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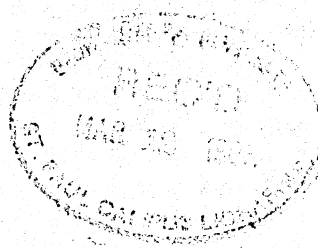
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POSSIBLE DEVELOPMENTS IN SOUTH AFRICAN
AGRICULTURE

Speech by Dr. A.S. Jacobs, Deputy Governor of
the South African Reserve Bank, at the 1984
Agricultural Outlook Conference to be held
in Pretoria at 14h00 on 19 January 1984

The scope of the field I want to explore with you today not only covers the possible influence which domestic and international economic developments may have on South African agriculture during 1984, but also certain problems regarding structural adjustments facing the agricultural sector as well as the changed market system and policy framework in which this sector has to operate in future.

As a result of the more favourable climatic conditions, the agricultural outlook is at present much more favourable, which means that the farming industry will again be able to make a positive contribution to the Republic's gross domestic product; that the current account of the balance of payments should benefit and that the food price index will probably increase at a lower rate. For the farming community, especially in the summer rainfall grain areas, it also means that their liquidity, creditworthiness and debt position will benefit, although agricultural conditions are not uniformly more favourable.

With the recent instability of and the lower trend in the gold price, it has become clear that the consolidation phase in the economy is not yet completed. This means that a restrictive monetary and fiscal policy will have to be continued and that the economy is not as yet ready for an

economic upswing. Consequently, the monetary authorities have allowed short-term interest rates to continue their upward move as a result of market forces. As part of the authorities' anti-inflationary policy steps were also taken to defend the decline in the external value of the rand, mainly against the US dollar.

The Republic's exports, excluding gold, towards the end of 1983 started to benefit from the international economic recovery, both in terms of volume and prices, although the recovery in the important industrial countries was still largely confined to the US. In addition, the larger agricultural production envisaged will also make a moderate contribution later in 1984 to stimulate the economy. The gold price, for which purpose the external value of the US dollar against the most important international currencies is of utmost importance, will, however, play a key role in the Republic's short-term economic outlook and at this stage it would be risky to bargain on a substantially higher average dollar price for gold in 1984 than in 1983.

Given the international circumstances, the dollar price of gold has nevertheless remained relatively stable. Unless it declines substantially further, it would appear that circumstances could become more favourable in the second half of 1984 for a gradual upswing in the South African economy. It should, however, be noted that such an upswing would of necessity have to be of an export-led nature and not be based on

an increase in total consumption expenditure. This statement implies that it is impossible at this stage for the authorities to consider stimulating the economy.

The influence of national and international factors on South African agriculture

The South African agricultural industry should benefit moderately in the second half of 1984 from the more favourable conditions in the economy, whilst the same applies in respect of exports of agricultural products during 1984. In the latter case it is not only the economic recovery in the industrial countries that matters, but also the agricultural conditions in the relative countries and in South Africa's most important export competitors, as well as movements in the value of the rand against the currencies of its export competitors and relative to those of the countries in which its agricultural products are marketed.

In this connection it should be borne in mind that the economic recovery in the industrial countries is at this stage still largely limited to the US, but that the US in fact has a dominant influence, through its production and supply, on the prices of internationally traded agricultural products. With a few exceptions, the US is South Africa's dominating competitor in respect of the exportation of agricultural products. As a result of the unfavourable climatic conditions which the US and West European countries experienced during 1983 and the resultant lower agricultural production, export prospects for South African agricultural products seem to be substantially

better in 1984 - in which respect the depreciation of the rand against the US dollar during the past few years will also benefit agricultural exports. We should be careful, however, not to project a more favourable outlook for some agricultural products on the grounds of such fortuitous factors as the serious drought and the snow damage which American agriculture experienced during 1983.

During 1983 the value of the rand depreciated by a further 11,6 per cent against the US dollar and 1,5 per cent against sterling, compared with an appreciation of 1,0 per cent against the German mark. The effective exchange rate of the rand against the most important international currencies declined during 1983 by 4,3 per cent. During the first two weeks of January 1984 the rand depreciated by a further 3,9 per cent against the US dollar and on average by 1,9 per cent against the most important international currencies. Exchange rate movements have consequently benefited South African exporters of agricultural products compared with American exports - although the difference in the two countries' inflation rates has partly neutralised this advantage.

Structural problems in agriculture

Last year the Agricultural Working Committee completed an investigation into bottlenecks in agriculture as part of its contribution to the drafting of a long-term strategy for the South African agricultural industry. Structural problems which

necessitate adjustments to the pattern of agricultural production and marketing were on a number of occasions identified in respect of certain agricultural sectors during recent years. It is therefore essential that the causes of these problems are identified and that such structural adjustments are not postponed for too long.

A market-orientated agricultural industry will more rapidly convey to producers the signals in the form of a smaller demand or stagnating price and profit margins of a change in the market situation (demand and/or supply) i.r.o. a certain product, than would a regulated production, marketing and price support system. A contributory factor to the structural problems which are increasingly experienced in the South African agricultural industry is the fact that agricultural production and prices are not to a larger extent market-orientated.

