

# How Necessary is Government Support for Agriculture?

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*William Hynes discusses the reason for government intervention in agriculture and the means by which different countries intervene in agricultural markets. The adverse effects of this intervention are also explored. The author concludes that intervention is a failure from an economic point of view and it fails both farmers and consumers.*

*'Public rights come first, and private interests second'*  
(Theodore Roosevelt)

The agricultural issue has always been an area of controversy – disagreements over agricultural policies almost caused the breakdown of the World Trade talks on the eve of a new Trade Round in Doha. Therefore, it is appropriate to question the necessity of government support policies and the subsequent regulation of agriculture. In most industrialised economies, the European Union (EU), spends \$45 billion a year of taxpayers money on subsidising farmers through the common agricultural policy. The EU protects the market for farm goods to ensure that consumers pay artificially high prices for their food. Despite subsidies and substantial transfer payments, farmers frequently complain of poverty and of a declining standard of life.<sup>1</sup> This begs the question, why do governments favour policies of intervention? This essay will examine the classical arguments for such government intervention in agriculture, highlighting the inherent problems, which make agriculture a special case. The methods of intervention will be considered, with particular emphasis on the Irish beef sector compared with the New Zealand model of agriculture, in which farmers operate with minimum interference. Some of the adverse effects of intervention will then be addressed, before finally coming to a conclusion on whether U.S Secretary of Agriculture Dan Glickman was right when he described *'completely free agricultural markets as a purely academic concept'*<sup>2</sup>

## Classical Arguments for Government Intervention

There are unique problems inherent within agriculture:

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<sup>1</sup> The Economist: "Ploughshares into swords" Oct 21<sup>st</sup> 1999

<sup>2</sup> Franz Fischler, Speech at Congress Verona, 24 September 1999

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- Many of the variables that dictate agricultural output are out of the control of the producers. *'Agricultural products are susceptible to price fluctuations arising from the fact output cannot be immediately adjusted to current market prices: this can give rise to a cobweb-type cycles.'*<sup>3</sup> This means it is difficult to plan ahead.
- Engel's Law indicates that *'most agricultural output is part of the food budget of citizens and income elasticities are therefore low'*<sup>4</sup>, the agriculture industry depends on population growth however agricultural output is increasing at a far faster rate than population growth.
- There is limited labour mobility meaning resources are trapped within farming. Due to the declining efficiency of farming relative to other sectors incomes are further depressed and not helped by the price cost squeeze.
- Livestock are susceptible to disease, evident in the BSE scare and the foot and mouth crisis, this can leave farmers vulnerable.

Thus the "farm problem" is the primary reason for support of agriculture. Murray Benedict (1955), identified the farm problem with *'the whole array of grievances and aspirations that cause farmers to seek government aid'*<sup>5</sup> In the European model of agriculture, multifunctionality is another key argument for support; the term refers to any unpriced spillover benefits that are additional to the provision of food and fibre. Claimed benefits range from environmental values, rural amenities, cultural values, rural employment and rural development.<sup>6</sup> Much of the current rationale in Ireland is based on the fact that benefits accrue to a society from the achievement of social objectives. Economists cannot quantify their value. Winters (1990), analyses the economics of the officially stated case for agricultural support, what he terms the "So-called Non-economic Objectives". He found that while certain justifications for agricultural intervention exist, they are very specific e.g., disaster insurance may need subsidisation, rural amenities may require support, and

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<sup>3</sup> McDonald and Deardon, 1999: 282

<sup>4</sup> Pelkmans, 1997: 164

<sup>5</sup> Gardner, 1992: 64

<sup>6</sup> ABARE August 1999 "Multifunctionality: A Pretext for Protection"

official inventories may contribute to national security. These would not be provided in a market economy. Market failures provide a case for some kind of government intervention either by direct provision or through subsidisation. However, government failures may lead to an even more inefficient outcome than imperfect markets. Some commentators believe that farm policy is *'better explained by the success of agricultural groups in using governmental power to increase their own wealth'*.<sup>7</sup> *'In farm programs, the benefits are concentrated on a relatively small number of producers or landowners, while the costs are widely diffused among taxpayers and consumers - the basis inherent in the political process which favours small groups at the expense of the public at large'*.<sup>8</sup> The optimal degree of government intervention must balance the prospective gains against the potential implementation problems. Winters believes that agricultural policy is an economic issue and is wasteful, and that the justification is entirely political. He also contends that more often than not policy is harmful to its declared objectives.<sup>9</sup> While different governments use different rationales in justifying intervention, one factor is usually consistent, *'given the stated objectives of governments and the varieties of means to achieve them, agricultural policy is very inefficient.'*<sup>10</sup>

