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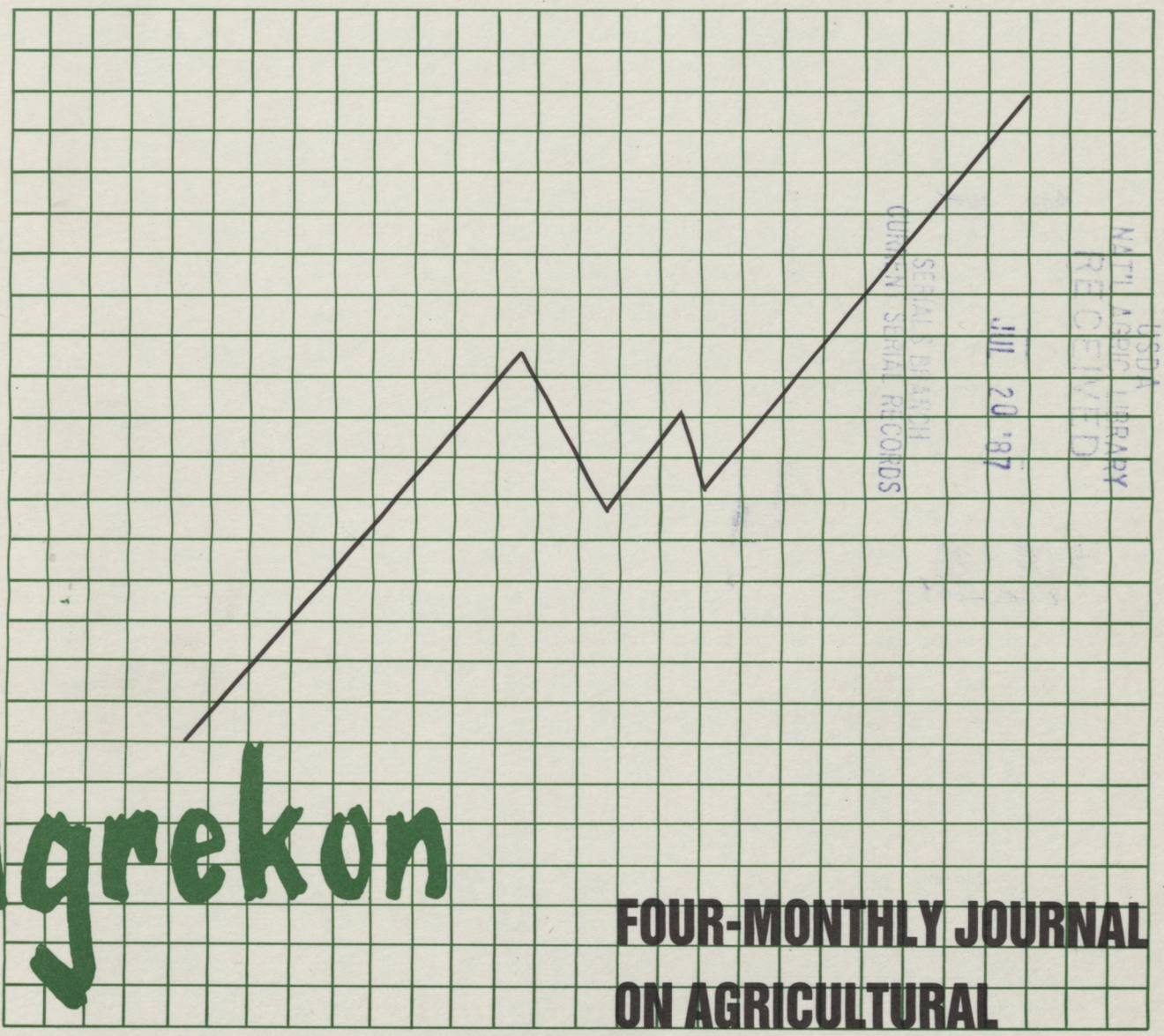

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IS THE AGRICULTURAL POLITICAL MARKET EFFICIENT?