As a result of the unstable climatic conditions, agricultural production, and consequently the producers' net farming income, is subject to large annual fluctuations. With regard to the marketing of agricultural products, a case can also be made out to strengthen the individual producer's competitiveness against the more concentrated market demand. To enhance the more efficient utilisation of resources with regard to agricultural production, a more market-orientated policy is necessary - which means that the demand for a certain product or the competition from other countries with regard to such a product must be taken into account in its marketing and pricing policy.

It is, however, a fact that governments in developed as well as developing countries, irrespective of their economic ideologies, for strategic and socio-economic considerations interfere to a large extent in the production, marketing and pricing of agricultural products. This also explains the lack of progress that has thusfar been made in applying the GATT principles to international trade in agricultural products. The most important agricultural export countries are in general in favour of the liberalisation of the international trade in agricultural products, while the importing countries - e.g. the EEC countries - are increasingly expanding their agricultural production by means of protection and subsidies.

The latter aspect and the increasing competition which is emanating from developing countries, are largely responsible for the problems which are currently experienced by some of South Africa's agricultural exports. As a result of the present intervention by governments in their agricultural industries, it would be unfair to insist that the South African agricultural policy should be based entirely on the principle of a free market system. As I will show later, the South African economy is moving increasingly to a free market system, a move of which the agricultural industry should take note and to which agricultural policy will have to be adapted.

The bottlenecks in agriculture which were identified in its investigations by the Agricultural Working Committee are the following:

- a. The high inflation rate in South Africa relative to those of the industrial countries and the effect thereof on the agricultural industry's export competitiveness;
- b. the value of the rand against the currencies of the most important industrial countries when the international gold price rises sharply and the effective exchange rate of the rand consequently strengthens;
- c. the need for an "appropriate" agricultural financing system;
- d. the lack of adequate agricultural research and extension services and the lack of co-ordination in this respect; and
- e. the need for a reserve fund as a measure to promote income stability in agriculture.

In our assessment of the future prospects for the agricultural industry we must be careful not to allow the events experienced during the past two years to influence our vision of the future unduly. It is nonetheless obvious that the agricultural industry is facing certain structural problems, but that the solution for these problems should not be sought in state subsidies.

If the proposed system of differential prices for maize which is marketed in the domestic and foreign markets, respectively, is introduced, it will no doubt effect the pattern of agricultural production and induce producers to take note to a larger extent of market factors in the planning of agricultural production. The relative prices in respect of agricultural products and the movement of these prices over

time will in such circumstances become more important than is currently the case. Information regarding national and international production and price trends would become essential inputs for purposes of the producer's farming decisions.

The structural problems facing the agricultural industry can partly be ascribed to inadequate agricultural research and extension services. In a more market-orientated agricultural industry, up to date information and advice regarding market trends are of the utmost importance. For a vigorous and competitive agricultural industry it is of equal importance that agricultural research should be accorded its rightful priority in, amongst other things, the government's expenditure programme and that the results of such research be made available to producers. This matter is at present being investigated by the KOLB Committee which aims to complete its investigations and report during the first half of 1984.

The market system and policy framework within which the South African agricultural sector functions

Important changes have and are still manifesting themselves in the South African economic system. The gradual abolition of price control, the phasing out of import control, the monitoring of restrictive business practices, the more critical attitude on the part of Government with regard to economic concentrations, the abolition of exchange control in respect of non-residents, the implementation of a floating exchange rate system for the rand, the use of market-orientated monetary policy measures and acceptance of market-

related interest rates, serve as evidence of the progress that has been made to establish a free market system, within certain limits, in South Africa.

A good start has been made with the establishment of a more competitive and market-orientated economic system in South Africa, which implies that national and international market forces will in future tend to play a more prominent role in the allocation of the Republic's economic resources. In other words, the pattern and volume of production in the economy will increasingly be determined by market forces and the directional effects caused by subsidies and similar instruments on the allocation of resources in the economy will tend to diminish. Under any economic system governments are of course free to use e.g. food subsidies to attain certain socio-economic objectives, whilst a policy of economic decentralisation also deserves special mention. The general use of subsidies in order to direct the pattern and volume of production into certain areas often means that certain industries need increasing government assistance and intervention to survive and grow - with all the attendant adverse consequences.

The gradual phasing out of import control as a protectionist measure for the industrial sector implies greater foreign competition for the manufacturing industry, which is particularly important for a country like South Africa where large conglomerates is a feature of the economic system. Industrial protection through import tariffs can, of course, be justified on economic grounds, but the exclusion of effective

foreign competition in a country with a strong monopolistic/duopolistic/oligopolistic production structure sometimes implies that the users (of intermediary inputs) and the consumers of products have to subsidise the industries concerned and that the viability of other industries is harmed in the process.

Inflation feeds on inflationary expectations. Furthermore it is of no avail, except if overriding strategic considerations should apply, to develop certain industries which could impair the growth potential of others. An excessive protectionist policy and a policy to regard the depreciation of the exchange rate as a compromise for effective monetary and fiscal policy measures, must obviously enhance the process of inflation in a country which in turn may impair the competitiveness of its products and eventually its growth potential.

