

Guth, Eckart

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Eckart Guth\*

## Agriculture in Eastern European Countries: Light at the End of the Tunnel?

*Following recent events in East European countries the question has arisen as to what effect the possible changes in the agricultural policies of these countries might have on agricultural production and trade. Our author addresses this question paying special regard to the consequences for EC agriculture and the present GATT Round.*

Nobody is qualified to become a statesman who is entirely ignorant of the problem of wheat" (Socrates). The wisdom of this saying seems to be borne out by recent events in East European countries. The food supply situation is an important internal factor in the reform process and will certainly be considered by the population as an essential yard-stick for the success or failure of the reforms. All political leaders and parties will therefore have to put great emphasis on the question of agricultural production and trade. The analytical work which has been done up until now was based on the assumption that the existing political system would remain in place in the East European countries and that improvements in agriculture would have to be sought within that system.

Almost no work has been done so far on the consequences of market-orientated agricultural policies and the implications these would have on trade between East and West European countries. The following reflections must therefore be considered as a starting-point, which will no doubt need to be completed with more in-depth analysis at a later stage.

### Some Historical Lessons

Just as Western industrialized countries had to ask themselves, in the context of increasing surpluses and agricultural trade problems, "What went wrong in the 70s?" (US Secretary for Agriculture, Block), the Eastern European Countries for their part, but for just the opposite reason, have to answer the question, "What went wrong over the last four decades in our food complex?" A look at the world grain trading routes of today and those of a hundred years ago clearly indicates how much the grain trade has changed over the last

century. While the East was traditionally the bread basket of Europe, it has nowadays developed into a major market for grain. It is interesting to note that the change began with political turmoil: "In the year before 1914, Russia was the world's largest wheat producer and exporter and British India was an important supplier to Europe. After the war, Russia became caught up in civil war and revolution and India's growing population finally began to absorb its surplus grain. Neither country's wheat was ever again a significant part of Europe's food supply."<sup>1</sup>

Although the Balkan states were big suppliers of cereals (Romania was one of the world's largest producers of corn), the continual political turmoil meant that the situation there became even less conducive for foreign enterprise and traders.

As a result, the countries of Eastern Europe have (with few exceptions – notably Hungary and the GDR) problems in the food sector. While countries like China and India were capable of overcoming their serious food problems and were both even capable of exporting wheat to Russia at one stage by increasing their production, most East European countries have continued to face severe food problems. It seems that proper market incentives, along with economic and political stability, contributed most to the upsurge of food production in both the above-mentioned developing countries.

### The Bad Example of Soviet Agriculture

Although the natural, structural and economic conditions of agriculture in the Eastern European countries differ considerably, the fundamental problems of socialist agricultural policies are largely the same.

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\* Commission of the European Communities, Brussels, Belgium. The article represents the author's personal views.

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<sup>1</sup> D. Morgan: Merchants of Grain, New York 1980, p. 65.

They are perhaps best demonstrated by the bad example of Soviet agriculture. By the mid-1970s the USSR had become one of the largest importers of agricultural products. Since the 1980s the USSR imported each year between 20 million tonnes and 55 million tonnes of grain and considerable amounts of meat, sugar, butter, oilseeds, fruit and vegetables. This import surge went in parallel with tremendous efforts by the USSR to improve the productivity of its agriculture and food complex. Official statistics – for what they may be worth – indicate that:

- ☐ Soviet citizens are eating more (and better?) today than 10 or 20 years ago;
- ☐ the production of agricultural machinery has increased;
- ☐ fertilizer use is higher than in comparable areas of North America.

The Soviet consumer would probably be very surprised if he knew how well off he is in statistical terms. All this does not mean in the least that the USSR food and agricultural industry is out of the woods. On the contrary:

☐ Signs of food shortages are becoming more and more evident. The problem of short supply is further aggravated by the fact that controlled retail prices on the one hand and increasing incomes on the other hand do not allow the market to find its equilibrium. Where food is distributed through state stores at subsidized prices, the result is inefficient use and even wastage of food, despite overall shortages.

☐ The large amount of machinery produced by Soviet industry seems to be of low quality.

☐ The low standards of post-harvest food-handling lead to huge losses. According to some estimates about 20% of grain production is spoiled each year due to poor techniques in harvesting, drying, transportation and storage. It would appear that it is easier to import these quantities than to tackle the roots of the problems.

☐ Similar insufficiencies exist in the distribution system. The problem has grown to such an extent that financial, industrial and research resources are increasingly being transferred from the military complex to the agro-food complex.

☐ Heavy investment in the food processing industry, resulting in increased overall capacity, proved to be inefficient for a variety of reasons: poor quality of equipment, a lack of agricultural raw materials because of transportation problems or incorrect location of plants.