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The topic allocated to me by the Agricultural Economic Association of South Africa implies a very large number of questions, and difficult questions at that. I had to consider what it really meant, and during this process I felt that I should reply to the question "Is the Agricultural Political Market Efficient?" in just one simple word: "No."

This brief answer would hold true for nearly all societies in the world today. In view of the important influence of governments and government agencies upon the agricultural sector, agricultural policy and consequently agricultural marketing is one of the best examples of a politico-economic combination. In German we call it the politico-economic approach. This means that the agricultural sector is influenced by such a large number of political aspects, like social policy, structural policy etc., that the economic factors on the agricultural market are only one of a large number of influencing factors.

The agricultural political market in the Western world is organised under the democratic system. In a democracy a certain number of political parties are fighting for votes. To maximise the votes, each party has to devise programmes, subject to the constitution and the legislation governing elections. As far as the agricultural market is concerned, the interests of farmers, farm workers and consumers have to be borne in mind, together with numerous other values.

To test this theory, a study was conducted in the Federal Republic of Germany in the early eighties, In this study the popularity of the government and the budget of the Ministry for Food, Agriculture and Forestry were considered simultaneously against the figures for unemployment, inflation and specific agricultural values, such as the agricultural net profit, the income distribution within agriculture and the income disparity between agriculture and other sectors. Besides some limitations, these simultaneous models showed some measurable relationships. The study proved that the concept of the so-called political entrepreneur has become an important reality in economic theory. As a result, we talk nowadays about the "transferability of the economic theory of democracy into agricultural politics/agricultural economy." This also embraces the influence of the various interest groups and organisations in the agricultural field upon politico-economic thinking.

In this connection the question arises, how far can "group interest" be organised and how far can the intentions of certain groups influence the decision-making process. Following studies in Germany, organisations like the German Farmers' Union were regarded in the models as influential bodies. This organisation is a conduit for a certain amount of public influence, e.g. through lobbying. Through feedback and individual advice to members the organisation fosters the closing of ranks among members.

Preferential treatment and privileges will be asked for by the various interest groups, and the politicians either accede to these requests or reject them. The main task of the government is to create a balance between the requests of the different interest groups. Imbalance between different influential groups magnifies the dynamic process of adjustment.

These studies were used in order to prove the fact that in many countries the different markets, especially the agricultural market, where a great deal of government influence is noticeable, are influenced only to a very small degree by economic considerations, but to a larger degree by political thinking. As a result, the agricultural market is very rarely efficient by economic standards. But the question also concerns the *agricultural political* market. When evaluating efficiency in any country, therefore, it is necessary to take the political aims of that country into account. In order to avoid too much confusion in the theoretical field, numerous examples are given, such as why the EEC agricultural policy is far from being efficient. But, for the first time, a real beginning has been made with a common market agricultural policy. Efforts are being made to make the agricultural political market more efficient. Admittedly, the impetus to do this was a result of the shortage of funds caused by the disposal of overproduction in an unbalanced market. The following are some examples, with an indication of results, of how things should be changed to increase efficiency in the agricultural political market. The intention is merely to provide some guidelines, not a prescription for other countries. But the conclusion that can be drawn from the difficult years agricultural policy and marketing in the EEC passed through is that "the longer you ignore basic economic factors, and follow so-called political necessities or the demands of pressure groups the more difficulties and imbalances

will develop". The necessary adjustments afterwards are much more painful than observing sound economic factors from an early stage.

CONTINUED GROWTH IN OECD OUTPUT IN 1985

Although slightly lower than last year's record (attributed to the exceptionally favourable climatic conditions that prevailed, particularly in Europe), wheat production has once again reached a very high level despite acreage reductions in the United States in particular, and to a lesser extent in the EEC. The continuous rise in yields is no doubt one of the main factors which contributed to this situation; this suggests that the fall in world prices and/or the lower support provided for this crop was insufficient to offset the productivity gains. A similar situation prevails for coarse grains with, in addition, a dramatic increase in the crop in the main producing country, i.e., the United States, where output is likely to exceed the level that three years ago led to the implementation of the PIK programme. Overall cereal production in the OECD area will therefore reach a record level. Of the other crops, production of beet sugar is expected to decline slightly; this is also the case for the main overall fruit and vegetable crops with the exception of citrus fruit.

