

RURAL ECONOMY

**Working Harder, Getting More Efficient and Losing Prosperity:
Arguments for New Rural Coalitions and Social Contracts**

or

On Getting the Problem Right

Leonard P. Apedaile

Staff Paper 92-01

STAFF PAPER



Department of Rural Economy
Faculty of Agriculture and Forestry
University of Alberta
Edmonton, Canada

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The author is Professor, Department of Rural Economy, University of Alberta, Edmonton.

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Agricultural Trends and Rural Traditions

Canadian agriculture and the rural economy are caught up in the process of global economic integration. This paper argues that new coalitions and contractual agreements are required to keep up with this globalization. The Uruguay Round of the GATT is an example of the effort of the international economy to keep up with global change as various coalitions renegotiate a trade agreement.

Market processes at work on restructuring the rural economy should be supplemented to cope with the concomitant effects of market failure. Coalitions among rural interests, cutting across all sectors from agriculture through to forestry and services can supplement the market. Contracts can link rural and urban economies where markets fail. The window of opportunity for substantive gains from coalitions within agriculture alone is almost closed.

The meaning of rural is changing rapidly. Greenness, countryside, smallness, simplicity and remoteness still convey ruralness. However, the many different types of rural lifestyles and preferences render simplistic rural/urban distinctions meaningless (Fuller et al, 1991). There is now a need to combine identity with one's home and community with the requirement to interact in several places at once to achieve the quality of life expected today. A global awareness of opportunities, risks, competitors and predators is now indispensable for achievement in rural places.

The new Canadian agriculture is becoming less and less important to the new rural economy, and indeed to the larger national economy. Economic linkages for agriculture have been redirected to urban industrial manufacturing and services. Agriculture has been decoupled from rural (Apedaile, 1991). It not only plays a less important role generally, but also in the nineties is increasingly seen to be somewhat of a nuisance as the global economy integrates. This situation is new and troublesome.

Up to about 15 years ago agriculture was accorded high status as a key sector for advancing the national interest. In the best of the European Mercantilist and Physiocratic traditions dating from the time of the founding of Quebec City by de Champlain, agriculture in Canada provided the base for a strong, competitive low cost trader economy. In this century, agricultural products joined fish, forest products and minerals as a major export industry. Agriculture was a leading sector in the industrial revolution and in achieving overall productivity gains in the Canadian economy. Agriculture was the national hearthstone of individualism, thrift, social prestige and the spirit of competition. Agriculture was rural and rural was agriculture.

Rural was still almost the whole economy as late as the early 1800s. Then industrialization, long distance sea transportation and the development of prairie agriculture progressed rapidly. Agriculture and mining joined forestry and fishing as important sources of raw materials for export. Agriculture helped to maintain the

stable purchasing power of industrial wages. However economists foresaw a decline of rural economic activity and a tendency for rural incomes to approach the level of basic needs, the so-called "iron law of wages".

Technology, overlooked by these economists, has so far offset the effects of depletion of the agricultural land and water base. However pressure has mounted for some years on farm incomes and indeed the revenues of all rural resource enterprises no matter how industrialized in forestry, mining and transportation (Freshwater et al, 1991). Much of the pressure arises from global change, some from cyclical recession and trade wars, some from slack operations and some from resource depletion.

Can faster technological change, harder work and better marketing shore up farm revenue in the long run? Will liberalized trade, less government and getting the prices right provide the signals necessary to achieve healthy rural communities? Can wealth be expected to accrue from better technology and greater trade volumes to those who hold rural assets? The answers are far from obvious.

What You Get is What You See

The role for agriculture in Canada is defined by the much larger urban and industrialized economy. The role is to supply low cost food commodities as a basis for stabilizing wages and earning foreign exchange. That economy also defines what it will pay rural people for fulfilling this role and how the price will be determined. Currently, Canadians have chosen to pay through the cash register about the full cost of milk, eggs, poultry, pork, beef, fruit and vegetables. They pay something like the world price for cereals and oilseeds through the cash register and pay for the balance of the cost through subsidies linked to output. They pay little or nothing for countryside amenities and for dumping urban pollution, waste and stress on rural places.