☐ In spite of tremendous economic and political efforts (creation of Kolkhoz and Soukhoz, large scale irrigation, cultivation of new land) growth in production did not meet the overall demand for basic food products. It is interesting in this context to note that agriculture in Canada, which in some areas faces equally hazardous weather conditions and has also to put up with infrastructural handicaps such as long-distance rail haulage, does so much better.

From the purely structural point of view, one might expect that Soviet agriculture, with its large-scale production units, is well placed for efficient agricultural production and marketing. It seems, however, that sheer size is not the only condition for efficient agriculture. Appropriate market and price signals, the freedom to reinvest the profits from production as well as individual responsibility and incentives are of no lesser importance. The latter aspect is of special importance in agriculture, where the results of a particular year may virtually depend upon very swift decision-making (for example in the case of plant and animal diseases).

On top of the above problems, Soviet agriculture has to face the following serious problems of soil fertility, which are largely due to inappropriate production methods:

- ☐ loss of organic substance;
- ☐ inadequate nutrient composition;
- ☐ inadequate irrigation (quality and quantity of water);
- ☐ soil erosion.

Thus, within the past 15 years, the area of eroded land in the USSR has increased by 26 million hectares and caused serious damage to crop yields.

Although, in principle, agriculture in the other East European countries faces problems similar to those of USSR agriculture, there seem to be differences in some important aspects.

Thus Polish agriculture is still characterised by rather small family farms with large labour forces available. If price and market signals were to be properly provided, one would expect that agricultural production would improve considerably, even with very little capital investment. Family farms would probably prove to be best suited to sudden changes.

In Hungary, the agricultural sector has responded to the liberalisation policy and Hungary is already in a position to reap some benefits by being a net food exporter.

Agriculture in the GDR seems to be able to provide basic foodstuffs to the population. With large-scale

agriculture, good natural production conditions and less severe infrastructural problems than in the USSR, the GDR might be the country where a certain capital injection into agriculture (machinery, food processing) would show the most rapid results in terms of increases in production.

Romania and Bulgaria are two countries with good natural conditions, where a considerable number of family farms could provide the backbone for an increase in agricultural production. However, especially in Romania, much of the production and the potential increase would be needed to feed the population, and it would be some time before exports started to pick up again.

### Conditions for Change for the Better

The conditions for change for the better are best described by an insider, who spent much of his career as a minister for agriculture. According to Mr Gorbachev, the following principles should guide the reform of Soviet agriculture:

☐ give farmers control of their own land on a secure basis;

☐ introduce "equivalent" trade between agriculture and the rest of the economy and between town and country (this equivalence is not defined and there is no clear commitment to any practical course of action);

☐ switch from interventionist to democratic management of the sector, on the basis of initiatives and decisions by basic production units;

☐ ensure a major improvement in rural infrastructure;

☐ implement radical improvement of living and working conditions in rural areas.

Mr Gorbachev's approach nevertheless does not involve wiping the slate clean.

A central point is that agricultural collectivism is not condemned in principle, since it is regarded as an economic and social necessity and as having "great potential", and has given positive results in a small number of cases in the USSR and other socialist countries.

As in other political fields much will depend upon the speed with which further liberalisation can be introduced. The most delicate question will be how to change from a planned economy with heavily

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The number of developing countries with which the IMF and the World Bank have made structural adjustment agreements has increased rapidly in the eighties. At the same time the discussion on the conflicts arising from such adjustment programmes has been greatly intensified. On the premise that the success or failure of the programmes, the way in which they are conducted and the period for which they can be politically supported, is determined decisively by the activity of interest groups, an empirical analysis of Mauritius was conducted. The example of this small island economy can serve to elaborate the relevance of a broad social consensus for the success of adjustment programmes. (Only available in German.)

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subsidized consumer prices to a market economy. Agricultural reforms which would change the allocation of subsidies or reduce their level but which were not accompanied by improvements in production on the farm and in the food sector, would further aggravate the food supply situation and exacerbate social and political problems.

In view of the huge problems which have to be solved by a process of reform it seems inevitable that such reform cannot be achieved in one fell swoop but will be the result of "trial and error" and the competition of ideas and concepts. This is best seen in the ongoing debate as to whether private family farms or state farms are best suited to solve the Soviet Union's food problem.

### **Private Family or State Farms?**

As more fresh food comes on stream from production on private land which is worked by state farm workers, the idea is to further increase such production by leasing land to farmers and thereby building up kinds of family farms. It must, however, be kept in mind that private farming activities are often taking place in close symbiosis with state farms and are often simply based on parasitism. A separation of the two forms of agriculture would not therefore automatically lead to better production results.

Before the Soviet Union could be in a position to build up a broad base of family farms, they would first have to correct history and create a kind of traditional farm sector. This in itself would take time and would not bring about change and results as quickly as is needed. Against this background, it can be understood that the Soviet Union wants to cut corners and opt for immediate modernization of the large kolkhoz and state farms.

