- (g) improved socio-economic standards of living in rural areas, training and development of the manpower potential;
- (h) integrated rural development projects;
- (i) the establishment and strengthening of farmers' organisations through which new technology can be channelled.

## 2.12 Conclusion

"It has increasingly come to be recognised that the problems of agriculture, and in particular the problem of agricultural incomes, cannot be adequately solved so long as the basic structure of the sector remains deficient". (25, p. 1)

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