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EAST OF SCOTLAND COLLEGE OF AGRICULTURE
ECONOMICS DEPARTMENT

A Guide to Agricultural Support Policies
in Britain and the E.E.C.

D. Ray

CORRECTIONS

Page 23

Para. 6 Line 3.
should read.

..... 5%, the guaranteed price falls by around 5%

Para. 8 Line 3.
should read:

..... (per cwt) then the guaranteed price rises by
1p per score (i.e.

Page 25

Para. 2 Line 3.
should read:

..... price is based on an acreage quota. Whereas
in England"

Para 2. Line 5.
should read:

..... to the factory, Scottish growers"

Page 47

should read:

"pigs les porcs."

EAST OF SCOTLAND COLLEGE OF AGRICULTURE

Economics Department

A Guide to Agricultural Support Policies
in Britain and the E.E.C.

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Foreword

Since the passing of the Agriculture Act in 1947, Government involvement in agricultural policy has increased to a marked extent and inevitably, the mechanisms of agricultural support have become progressively more complicated.

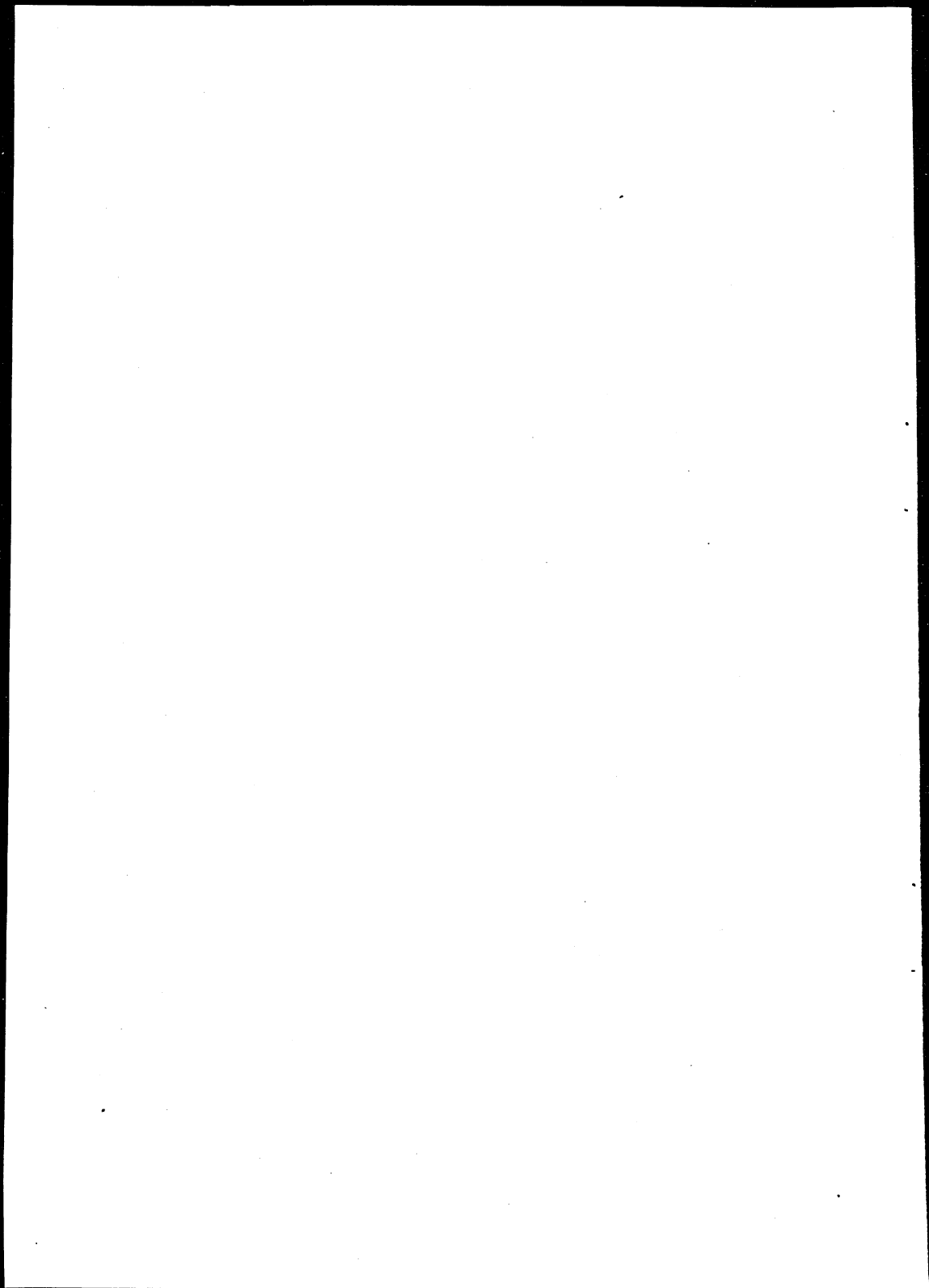
With the prospect of entry into the Common Market, an understanding of the U.K. and E.E.C. agricultural support systems becomes essential and in this booklet, the operation of the two systems is discussed in a series of questions and answers.