This latter approach would, at least in theory, be equally possible. Besides the necessary political reform, this way would, however, also necessitate rather rapid high capital investment, because it would not be possible to accumulate investments during a relatively long phase of labour-intensive production methods in the same way as is possible on family farms.

The improvement of state farms as an approach towards solving food problems also seems to be the more likely approach, because widespread development of family units on a true leasing basis is not only being opposed by kolkhoz and local officials, but is also encountering inertia and resistance on the part of most collective and state farm workers. This is hardly surprising, since the latter have now been wage earners for several generations. Even more understandable is their general lack of enthusiasm for the rather riskier

venture of "peasant farming". Aside from the supply shortages and risks, the legal uncertainty and the fears that current policy may be short-lived, there is a serious and widespread psycho-sociological barrier.

Except for Poland where family farms are still predominant, it seems likely that large farms, whether privatised or state-owned, will continue to typify East European agriculture and that the agricultural sector will have to be adjusted very much along the lines suggested by Mr. Gorbachev for Soviet agriculture.

The above considerations allow us to draw the following conclusions:

- ☐ East European countries have the natural capacity to be large and efficient agricultural producers;
- ☐ per capita consumption indicates that any possible increases in production would be absorbed for some time by the increased demand in the countries themselves, especially in the USSR and Romania;
- ☐ production figures indicate that an increase in production does not necessitate the invention of new production techniques, but rather the proper application of those existing and easily available;
- ☐ the downgrading of agriculture in East European countries is due to the political and economic turmoil which has prevailed in some of those countries for almost a century;
- ☐ it seems therefore unrealistic to assume that things could change for the better in the short term. The damage done in terms of psycho-sociological barriers, inadequate rural development and infrastructure, loss of professionalism in farming, and lack of entrepreneurship is too large to allow rapid overall results;
- ☐ having destroyed the family farm, which historically has been the basis for rapid agricultural development without a large supply of capital from the non-farm sector, most of the East European countries will be obliged to continue to run large farms and accept that investment capital will not come from the austerity of a hard-working farm family, but will have to be provided by injections from outside the farm sector.

### **Possible Effects on Agricultural Trade**

If policy reform in East European countries and necessary changes in the economy as well as in agricultural policies were to be successful, one could assume that agricultural production would grow faster than in the past. In overall terms, the growth of supply would be accompanied, for some time at least, by an equally growing internal demand for food. Since food

supply levels as well as income are relatively low, one can assume that the income elasticity of demand for food products would be rather high. Therefore, most of the increased agricultural production would be absorbed by an increase in demand.

Increasing demand for animal products (beef, pork, dairy products, eggs) in particular will cause an increase in the use of cereals and cereal substitutes. It therefore seems likely that the East European countries will continue to remain net food importers in global terms for quite some time. In the short and medium term, the political necessity to demonstrate to the consumer that reform measures do have positive effects on food supply may even make it necessary for some countries to speed up imports of agricultural products.

This situation would have a positive feedback on world trade in agricultural products and thus reduce the present tension amongst the major exporters. The fact that the USSR is interested in renewing its long-term contract with the USA on grain imports and that the USSR is increasing its oilseed imports and absorbing more and more cereal substitutes (manioc from Thailand for example) supports the above thesis.

If reform were to become a real success story and if the East European countries were to increase their global self-sufficiency beyond 100 %, then some of the historical trade patterns might reappear again in the longer term.

In such a case, agriculture in some member states of the Community would have to face growing competition on internal and external markets. However, even under this optimistic outlook (from the point of view of East European countries), the overall consequences for West European agriculture and its food industry would not be disastrous. For the foreseeable future, the West European countries will probably keep their comparative advantage in the production of high quality food and, notably, processed food. The Community may therefore benefit in the medium and longer term from the increasing demand for high quality processed food which would result from possible growth of the economies of East European countries.

The above global scenario might leave the impression that everything could be fine in East-West trade in agricultural products. That will, however, not necessarily be the case for a number of reasons:

Firstly, food prices in the Community are amongst the highest in the world (at least in that part of it which is in the vicinity of the East European countries). The East European countries will therefore try to sell whatever they can in order to earn hard currency. That is

particularly the case for countries which already have a certain place on Community markets, such as Hungary and Poland, and for products which benefit from preferential arrangements (GSP). Much will depend therefore on the future evolution of exchange rates and the outcome of the present GATT Round regarding improved market access for agricultural products.

Secondly, the cheap labour and land available in East European countries, in combination with the proximity to the Community market, may inspire some European food companies to invest in those countries, in order to bring about a rapid and large-scale production of certain commodities which could cause problems once exported to the Community. The most recent example is the expansion of mushroom production in Poland, which appears to be based to a great extent on Dutch know-how.

