

English summaries

LAURI KETTUNEN: *Agricultural policy in Finland: how did it happen?*

Agricultural policy in Finland has in recent years come under strong criticism. Domestically, the criticism has focussed on high food prices as well as on the high level of government subsidies paid to agriculture. From abroad the Finnish agricultural policy has been criticized for its high degree of protection.

Although the regulation and protection of agriculture started already in the early years of Finland's independence, comprehensive price regulation became a rule as late as in the 1950s. Since then producer prices have been determined in the negotiations between the government and the producer organisations. This mechanism has guaranteed full compensation to producers for all increases in input prices. Although producer prices have in the long run risen roughly at the same rate as prices in general, the price formation process within the agricultural sector as a whole has been artificial and largely unaffected by market forces. Price regulation may have been beneficial to agriculture, but its negative consequences elsewhere can hardly be denied. It

may have reduced incentives to rationalize production. In addition, it may have contributed to unnecessary rises in input prices, because sellers know that buyers receive compensation for all cost increases.

Excess production of a number of products has been a major problem since the 1960s. Efforts to balance production and domestic consumption have brought about extensive legislation and bureaucracy. This has further restricted possibilities for farmers to act as entrepreneurs. Inconsistency has been characteristic of efforts to restrict production. For example, temporary reductions in production have often led to relaxation of production ceilings, although the authorities should have been able to foresee this over the short-term.

The government subsidies to agriculture can hardly be defended by economic arguments. Non-economic arguments, such as employment policy or regional policy, as a justification for agricultural subsidies can be questioned, because the same employment or regional effects could be achieved by other measures at a lower cost. Self-sufficiency is the only acceptable argument for support, but it is no defence for excess production.

ANTERO TUOMINEN: *Why should the agricultural policy be changed: the need for international and domestic policy reforms*

It is argued that the need for international agricultural policy reforms has arisen because of the large trade diversion and budgetary problems created by the EC agricultural policy. The trade diversion has been especially damaging for many LDC's. Consumer interests and the experiences from the US agricultural crisis of the early 1980's also call

out in favour of reforms. In Finland consumer food prices are much higher than in other countries and thus consumers are pushing harder for reform than elsewhere. The reform must tie domestic prices to international prices by abolishing the systems of import quotas and variable duties. To avoid unnecessary damage to the agricultural producer a temporary relief in the form of direct income support is needed. This relief must not be tied to the level of production.

EWA RABINOWICZ: *Abolishing Agricultural Regulation the Swedish Way*

A fundamental reform of agricultural policy will take place in Sweden on July 1, 1991. The main element is abolishment of the internal market regulation. External regulations will stay at least until the GATT negotiations on agriculture are over.

In the transitional period regulation will stay in a simplified form. There will be also support for the most debt-ridden farmers and for those who want to stop producing milk. The costs of this transitional period are SEK 10,7 billion, which includes for instance gradually declining direct income support during 5 years (SEK 5,6 billion) and measures to convert cultivated land for use in non-food production (SEK 3,9 billion).

The effects of these reforms on consumers will be relatively insignificant. The final de-

cline in prices is estimated to be only 3—4 percents on average. Abolishing the internal regulations has, however, many advantages from a dynamic point of view. It means fundamental institutional change. The state will no longer be responsible for keeping certain price and income level on the agricultural sector, which will be thus equal with other sectors in the society.

An important question is how does the reform fit in with the integration development, as the Swedish parliament has made an official decision to apply for EC membership in future. In a way, the agricultural reform in Sweden is therefore needless. There are quite big similarities between the traditional Swedish agricultural policy and the EC agricultural policy (CAP). So in the EC we would return to a system which we have just decided to leave.

HEIKKI HAAVISTO: *Agriculture and Agricultural Policy*

Agricultural policy in Finland is not different from that practised in other countries. All countries give high priority to the domestic supply of food and self-sufficiency. Because only marginal amounts of the world agricultural production are traded in the world market, the world market prices of these products are far below the costs of production. The high food prices in Finland do not depend on arbitrary political decisions. They are high because input prices are high and because the average farm size is small. In addition, the harvests are lower in Finland than in Central Europe, owing to both climatic factors and less extensive use of fertilizers.

The agricultural policy in Finland has well fulfilled its objectives. There are, however, areas where much more could be done. The negotiations on agricultural incomes affect only the producers but they do not have any influence on the price formation of agricul-

tural inputs or food processing and distribution. Agriculture itself is committed to restrict excess production.