The abolition of import control, the implementation of a floating exchange rate system, the monitoring of restrictive business practices, etc. do not constitute substitutes for a well co-ordinated and effective fiscal and monetary policy, but could be regarded as essential pre-conditions for this purpose. Competitive markets create an environment in which market forces as well as fiscal and monetary measures can be more effectively employed to combat inflation.

South African agriculture has, justifiably, taken a strong stand against the high rate of inflation in the Republic

relative to those in the industrial countries (its most important market outlets); it has been asserted that the protection enjoyed by the industrial sector is playing an important role in this regard and that the international competitiveness of South African agricultural products is declining as a consequence of the Republic's high rate of inflation. Organised agriculture, therefore, basically favours a policy that would permit the agricultural sector to purchase its capital goods and intermediary inputs at the lowest cost possible - irrespective of whether the goods are locally produced or imported. The question arises, however, whether the agricultural sector is also prepared to subject itself to the discipline of the market place.

Considerable progress has been made since mid-1982 to also apply a market-orientated interest rate policy in respect of the agricultural sector. The present system being used to fund the Land Bank by selling Land Bank paper ranking as liquid assets to the banks, has increased their holding of liquid assets substantially - which in turn has adversely effected the monetary policy stance of the authorities. As a consequence of the large and increasing amounts which the banks have to provide in the form of liquid assets for the financing of agriculture - in the form of mortgages, medium-term finance, production credit and the financing of inventories - they were reluctant to continue investing in these assets unless they were issued at market-related interest rates.

Despite the high level to which interest rates have risen during the past two years, and notwithstanding the serious damage caused by the drought to agricultural production and the consequential increase in the total debt of producers, the agricultural industry has adapted itself remarkably well to this new policy approach - allowing, of course, for the fact that the State has cushioned the impact of this transformation on the interest cost to producers by means of the system of interest rate subsidies. Mention should, however, also be made of a new problem which has surfaced in respect of the funding of the Land Bank through the issuance of liquid assets to the banks.

As a result of the lowering of the (large) banks' liquid asset requirements from inter alia 58 per cent in respect of their short-term liabilities against the public in August 1980 to 30 per cent in December 1983, the banks' required holdings of liquid assets have declined considerably. On account of the undertaking by the "big five" commercial banks to make certain financial facilities available to the Land Bank during the year ending 30 June 1984, the liquid assets of the Land Bank are constituting a growing percentage of their total liquid asset holdings for which a market outside the banking system is not readily available.

In view of the fact that the De Kock Commission is in favour of controlling the banks' cash holdings for monetary control purposes, which means that the system of liquid asset requirements will no longer be used for this purpose (a policy which is already being phased in), the market for liquid assets

will inevitably become smaller in future so that the interest rates on these credit instruments will have to be completely market-related. The new approach to monetary control also requires that all transactions currently being financed by means of liquid assets should be critically assessed in order to determine whether the continued financing of some of these transactions by way of liquid assets can still be justified. It is the task of the De Kock Commission to investigate this matter and the full implications of any possible amendment to the definition of liquid assets in the Banks Act and Building Societies Act will only become clear when the Commission's report is released later this year.

The authorities do not influence exchange rate movements of the rand to the advantage of certain sectors of the economy. Although some sectors of the economy or industries will benefit from a depreciation of the rand, the inflationary consequences thereof for the economy in general can hardly be over-emphasized. The risk prevails that the good progress that has been made to reduce the rate of inflation may be neutralised in due course by the depreciation in the effective exchange rate of the rand. It is consequently important to continue for the time being with a restrictive monetary and fiscal policy.

With the help of the Reserve Bank's quarterly econometric model and based on the circumstances which prevailed in 1982, the effects of a devaluation of the rand by 10 per cent in terms of the main currencies, were tested. The

results show that the current account of the balance of payments would have benefited very little from such a depreciation in both 1983 and 1984, but that this would have caused a rise in the general price level by 6 per cent in 1983 and 6,5 per cent in 1984. This means that the advantages of such a depreciation, in macro-economic terms, would soon be wiped out and that a further depreciation, with the above-mentioned effect, would be required to maintain the benefits of a larger rand income for the export industries and to shield domestic enterprises against foreign competition. For this reason the need to protect the external value of the rand with suitable monetary and fiscal policy measures cannot be over-emphasized.

Conclusion

In the year ahead, greater clarity regarding the future financing system for agriculture will emerge. The role of the State, the marketing boards, and agricultural co-operatives in respect of agricultural research and extension services, will also have to be defined. In view of the progress that has been made in fostering a free market system in South Africa, the orientation of a more market-related agricultural policy will have to be considered. Agricultural prospects for 1984 in general seem much more favourable, which would enable producers to improve their income and liquidity and to reduce their debt burden.

The state of the agricultural industry cannot be regarded as particularly healthy at this stage, but it is nevertheless much better than a year ago.