Canadians support the rural economy in other ways. Myriad tax concessions, input subsidies, subsidies for research, development and extension and credit guaranties for exports have accumulated over the years to strengthen the rural economy. The Canadian public also pays the costs of import protection. Each jurisdiction of government has different programs to support agriculture. It is difficult to tell exactly, but most estimates place the aggregate measure of Canadian support to agriculture at close to the US and European levels.

The \$250 billion cost of support to agriculture in OECD countries has become a problem. Canada is one of these countries.

There are several reasons for the problem. Treasury and consumer costs are meeting public resistance. Rural recipients of subsidies and other concessions are increasingly being associated with environmental damage. The design of support programs is an aggravation to larger trade interests. And finally, without support, agricultural economies and related urban industry would be critically wounded. This last reason has fundamental economic roots, whereas the first three reasons arise mainly from problems of design and the economic times in which we live.

The long term need for agricultural support programs is neither well understood, nor well accepted. Nevertheless, classical economists in the nineteenth century explained the theoretical basis for inevitable impoverishment of rural places. In 1959, Prebisch drew attention to the possibility of immiserizing growth when growth in the domestic economy was tied to exports of primary commodities (Ghatak, 1978). Also about thirty years ago a well known development economist, Hyla Myint (1964), observed that a particular relationship between economies and diseconomies of size would lead to impoverishment. The industrialization of agriculture produces this particular relationship. A Canadian economist, Easterbrook (1990), recently deceased, argues that center-periphery theories explain how industrial and commercial central places syphon off income and wealth from hinterlands. Agriculture takes place in hinterlands.

Most of the rural revenue problems which underlie Canadian support to counter the impoverishment of agriculture may be laid at the door of technologies which offer economies of size with reduced enterprise flexibility. The aggregate long run cost structure for most agricultural commodities behaves like those for electricity, telephone services and natural gas, classic public utilities. Price and quantity decisions in Canada are not left to the market place for these latter commodities.

Agricultural producers with highly industrialized enterprises can, with some organization, and do exercise monopoly powers over the pricing and setting of output levels, as is the case for supply managed commodities. In Canada these powers are supervised. Agreements between producers and consumers have been negotiated politically and expressed in legislation, to govern production of safe, high quality products at something like full cost pricing. Europeans have expressed interest in these types of agreements to shift their burden of agricultural support to consumers from taxpayers and to reduce the aggravation to international trade created by surplus disposal measures.

For the case of grains and oilseeds, the same kinds of economies exist. However, these producers are unable to exercise monopoly power because most of their output is exported in markets with other major players. The world's grains players, like those involved in oil, coffee, copper, tin, cacao and the production of many other primary resource commodities, have been and will continue to be unsuccessful in forming a cartel.

Each Canadian cereal farm can do better only by working harder, industrializing further and becoming part of the collective competitive effort by the Pools, grain companies, railways, ports and the Wheat Board to secure a stable share of the world market. The result in Western Canada is farm consolidation, rural depopulation and concentration of ownership of land.

On the plus side, global food security in cereals is being assured on average, generated in part by greater efficiencies in the Canadian grain system. Nevertheless, even at low world prices, poverty precludes food security for over a billion of the world's population. There seems to be no price low enough to be 'right' in the sense of food security.

In summary, farms in most countries of the world are either subsidized or form the large part of those denied food security for reasons of poverty. Maybe the classical economists were right. The "iron law of wages" really does apply to agriculture, even when rapid technological advance is taken into account. Certainly, the industrialization of agriculture is globally helpful in terms of food security. However, it tends to impoverish agricultural enterprises because of disproportionate economies of scale. Industrialization also reduces the proportion of inputs attributable to farm households and therefore reduces their claim against value added through hard work and risk taking.

How Does all This Complexity Work?

The linkages among the parts of the economic system are similar to those that bind predator and prey. Competition or cooperation may prevail at times, but mainly as part of a strategy of predation (Apedaile and Schilizzi, 1992 forthcoming). The term predation is not used here in any sort of derogatory sense, but in an ecological sense. Economic predation is largely made possible by differences in technological economies of size. Excesses by economic and social predators are limited by democratic institutions.

The relationship between agriculture and the manufacturing sectors appears to be one of predation, where farm firms are the prey. The same farms in turn often display predator behaviour with respect to their land, water and biological resource base. Human and institutional predation is the origin of pressure upon the environment.