On the other hand, milk production is increasing again, particularly in the United States; the countries that introduced production control measures have, to a large extent, succeeded in ensuring that their objectives are met. Stocks of dairy products are still at very high levels, as are those of beef in the EEC. Although beef and pork output is currently on a cyclical downturn in the United States and beef production is falling in the EEC, these trends are likely to be affected if additional measures are taken to restrict milk production even further. The beef production cycle in Member Countries of the Southern Hemisphere is now showing an upward trend. Production of other meats is also increasing. The overall structural surplus nature of production is therefore likely to persist and will be even more pronounced in the cereal sector.

Stagnation of demand in the OECD area and reduction in import demand by the rest of the world

On the demand side, the fact that human consumption is stagnating in OECD countries is aggravated by a continuing high level of unemployment and changes in consumer habits due mainly to dietary considerations. Even with new technologies, industrial outlets for agricultural raw materials seem limited, unless farmgate prices fall to a much lower level than those now prevailing. The appreciation of the United States dollar, together with high interest rates, has increased the repayment difficulties of heavily indebted developing countries, mainly in South America, and although some measures have been taken to alleviate the situation, a long-term and sustainable solution has not yet been achieved. The necessary adjustment policies in these countries need, *inter alia*, to be supported by a better access for their exports in OECD countries and also by higher international commodity prices.

Since 1982, a combination of factors which seems unlikely to change substantially in the near future has restricted exports to developing countries. One positive change in terms of both humanitarian and economic goals is the increase in the number of developing countries that have changed from policies whose effect has been to penalise agriculture to policies that are neutral or even supportive of agriculture. The international impact of increased production in developing countries is perhaps best shown by current cereal stocks and exports by China and India, but numerous developing countries have also adopted macro-economic and agricultural policies that sustain increased agricultural production and exports. The awareness, particularly in Asia, of the need for consistently competitive exchange rates, for macro-economic policies that limit inflation and for trade liberalisation that limits government intervention, has produced some formidable competition for exporters. Asian countries are increasing their export market share, at a time of relatively low international prices for rice, vegetable oils, maize and wheat. At a time of surpluses, inadequate stocking facilities in some developing countries would encourage disposals on international markets. This risk was, however, considered temporary pending production of more exports to developing countries; exports with a higher value-added content have continued to expand in several of the markets. Similarly, OECD exports of some key agricultural inputs - namely tractors and pesticides - have been resilient.

A relative decline in food and feed import requirements is taking place in the centrally planned countries. This is particularly large this year in the cereal sector. The Soviet Union will nevertheless remain a major client for food and feed in the medium term.

Eastern Europe's agriculture is improving steadily and the region as a whole has now achieved a balance between grain imports and exports and is likely to remain in this position in the future but will continue to import large amounts of protein concentrates. China has emerged as an important agricultural exporter and achieved a positive agricultural trade balance. It is believed, however, that this country will continue to import wheat in large quantities in the medium term. The effects of a sweeping change in China's price and market management policies are as yet uncertain but it appears that the period of rapid agricultural commodity trade within the Eastern block countries is being stimulated by Eastern Europe's trade deficit with the Soviet Union and foreign exchange shortages; this may also be one of the reasons for the development of closer agricultural trade relations between Eastern Europe and China. However, while the importance of the centrally planned economies as

importers of food and feed may be decreasing, these countries seem to be willing to expand their imports of agricultural inputs and technology for agriculture and the food industry.

Tension on international markets continues

Although firm estimates concerning the level of agricultural trade in 1985 are not yet available, it is evident that the volume will be lower than in 1984. It is likely that the trade volume will decline for several major commodities, in particular for cereals. The aggregate value of agricultural trade will also be considerably lower than last year owing to lower volumes and significantly lower prices for virtually all temperate commodities. Furthermore, surplus production and hence increasing stocks within the OECD as a whole are continuing to overhang the markets for commodities such as cereals, dairy products, beef, sugar and, to a lesser extent, oilseeds. However, the severity of the situation differs substantially from country to country and from one commodity to another, especially among the major exporters.