## Ireland

Even after a number of years of exceptionally high economic growth primary agriculture still accounts for 6.2% of Irish GDP. In comparative terms agriculture is nearly three times as important to the Irish economy as it is to the EU economy as a whole. *'Nobody should be surprised therefore that the future well-being and prosperity of agriculture is a matter of major concern at every level of Irish life'*<sup>11</sup> Beef accounts for 33.2% of Irish agricultural output. While for the purposes of this essay I will be concentrating on the beef sector, it should be noted that:

- It is impossible to examine the effects of liberalising the beef regime in Ireland in isolation from reforming policy in the dairy, cereals, sheep and other sectors.

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<sup>7</sup> Pasour, 1990:

<sup>8</sup> Pasour, 1990: 18

<sup>9</sup> Winters 1990

<sup>10</sup> Winters 1990

<sup>11</sup> Joe Walsh, Minister for Agriculture and Food 26<sup>th</sup> March 1998

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- Irish beef policy, especially as it applies to farmers, is EU policy. Irish beef farming is particularly sensitive to changes in EU policy: *'Any fall in price in the EU is magnified in Ireland given its position as a major exporter.'*<sup>12</sup> The aim of Agenda 2000 was to make the beef sector more market driven to make EU prices converge with world prices. The accumulation of intervention stocks was one of the main motives for reform. The period 1997 – 2001 was a tumultuous time in Irish agriculture. In particular the beef sector has been hit by large shocks (such as the BSE scare and the Foot and Mouth crisis), and has had to adjust to large-scale policy changes within the EU. The current support system is composed of direct payments. Agenda 2000 increased the value of payments and the increases were sufficient to offset the drop in market returns. The current support system is much better than it was, but Winters (1990), identifies two problems that farmers have with direct payments. Firstly some regard it as charity. The previous system was no more than covert and inefficient charity, with wide ranging negative externalities. Secondly direct payments are seen as a very expensive option. In budgetary terms, yes, but in economic terms they are much cheaper than market support. Overall the move towards direct payments is a step in the right direction, but what about the effect of a total dismantling of government support? Dr Kevin H Hanrahan of Teagasc, a leading economic researcher on the beef sector, gives his views on the prospects for this sector, should it be exposed to an environment of no subsidies? So long as there is a dairy industry there will be some beef production and a beef industry per se. Given Ireland's climatic advantages in growing of grass I would expect that even in the event of a very radical reform of EU beef policy that some specialised beef producers would remain in business. Are Irish beef producers ready for an environment where they receive little or no support from taxpayers or consumers? Most analysis would indicate that in the short term many would face severe difficulty. Farmers become addicted to government support. In Ireland, Teagasc estimates that 72% of beef farmer's income in 2007 will be in the form of direct payments. Such dependency is risky for farmers, as their livelihoods can be changed by unpredictable and uncontrollable changes in government policy. This has happened in New Zealand (NZ).

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<sup>12</sup> Binfield et al 2001 : 1

## New Zealand

In the mid eighties, New Zealand embarked upon a program of enormous reformation and restructuring, embracing a market-oriented economic philosophy. A key tenet was that economic efficiency would be optimised if markets were allowed to develop and operate with a minimum amount of government intervention. Government assistance to the beef sector had existed for decades in NZ and was intensified to very high levels in the late 70s and early 80s. Assistance to farmers occurred in the form of output price (supplementary minimum prices), but also on inputs like fertiliser, pest control, and low interest rates. This high level of support was unsustainable and with the NZ economy running into difficulty in 1984, a new government transformed its agricultural policy by removing all direct subsidies within two years. This represented a tremendous shock and an important response to the reforms was an exit response. Many farms went out of business; the beef sector being one of the hardest hit. NZ farmers responded to policy reform by shifting away from producing traditional crops to more non-traditional crops. Beef farming declined, while fruit, vegetable and horticultural products became increasingly prominent. Those who survived were quick to respond to the economic conditions and the dire consequences predicted for the beef sector did not materialise. The reorganisation of how beef farmers ran their businesses was an essential requirement for survival and this transition was not costless. A lower level of support for the beef sector meant that production fell, even when international prices were relatively good. As a country, New Zealand lost out. Land prices collapsed dropping by 40 – 60% from their peak in 1982. Had other countries deregulated agriculture in a similar manner to that of NZ, farmers there would have been much more competitive internationally and land values would not have declined so dramatically.