R. F. LORD

Head of Economics Department

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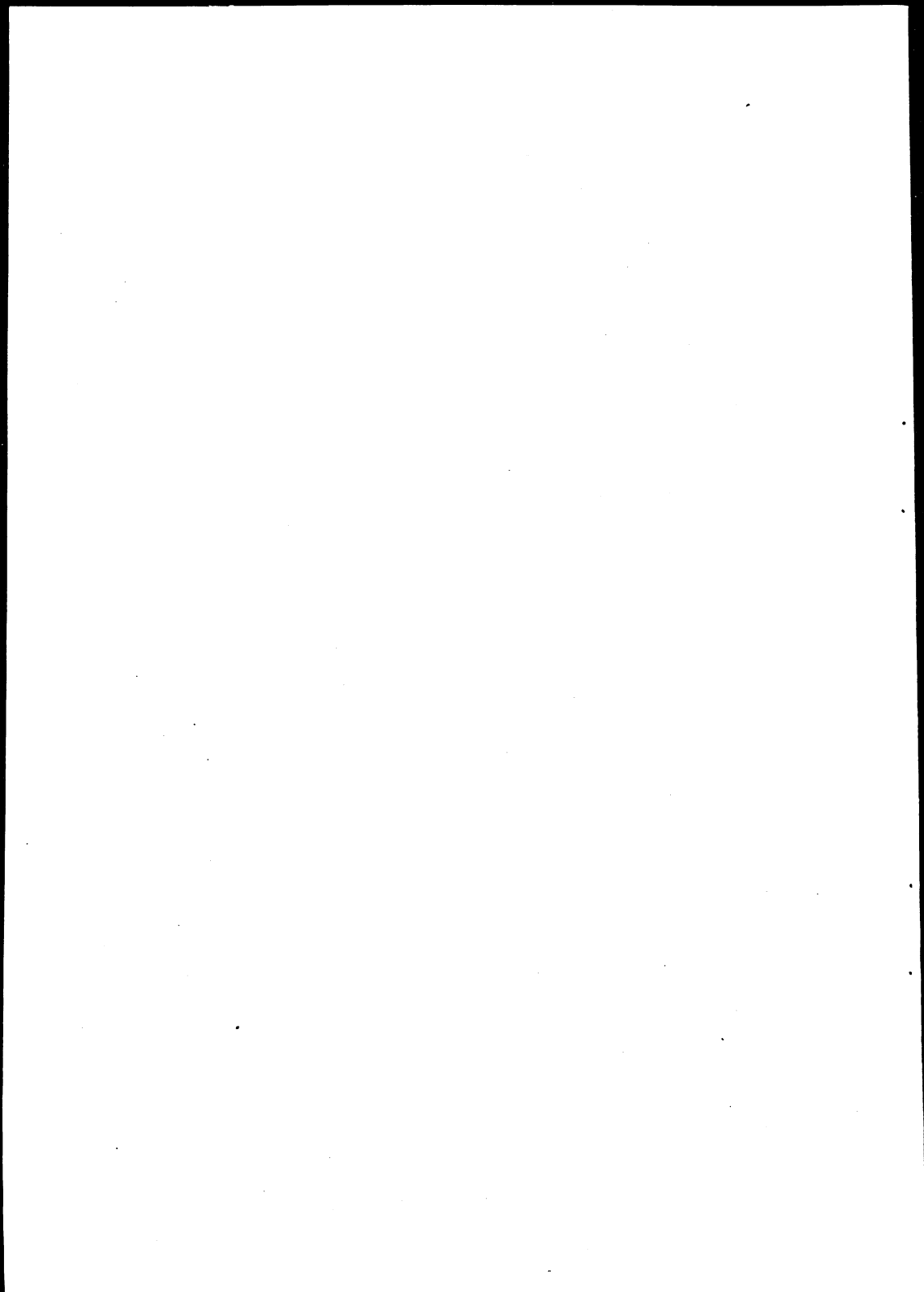
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A. The Problems of Agriculture

1. What is the present state of world agriculture?

As far as temperate agriculture is concerned, one of excess production (see glossary). Surplus production of cereals in North America emerged in the 1950s and was partly absorbed by the hungry, 'Third World'. The development of high yielding cereals and new techniques has now increased output in these poorer countries and markets for North American cereals have contracted. In the U.S.A. policies designed to limit acreage have failed to eliminate the surpluses.