Agricultural trade problems continue to be a source of tension within the international trading system. The continued existence of large stocks of several temperate commodities, in the face of slow-growth world markets and significantly weaker prices for such commodities has led to a continuation of aggressive marketing practices among major exporters in both developed and developing countries. Such practices vary between countries, but have generally taken the form of generous export incentives, which may include reduced export prices, more attractive credit terms and export promotional programmes designed to assist individual countries to maintain or increase their market shares in a sluggish market. In such an atmosphere, exporters sometimes feel compelled to offer equally attractive export incentives in order to "match the competition". As in the past, a side-effect of such competitive market conditions has been a continuation of the protectionist nature of many domestic trade-oriented policy measures which continue to hamper exports of both developed and developing countries.

The high value of the United States dollar has had both negative and positive effects. While it is difficult to assess the direct linkages between world agricultural market prices and United States dollar variations, especially in the context of the current oversupply situation, it is a fact that United States agricultural exports have fallen and that other exporting countries' opportunities have risen. Commercial demand for commodities denominated mainly in United States dollar terms has been dampened. On the other hand, it is also true that unit export receipts from the United States market have improved, especially for some exporting developing countries. If sustained, the recent fall in the value of the United States dollar, to the extent that it allows an easing of macro-economic policies, may lead to a higher demand for agricultural commodities, but the overall excess supply situation for virtually all temperate farm products will continue to have adverse effects on markets.

Exchange rate variations have added to the already deteriorating trade conditions - mainly induced by the excess supply situtation - and triggered protectionist pressures. Recent concerted endeavours to achieve greater stability of exchange rates could lead to opportunities for a rollback of aggressive trade practices and for a more co-operative approach between OECD countries on how to improve the functioning of agricultural markets, provided that agricultural support prices are increasingly geared to more medium-term international market prospects.

The variety of policy constraints

Market disequilibrium has substantial effects on both farmers and society as a whole. Farmers receive lower prices and, despite productivity gains, these have repercussions on their incomes and their indebtedness tends to increase. In those countries with a large agricultural population the capacity of other sectors to absorb agricultural labour is limited by unemployment. On the other hand, governments have to meet increasing costs, in the form of direct payments and the cost of storage or disposal, despite the necessity for rigour in budget management. For many years, the main aim of policies was to restore the supply/demand balance. Measures taken in the dairy sector have yielded some preliminary results, but it is clear that they need to be continued and reinforced in some cases. Meanwhile, the situation in the cereal market has become increasingly dramatic, and surpluses in other sectors (wine, rapeseed, etc.) are beginning to cause concern.

The need for a long-term perspective

Policy makers nowadays are largely in agreement about the medium-term to long-term outlook. Despite the stagnation of demand, it is more and more evident that, for technical reasons, the rate of increase of yields is unlikely to slow down in the next few years. The possibilities of breeding and multiplying new varieties through progress in genetics and cloning are enormous. In addition, it appears increasingly illusory to consider exporting as a means of marketing increases in domestic production; outlets in both centrally planned countries and developing countries are in fact contracting. The disposal of surpluses on these markets is becoming increasingly costly and would aggravate the trade conflicts which are of benefit only to those importers who have the necessary funds to purchase the surpluses. In agriculture, as in other sectors, productivity gains have overall positive economic effects, but also entail a degree of social distress. In this connection, it is essential to look

carefully at the outlook for the agricultural sector and, while taking the emergency measures that are necessary, to endeavour to identify the way in which the sector can adapt to the changing situation.