### Several Lessons were learned about the nature of farm support <sup>13</sup>

- Levels of support altered the way NZ farmers farmed.
- Prices increased as support was capitalised into land values. This created a debt problem as farmers borrowed against this apparent equity using income supported by government. Farmers often farmed for capital gain rather than for farm profitability.

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<sup>13</sup> Ministry of Agriculture and Food New Zealand Publications: “Reform of NZ Agriculture”

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- NZ farmers were insulated from international prices; both for the products they produced and for the inputs they used.
- They had no way of knowing what the actual international prices were, and that NZ farming was not in line with international requirements or prices. This was a very bad situation for a country, which exports around 80% of its agricultural output.
- Government carried the risk of wrong or poor decisions because, regardless of what farmers did, they were still paid. This cost taxpayers a lot of money.
- NZ gradually lost international competitiveness.
- Most importantly, NZ farming is now stronger in a deregulated economy than it was when supported by the government. Farmers now produce products consumers want. Inputs are used more efficiently and wisely. New Zealand farming decisions are now based on actual prices paid for farm products on international markets. This has reduced the risk of reliance on government support. It has improved efficiency and made NZ farmers focus on consumer requirements. Knowing that consumer needs must be met has improved marketing and strategic planning. In short, the NZ experiment has been a success. *'The NZ experience does indicate that farming without price supports is possible, and not as unhealthy as many had feared'*<sup>14</sup>.

### Key Points from New Zealand's Experience<sup>15</sup>

- In a market-driven economy, farming must be based on the prices consumers are willing to pay.
- The process of reform must take a whole economy approach and be based on a strategic assessment of how to reach the desired outcome.
- Government intervention in New Zealand created unsustainable farming.
- Farmers and rural communities responded to well developed and integrated

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<sup>14</sup> Tronstad 1996

<sup>15</sup> MAF NZ "Reform of NZ Agriculture" Chapter 11: Summary of Key Lessons Learned in New Zealand When Moving from a Regulated to a Deregulated Economy

government policies once they perceived these would lead to sustainable benefits.

- Slow responses from large organisations delayed benefits to farmers.
- Bureaucratic reform must be driven by purpose for the organisation.
- As a result of exposure to international market prices, New Zealand farming has become more responsive, more efficient and internationally more competitive.

New Zealand's experience shows that it is possible to go from a heavily supported and controlled agricultural sector to one which is fully market driven and which has no government protection.<sup>16</sup>

### **Adverse Effects of Intervention**

In addition to the high cost there are also additional adverse effects of intervention, many have been highlighted by the NZ experiment as described above.

- Under the old Common Agricultural Policy (CAP) system, because export subsidies were paid, large amounts of beef were held as intervention stocks. The cost of preserving the beef was prohibitive and amounted to enormous waste. But with recent reforms, surpluses of beef have been reduced to manageable levels.
- The current direct payments scheme to beef farmers is inequitable, with a small number of farmers receiving the majority of payments. Given that consumers have to pay for this, current farm policies 'not only reduce societal welfare but are also grossly unfair'<sup>17</sup>.
- Incentives can encourage farmers to farm specific crops. In NZ, initially forestry was encouraged by a grant, but was later discouraged by changes in taxation. Forestry is now, however, very profitable and new tree plantings are increasing.

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<sup>16</sup>MAF NZ "Reform of NZ Agriculture" Chapter 11: Summary of Key Lessons Learned in New Zealand When Moving from a Regulated to a Deregulated Economy

<sup>17</sup> ABARE: US and EU agricultural support

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- Negative spin-offs in the economy have resulted in the servicing sector becoming less efficient. Because farmers receive good prices, the service sector may have the view that farmers can "afford" to pay more for fertiliser, transport and processing costs. This discourages these firms to become more efficient. Less technology is introduced, as there is little incentive to do so. Much of the support paid to farmers was actually captured by processors.
- Support linked to production will make farmers strive to produce as much as they can. This can have harmful effects on the environment. De-coupled support including direct payment still has the same perverse incentives. Also it must be acknowledged that the multifunctionality of agriculture has considerable negative externalities in addition to the positive ones.
- While the effects above are largely domestic, there is also a wider liability to consider. Government support distorts trade and makes goods produced by inefficient farming practices competitive on the global market. This penalises countries like NZ who are efficient, but whose farmers do not receive the same level of government assistance. Third world countries lose out as they depend on the export market for their very survival. The costs of domestic farm programs extend internationally.