There has also been excess production of other commodities such as dairy products, sugar and wool in North America, Europe and Australasia.

2. How does the U.K. fit into this picture?

The U.K. is the largest market in the world for exported temperate foodstuffs. It is also the only major free market unimpeded by import levies or tariffs (see glossary). Many of the U.K. food imports are subject to market-access agreements or quota arrangements but these serve partly to protect exporting countries from 'unfair' competition (see glossary - Dumping). About a third of all U.K. food requirements and about a fifth of U.K. temperate food requirements are imported. However, the output of home agriculture is rising faster than home demand and imports are gradually being replaced by home production. The increasing output is a result of government support policies (see Q.25, 26) and the cost price squeeze (see Q.8).

3. Why is the demand for food in the U.K. rising only slowly?

- (a) Because people have a limited capacity for food and spend higher incomes on other goods and services (see Q.8 and glossary).
- (b) Because population in the U.K. is increasing slowly (at about 0.7% per annum).

4. What is the role of the U.K. government in agriculture?

Since the 1947 Agriculture Act it has been to stabilise prices (see Q.7, 9) to support farm incomes (see Q.8, 10) and to encourage greater productivity (see Q.12). The methods used have been deficiency payments, direct grants and trade agreements (see Q.25, 26).

5. How is this role likely to change in the 1970s?

The government is changing the manner of the support of agriculture. Direct payments to farmers are to be replaced by higher market prices. The free importation of food will be replaced by levies on imports. This new U.K. system will dovetail more smoothly with the present E.E.C. system than did the old. (see Q.26).

6. Why do governments involve themselves with agriculture?

(a) Because by the very nature of the market for foodstuffs, (see Q.7), prices would vary a great deal unless governments stepped in. Such price variations would mean that farmers were impoverished from time to time and also that the cost of living for the rest of the country varied uncontrollably. Food prices are too important to be left solely to the forces of supply and demand.

(b) Because farm incomes tend to fall behind other incomes. (see Q.8).

7. Why are agricultural prices so unstable when governments do not intervene?

Production is carried out on a large number of small, independent farms. The weather and disease makes farming risky and the output which farmers plan to produce may be quite different from the output they actually achieve. The demand for food is price inelastic (see glossary); more food can only be sold at much lower prices, whilst a short fall in supply causes a more than proportional rise in price. Thus there is the irony that in a free market, farm incomes are higher when there is a bad harvest than when there is a glut. Prices may be made even more

unstable by farmers trying to produce and sell more food when prices are low in an attempt to increase their incomes. This of course only drives prices lower and again total revenue falls.

8. Why do farm incomes tend to fall behind other incomes?

Because, when economic growth takes place, manufacturing and service industry incomes always rise more rapidly than farm incomes. The reason is that the income elasticity of the demand for food is low (see glossary); increases in incomes lead to less than proportionate increases in the demand for food.

Looking at the economy as a whole, a rise in income leads to a less than equal rise in the demand for food and a more than equal rise in the demand for consumer goods and services. Unless the supply of food rises proportionately slowly and the supply of other goods and services proportionately quickly, there will be an excess supply of food and an excess demand for other goods. Food prices will fall (or if there is inflation, stand still) whilst the prices of goods and services with income elastic demand - consumer durables, packaging - and so on - will rise.

The answer, of course, is for the supply of food to increase slowly and in line with demand. This can occur in one of two ways. Either the amount of land, labour and capital employed in agriculture stays constant and productivity (output per resource) increases slowly, or resources leave agriculture and productivity increases rapidly. If the former happens, food prices are stabilised but because output per man increases relatively slowly, so does income per man and the earnings gap remains. Only by resources leaving at a rate that almost balances the rise in productivity will both food prices and agricultural incomes maintain their relative position.

The trouble is that if there is no income gap, there is precious little reason for resources to leave agriculture! Thus the income gap is never quite bridged.