The unique feature of predator prey relationships is the mutual need of one for the other. Thus the prey may be deprived, but not to the extent that it doesn't persist. Otherwise the predator is put in jeopardy. Subsidies and other support programs are in part an attempt to maintain the farm prey. It is in the interests of the urban workforce, manufacturing and industrial firms and of political parties to protect their long run interests as predators. These programs are also in part a consequence of successful rent seeking by agricultural lobbies. In this sense, rents are an economic return to a particular status or power, even possible for a prey, however acquired.

Price guarantees with or without supply management tie the protection of the prey more directly to the predator, a sort of predator-pay concept. The structure of EEC agricultural supports includes a greater measure of predator-pay than does the support structure in Canada. Here, farm support programs are largely paid for by taxpayers as a form of equalization payment.

A most interesting aspect of the effect of globalization on predation is the heightened role of competition in predation strategies. Competition, unlike predation sees no mutuality in the relationship between trading blocs, nations and firms. Competition is Darwinian, winner take all behaviour. Successful competition ends with a monopoly. Competition determines that only the cost of eliminating a foe or the benefit of cooperation, usually temporary, could prevent cut-throat behaviour over market shares. Of course such behaviour is generally unacceptable on a large scale. Thus the role of government in global arrangements is likely to increase to prevent jeopardy to the stability of the interdependence arrangements among countries and firms.

Economic globalization introduces a second new dimension into the predator argument. Economic integration requires both the larger economy and the rural economy, including agriculture to open up to offshore considerations. Any trend to complacency in domestic economic life is reduced because globalization steadily releases an economy from its national rules and traditions. Rural economies gain access to global financial markets. New non-Canadian partners with new expertise and

market access become available. Captive markets here and abroad are released to the freedom of competition. Flexibility and initiative grow more important to success than ever before.

The rub is that all inputs are not mobile enough to benefit from the opportunities offered by globalization. Just as before in the more closed pre-globalization stage of development, the least mobile are forced to take lower incomes. So land, natural resources, land improvements like farm buildings, special purpose equipment and older farmers are forced to take lower incomes.

Perhaps the tie which contributes most to binding farm families to a specific place is the special agroclimatic knowledge of the farmer and the accumulated artisan skill of farmers in managing the risks and uncertainties of that place. Automation of the input assembly and management process, especially in grain and ranching enterprises, would seem to preclude the economies of size available to their industrial and servicing associates. Thus farms may expect continuing pressure from globalization.

Mobility, though a tradition for a country built by immigrants, and a long standing feature of the rural economy, is nevertheless a last choice for most people. Communities resist folding. People argue that their offspring should not have to move away to earn a living. These form part of the norms of our society. Fulfilling them comes at the cost of efficiency gained through the mobility of others. Nevertheless efficiency is but one of many objectives in most societies. So preserving rural communities and maintaining rural postal service may be costs willingly assumed through negotiation with taxpayers.

The gains from globalization may be expected to follow those who can take advantage of economies of size. New sources of efficiencies arising from globalization are very powerful forces to be reckoned with, especially those rooted in economies of size. Information and distance reducing technologies are just two examples relevant to rural entrepreneurs. Gains arising in efficiency can be protected by avoiding external costs such as pollution, health care, product safety and human rights which could otherwise convert economies to diseconomies. These are the fundamental issues underlying negotiations over level playing fields for trade.

Free trade arguments are based on the principle that gains in efficiency from specialization and economies of size result in a positive sum game for all players large and small. Bluntly speaking, however, negotiations conducted within a predator prey framework, not economic trade theory, determine the outcome of globalization for rural places and people. Specialization in undifferentiated commodities, such as

cereals, tends to reduce the flexibility of a rural economy as it attempts to integrate into the global economy. These issues are the subject of new strategic trade theories which are attracting growing interest as economists try to fill major gaps in the conventional theory of comparative advantage which underlie current trade negotiations (Krugman, 1986).