*'Clearly agricultural support has been neither in the national interest nor justified by widely held perceptions of social justice'*<sup>18</sup> The *'adverse side effects of farm programs will be eliminated only when the incentive to produce for the government is replaced by the incentive to produce for the market.'*<sup>19</sup> The New Zealand beef sector in particular highlights the transition problems. The important thing is that beef farming there has survived. Agricultural Economist Dr Robin Johnson, was instrumental in planning the changes in New Zealand. He believes the route chartered by the country is the most sustainable and economically sensible way forward for farmers now living with the CAP. *'Subsidies could be phased out in a reasonable way and some of the money saved could be used to encourage farmers to consolidate, try new ventures or seek new ways of making a living'* he said.<sup>20</sup> History has shown that education and retraining, not protectionism is the solution to flagging competitiveness. It is doubtful that Ireland could ever be as efficient as

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<sup>18</sup> Harvey and Ritson 1992

<sup>19</sup> Pasour, 1990: 248

<sup>20</sup> BBC News "European farmers look to New Zealand" 24<sup>th</sup> August 2001



New Zealand, given NZ's natural advantage in land quality and weather conditions. It is probably true that Irish farmers were more efficient before CAP, which has encouraged farmers to farm in a rather unnatural way. CAP has put Irish farmers in a straightjacket; its removal could be the incentive to make them strive for efficiency once more. Unfortunately there would be huge transition problems involved in such a policy change. However dealing with these problems would not be as difficult as trying to achieve the political consensus necessary to base agricultural production and marketing decisions on market signals.<sup>21</sup>

## Conclusion

If government intervention policies in the beef sector proved effective and efficient all of the time then there would be a strong case for the necessity of such policies. However, in reality intervention sometimes fails and in some cases makes matters worse. From an economic point of view, farmers should be forced to take their chances on the open market. Let the market decide the winners and losers. *'If the policy is to keep beef farmers,(in the main), in business then the current policy would appear to be a successful one. If, on the other hand you consider this objective to be too narrow and think that some other objective is more important then it would be easy to conclude that the current policy is ineffective'*<sup>22</sup>. But in looking at only the economics of the policy, we would be writing off the social, cultural and psychological benefits from farm policy. Just because it is costly does not mean we should simply walk away letting a community and a tradition, which is at the very heart of our society die. Recent events such as the California Power Crisis and the Railtrack fiasco show us, government deregulation is not always the answer. Beef farming has become more efficient in this country due to reforms forcing this to happen. The elements of such reforms should be considered, rather than simply subscribing to the beliefs of what Robert Peel once described as *'the harsh cold blooded economist, regarding money as the only elements of national happiness.'*

In conclusion: Theodore Roosevelt once said, *'Public rights come first, and private interests second.'* It could be argued that the maintenance of the rural environment and preservation of the farmer's way of life are public rights. With rights come responsibilities and indeed, it is quite a high cost in monetary terms, but it is also a

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<sup>21</sup> Pasour, 1990: 249

<sup>22</sup> Dr Kevin F Hanrahan of Teagasc

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reflection of our “kinder, gentler” society. The way the general public rallied around the farming community in the midst of the Foot and Mouth crisis surely makes this point explicit. Other sectors such as tourism suffered but while farmers were generously compensated, tourism received only modest support. The special treatment of farm policy has been a recurring theme in this essay. In my opinion the issue of intervention in agriculture is a political one. It is strange that given its declining importance in the Irish economy, the farm lobby still has so much influence on EU policy. Agricultural policy therefore can be viewed as the private interests of the farm lobby coming first. This is at the expense of the public rights of consumers to pay lower prices for their food, and the rights of efficient producers abroad to compete in European markets. Overall the necessity for government support is ambiguous but the New Zealand experiment represents an important lesson for agriculture – it shows that governments might make their greatest contribution to economic stability by attempting to do less.<sup>23</sup>

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<sup>23</sup> Pasour, 1990: 245

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