Similar developments are possible in other sectors where the East Europeans already have a certain comparative advantage, such as in Poland for potato starch, geese, ducks, young bovine animals for fattening, or in Hungary for pork meat, or some fruits and vegetables. However, globally the agricultural sector of the Community could benefit rather than lose as a result of the reform process underway in the East European countries.

### Consequences for the GATT Round

In the longer term the Soviet Union and other Eastern European Countries may join countries like Poland and Hungary in the GATT. In the short term the changing situation in the East European countries could influence the ongoing GATT negotiations in two ways – one negative and one positive.

On the one hand, it is likely that farm lobby groups will start to interpret the food supply situation in the East European countries as a worldwide problem and call once again for an increase in agricultural production in the industrialized countries.

As surplus stocks in the Community and throughout the world have diminished considerably, farm lobby groups might once again start a campaign as in the 1970s, when the Club of Rome forecast a worldwide food shortage, and when the developing countries were considered an unlimited outlet for the food produced by the industrialised countries. It was under these circumstances that agricultural production was geared up in the 1970s to the extent to which it has created the problems with which the Uruguay Round is now faced.

If things were to move once more in a similar direction, much of the steam for changing agricultural trade rules

and disciplines would be taken out of the GATT, resulting in little progress, if any at all, in the new Round.

On the other hand, the situation in the East European countries could allow the necessary adjustments in world trade to be made less burdensome for some countries (EC, EFTA, Japan) and allow others to benefit more from the improving world market situation than they could expect from the results of the Uruguay Round alone (USA, the Cairns Group).

If the situation on world markets were to improve due to increasing demand from the East European countries, the gap between world market prices and internal support levels would be reduced, and thus the need and pressure to lower support levels would decrease. Time would thus be gained to make the necessary adjustments in support levels. It would actually be less important to reduce support levels than to avoid contracting parties to the GATT providing new support to production in response to the changed world market situation. A freeze of support levels would enable countries which are more competitive to benefit more from the improving market situation.

Countries with high support policies would not receive production incentives as long as their support levels remained above world market prices. Benefits would however occur in the form of financial savings in agricultural policies.

### **Short-term Effects of Market-oriented Reform**

Following an orientation towards a market economy such as seems to be taking place in Poland has the consequence that sooner or later supply and demand will be brought into balance. Thus, it may be possible that in a relatively short time food becomes available in the market place and that the population no longer has to queue. This immediate effect does not, however, mean that the provision of food is satisfactory from the social and political point of view. Another effect of the price mechanism is that those who cannot afford to buy are obliged to stay away. The increasing number of people from lower income groups in Poland who can no longer buy enough basic foods clearly indicates that this is already happening in Poland, and may soon also be seen in other countries such as Romania.

To provide normal food aid in these circumstances would not necessarily help the right people and, even more importantly, would interfere in a negative way with the creation of a market economy. In this situation it would be appropriate to help with so-called "care-parcels". These parcels could contain non-perishable

products such as pasta, instant coffee, chocolate, preserved soups, butter, sugar, ready to eat meals etc., and could be distributed free of charge to needy people by social welfare centres, churches, the Red Cross or other such organizations. With the European flag prominently displayed on them, these care-parcels would

- ☐ provide food in the least market-distorting way;
- ☐ respond to a real social and political need;
- ☐ render the Community assistance highly visible and politically effective.

### **Conclusion**

In the present circumstances of rapid change in Eastern European countries it is very difficult to make accurate "guesstimates" regarding possible evolution in the agricultural sector. The world has enough experience about the effects of a switch from a market economy system into a socialist planned economy, but little or no experience of turning the clock back in the opposite direction. As the political, structural and economic conditions governing the agricultural sectors are somewhat different from one Eastern European country to another, it is likely that each will have to find its own transitional path. Such a transition will certainly not always be a smooth one. It would appear that the unprecedented challenge of reshuffling both the political system and the economy at the same time can only be carried out at considerable cost. Moreover there is also the risk of not settling on the right reform system at the outset, and having to proceed by trial and error. It cannot therefore be excluded that in a number of cases the apparent light at the end of tunnel does not necessarily indicate the end of the tunnel, but rather the headlights of an oncoming train.

Just as the agricultural sectors in the Eastern European countries have to be adjusted to changing circumstances, Western industrialized countries themselves have to take account of the ongoing process. It seems certain that the changes in the Eastern European countries will create new opportunities in the form of new market outlets for the agriculture of the Western industrialized countries and developing countries as well. However, if trade should be of benefit to all the partners involved, it cannot be a one way street either. The agricultural policy-makers in the Community should try to find a way between the two extremes of optimism and pessimism, keeping in mind that Winston Churchill defined an optimist as someone who sees an opportunity in every danger and a pessimist as someone who sees a danger in every opportunity.