Need for a global production strategy

It is no longer possible to consider partial measures for limiting the production of cereals; these account for a substantial share of final agricultural output and a number of other field crops - generally in surplus - are also linked to them. Any limit placed on the production of one commodity leads to a switch to other products, which in turn become in surplus. As a result, there is a need for an *overall approach* for the adjustment of agriculture as a whole to the situation that has led to surpluses. Such an adjustment implies taking action at both the national and the international level. At the national level, each government now has to decide, in relation to the conditions prevailing in its own country, which combination of measures it should introduce to control production: lower guaranteed prices, implementation of quota schemes or an attempt to find alternative products. Adequate measures should be taken to alleviate, to a degree, the social consequences of the policy adopted. At the international level, it would be highly desirable for consultations between *countries* to lead to the *implementation of co-ordinated policies* so as to ensure that they reinforce each other and that they do not result in disorderly market fluctuations.

Reduction of real guaranteed prices

In the view of the majority of governments, *reduction of real guaranteed prices is indispensable* as a means of remedying market imbalances. It is essential that in this way producers should be given a clear indication of the situation to which they have to adapt their decisions. However, it is difficult to find a balance between various considerations. A sharp price reduction may be politically unacceptable because of its effect on income and economically damaging if it is beyond the adjustment capacity of agriculture. On the other hand, a small reduction may not succeed if its effects are offset by higher productivity due to technological progress. In any event, government policy on price stabilisation is not being brought into question. It might be possible gradually to bring guaranteed prices closer into line with international prices, either directly or indirectly (in relation to stock levels, for example), without excessive fluctuations by basing the reference period for the guaranteed prices on the average for a number of years.

Quotas: an emergency scheme

Even if a reduction in guaranteed prices goes beyond what could be offset by increased productivity, its short-term effects on the level of output remain uncertain and some time is likely to elapse before production begins to fall. More rapid results can be achieved by production *quota schemes*. However, they are complex in nature and need to be controlled; this control is sometimes difficult to exercise when production is not channelled through a limited number of collection or processing points. Although quota schemes are often implemented as an alternative to a reduction in guaranteed prices, these prices should be kept at a moderate level so as to avoid their capitalisation in the *value of quota rights or in land values*, which would slow down structural development. Consideration should also be given to the possibility of allowing over-quota production at prices to be determined by the world market.

The growth of milk production appears to have been brought substantially under control in those countries that have introduced quota schemes. However, a number of problems remain unresolved in these countries. In some cases, the *size of the overall quota has been fixed too high* and will have to be reduced. In addition, quota schemes often impel farmers to develop the production of other commodities; it would be useful to estimate as accurately as possible their consequences on the equilibrium of other markets. Finally, in order to avoid freezing the structure of dairy farms, it would also be useful to examine carefully the possibility of transferring quotas from one farm to another.

Alternative products

The *reduction of production* through the use of extensive methods of cultivation is possible in certain cases. Where it is not possible, in order to maintain their incomes, farmers may wish to use for other purposes land that is no longer required. Any attempt to produce a crop hitherto in short supply in the country concerned might prove very expensive in terms of subsidies and inhibit international specialisation and trade. The possibility of using agricultural biomass, especially cereals and sugar, *for non-food purposes* is arousing increasing interest in many countries and new plants are being constructed, sometimes on a larger scale. It is essential that thorough economic studies be undertaken to ascertain more precisely the conditions needed to make them profitable and hence the level of support that might be provided to them, particularly for environmental reasons.

Mitigation of social consequences

Whatever measures are chosen to balance supply and demand, they are bound to have *adverse effects on agricultural incomes*, particularly in the case of small farmers and those who do not have non-agricultural incomes. However, these should not be allowed to become incentives for production. A number of studies carried out in various countries have already made it possible to draw a distinction between temporary support to allow viable farmers

to adjust and overcome their problems of indebtedness, permanent support given to certain farmers who cannot achieve viability in regions where maintaining a certain type of environment is desirable and finally purely social aids to enable old or marginal farmers to retire from agricultural production.

Agricultural policies today face the difficult task of adjusting production rapidly without always having the means to offset the considerable sacrifices this often entails for farmers. It is possible that a political will is emerging to solve such problems in a way that takes account of the long-term outlook and is consistent with developments in other countries. Farmers would have the best possible basis on which to make their economic decisions if they could more clearly see the steps that were envisaged for bringing about the *gradual alignment of real market conditions* in the years to come.

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