The final argument to help unravel the complexity of rural economic problems is the absorption in rural places of certain costs of urban industrial central places (Freshwater et al, 1992 forthcoming). There are many examples of this form of urban predation. Rural places absorb, through lower wages, rents and returns to capital, many of the downstream adjustment costs of technology, shifts in consumer preferences and economic restructuring. Rural spaces process industrial waste and pollution with their crops, grasslands, forests, lakes, streams and marshes. Rural places provide landfill sites and golf courses. Rural places must also take on the stress and institutional dislocation of serving urban people who take over rural communities and their institutions with secondary homes, tourism, hunting, fishing and country driving.

These externalities are the costs of private urban enterprise and urbanization which are not captured in the market behaviour of the economy, but which can be removed geographically to rural places so as to protect urban wealth and quality of life. Processing these externalities within the rural economy constitutes production of a public good for which the urban end user is amorphous, remote, and therefore unpaying.

These issues of public goods, predator prey relationships and technology are intertwined. The rural economy is producing more than it is being paid for. Predation relationships with the larger national economy are distributing the gains from ingenuity and work away from rural enterprises. Subsidies are transferring increasing amounts of urban income to agriculture, forestry and other rural businesses. Quotas, tariffs and subsidies are distorting economic signals and promoting surplus production. Globalization of the economy is overlaying the whole rural economic system with both new opportunities and uncertainties.

In Conclusion

In conclusion, nothing in globalization would change the tendency of technology and predator prey behaviour to impoverish farm households and natural resource endowments. Nonetheless, the national arrangements of Canada, the USA, the European Community, Japan and other countries to protect agriculture by border measures such as quotas and other barriers and by internal subsidies will have to give

way to new arrangements which go to the roots of the problem. The new arrangements include broad coalitions of rural interests to extract corrections for predation and to negotiate economic and social contracts to recover the costs of public goods supplied by rural economies to urban economies.

The tap root of the problem is technology. Technology determines the relative economies of size between agriculture and its partners and therefore the nature of predator prey relationships. Two approaches appear to be required as rural industrialization proceeds, as it will. The first is to promote adjustment and flexibility for individual enterprises and in the rural economy as a whole. The second is to put in place a system of equalization payments to correct for the effects of predation. These approaches do not interfere with efficiency processes.

One means of financing flexibility is multilateral taxation of the use of new technologies to moderate their introduction and at the same time generate funds to compensate for dislocation and immobility. Another way is to reorient research and development to questions of flexibility in production processes and management. Equalization measures should be funded by progressive taxation.

The worst possible approach, faced with globalization, is to reinforce rigidities and immobilities. Nothing can stop human learning, whether by predators, prey, competitors or cooperators, which after all is what technology is all about.

The lateral roots to the problem are market failures which allow urban populations and manufacturing to dump waste and social stress upon rural places. Rural places provide countryside amenities to urban people. Rural enterprises and governments currently produce these services at little or no charge to the user. Users could be converted to willing buyers through contracts negotiated by rural coalitions.

A social contract could capture a payment structure for supplying these amenities and for dumping of wastes. France and Germany are among the forerunners in stabilizing rural communities and incomes with contracts to maintain heritage sites and a pleasing pollution free countryside for recreation. This kind of social and economic contract is particularly important for mountainous areas, remote places and areas close to urban concentrations, none of which are so suitable for agriculture, particularly under global competitive conditions.

The last but all pervasive hair roots of the problem are the market driven predations of agriculture upon the environment, and of industry upon agriculture, to the detriment of producers and consumers alike. This source of the problem, wrongly attributed to competition, extends beyond technology, to transactions within the food

chain. Generally any regulations and government participation to address this problem distorts markets, resulting in loss of efficiency paid for by consumers and the environment alike. However, current departures from the artificial, though appealing model of perfect and free competition also introduce efficiency losses.

The ideal approach, though so far not very successful, seems to be to manage the form and extent of predation in the rural economy. Competition legislation and its enforcement, and public utility boards could be used more effectively to supervise supply management, and the food processing industry where economies of size prevent the operation of competitive markets.

It is not in the interests of any of the parties involved in rural economies worldwide to have domestic prices get widely out of line compared to those in alternative markets. Attracting political heat and foreign retaliation puts into jeopardy sovereign solutions to the complex tradeoffs between efficiency, regional and social objectives. Rarely has this point been so evident as with the GATT negotiations now trying so hard to keep up with the realities of technological and economic globalization.

Useful readings

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