The argument can be applied to imported food as well as to home produced food. In the U.K. around 40% of all foodstuffs consumed and about 20% of temperate foodstuff, are imported. So

long as output per man in the food exporting countries increases food supplies by more than rising incomes and rising population increase the demand for food in the U.K., the price of imported food will fall. Without government support this will reduce the prices farmers receive and therefore their incomes.

In fact, non-agricultural prices constantly out-ride food prices and this leads to the familiar 'cost-price' squeeze. Interest rates, wages, factory raw materials, transport costs and so on are determined in the economy as a whole and will, therefore, increase relative to food prices, reducing farm incomes.

9. What methods can governments take to overcome price fluctuations?

To overcome unstable markets, governments can guarantee farmers certain prices and prevent excessively cheap imports upsetting markets. Where there are no imports the government can control acreage and livestock numbers through direct subsidies or quotas. Such policies may involve the government in buying up surpluses, carrying 'buffer stocks' from one year to another and selling in times of shortage. Finally, by encouraging research into disease, weather forecasting plus other services the government can eliminate at least some of the causes of price fluctuations.

10. What methods have been made to overcome the income problem?

Governments have two alternatives. Either they can prevent excess supplies from coming onto the open market and driving the prices that farmers receive down (as they do in the E.E.C. through import restrictions and official buying up policies). Alternatively they can let market prices fall, but hold up farm incomes through direct subsidies (as they do in the U.K., though as is explained below, the government puts limits on the extent to which market prices are left to fall on their own).

In the long run, neither strategy can solve the income problem without other measures designed to take resources out of agriculture (see Q.12).

11. Should the government encourage increasing output at all?

Obviously if home supplies can displace imports either by imports being made dear (E.E.C.) or by home producers being reimbursed by the government for lower market prices (U.K.) then home production can be encouraged. Once self-sufficiency is achieved, increased supplies must be limited to increases in the demand for food.

12. Should the government encourage increasing productivity?

Yes. Unless output per farm is increased, income per farm cannot rise without a steadily rising exchequer subsidy. However, if the productivity of farms is to be increased but total output is to rise less quickly, there can be only one result; the number of farms must fall (see Q.8). Thus, although the government should encourage greater productivity by aiding investment, fertiliser subsidies and so on, it must also prevent output rising too fast.

These policies designed to let some farmers obtain higher incomes at the expense of other farmers who are squeezed out of agriculture are often called Structural Policies. They include grants for amalgamations and pensions for retiring farmers.

B. The Role of International Trade

13. Why not encourage agricultural production to replace all U.K. food imports?

This would set the clock back to the days when international trade was restricted in the 1930s. The major reason for the economic boom in the world since 1945 has been the growth of world trade; it has expanded in volume at a rate of 10% p.a. Only through trade can nations specialise and achieve lower costs and greater output, thus increasing real incomes.

If the U.K. limits imports then:-

- (a) Industries in the U.K. that were based on cheap imports now have higher costs and consumers have to pay more for less output (e.g. consider livestock fattening based on cheap maize imports; limit the imports and you limit the output).

(b) The exporting country is no longer in a position to buy U.K. exports. Although the direct effect may be small, the world effect is to reduce the level of trade and therefore the level of incomes in the importing and exporting countries (i.e. incomes will be lower than they could have been with free trade).

14. Why not go to the other extreme - rely entirely on imports?

Firstly, because of the need to keep the land in good 'heart' and a certain minimum level of production in case of political or military threats to U.K. trade routes. Secondly, because the U.K. relies greatly on trade, it has frequently been forced to sacrifice economic growth and full employment in order to correct the balance of payments. Therefore, some import-saving can be justified, even if at the expense of economic efficiency. Thirdly, the output of farming is more than the food produced; the beauty of the countryside plus the educative and recreational benefits which farming provide should all be weighed in the scales when assessing the contribution of agriculture to the U.K.

15. What will be the optimum balance between home produced food and imports?

In theory this will depend on the relative productivity of factors of production in agriculture and industry in the U.K. compared with countries overseas. In practice, social, political and domestic economic pressures decide the final balance. 50 years ago the U.K. was 40% self-sufficient in food; now it is 60%. The U.K. government has encouraged the production of cereals and beef relative to other commodities since 1968 and the percentage produced at home looks like increasing as a consequence (for cereals from 40%, for beef from about 80%).

16. How can agricultural support policies minimise the damage to trade whilst providing sufficient home protection?

Obviously the deficiency payments system causes less harm to trade than the import levy system. However, both restrict trade. Any new support measures should be fully discussed with the main exporting countries liable to be affected. This will allow them