External effects of agricultural policy are important, although often neglected by the critics. For example, the rural population is the key source of labour for the main industry of the country, *viz.* forestry. The small size and the regional dispersion of farms make Finnish agriculture ecologically sustainable, contrary to the countries with large-scale intensive production. In the future, a clean environment will be increasingly important to Finnish agriculture.

A greater role for market forces is necessary in order to enhance efficiency. Deregulation must not, however, lead to chaos in the market. Rational co-operation between agriculture and the industry owned by the farmers must not be endangered by competition legislation. Full relaxation of all regulations is not possible, because the domestic food supply is of exceptional significance to the country.

LEENA SIMONEN: *Agricultural Policy and Consumers*

The Finnish agricultural policy has failed to deliver food to Finnish consumers at reasonable prices. The food is of only moderate quality and the available variety is small. Agricultural policy has thus failed in every aspect important to consumers. The bias towards high prices due to the policy is evidenced by the fact that the consumer prices for the food products for which a target producer price exists rose

PETER FAZER: *Foodstuffs industry and agricultural policy*

The foodstuffs industry has lived up to now in a quite sheltered environment in Finland. This has meant inefficiency in all parts of the chain. Agricultural policy has been independent to international developments. Liberalising of international trade on the basis of GATT and EEA negotiations will increase competition not only on the international but also on the domestic markets.

The foodstuffs industry looks at the agricultural policy mainly from a raw material point of view, which means in practise obtainability, quality and price of raw materials. In the

PENTTI PIKKARAINEN: *The basket peg exchange rate regime: what does it really mean?*

The paper deals with the properties of the basket peg exchange rate regime from alternative points of view.

In the basket peg regime the domestic risk-free interest rate is a weighted average of the foreign riskfree interest rates. If the currency index is an arithmetic mean, the domestic risk-free interest rate is a harmonic mean of the foreign riskfree interest rates. In the basket

by more than the consumer prices of other food products. This alone, however, cannot explain the high prices, since e.g. the producer prices for meat have recently fallen below the target prices but the consumer prices have risen faster than the food prices on average. Thus, from the consumers' point of view there is a need for twin reforms: the prices of agricultural products must be tied to the international prices and the competition in the retail trade must be increased through tough antitrust measures.

changing environment the foodstuffs industry must be able to act on an equal footing with its foreign competitors. There must be a possibility to equalize the raw material price differences on the border.

The Finnish foodstuffs industry will be mostly based on domestic raw materials in future, too. Liberalising imports means however broadening of raw material alternatives and the new possibilities can be utilized in innovations. When planning the future of Finnish agricultural policy, the price and aid systems of the EC must be taken into account. The suitable parts of the agricultural policy of the EC must be adopted in Finland.

peg arrangement investors can form a domestic currency denominated riskfree asset of the foreign riskfree assets without entering into the forward currency markets. Furthermore, investors have an incentive to hold fewer assets and the structure of capital flows tends to be more volatile but also more predictable in the basket peg system than in the regime with freely floating bilateral exchange rates.

Consider the behaviour of the firm in alternative exchange rate regimes. Assume input prices are uncertain due to fluctuating bilateral exchange rates. Suppose the expect-

ed values of bilateral exchange rates are perceived to change. Then, if inputs are technologically complements (strong substitutes), changes in input demands tend to be greater (smaller) in the basket peg regime than in the system with freely floating bilateral exchange rates. The basket peg arrangement tends to mitigate fluctuations in input demands and production due to changes in the variances of bilateral exchange rates.

Assume now that the selling price (output price) of the firm is uncertain due to fluctuating bilateral exchange rates. Due to a change in the expected values of bilateral exchange rates the basket peg system tends to reinforce changes in the export pattern but decrease changes in the level of production and inputs employed. If the variances of bilateral exchange rates change, the basket peg arrangement tends to mitigate changes in the level of production, inputs employed and the export pattern.

If money is introduced into the utility function of the domestic household and there are non-tradable goods in the economy, monetary policy affects the determination of real ex-

change rates. In the basket peg regime domestic monetary policy must support the value of the currency index, i.e., the money supply process becomes endogenous. It is proposed that the weighting scheme of the currency basket should be chosen so that it maximizes, for instance, the (expected) utility of domestic households.

Deviations of the Bank of Finland's currency index from the mean value of its fluctuation band have caused some loss in the credibility of the Finnish basket peg exchange rate policy. However, this internal credibility problem has not been so severe. On the other hand, private capital flows have strongly responded to movements in the external values of the Swedish krona and the Norwegian krona. Depreciations in the average value of the Swedish krona have caused devaluation expectations of the Finnish markka and accordingly capital outflows from Finland. On the contrary, in situations with great pressure on the Norwegian krona the private sector has typically trusted the exchange rate policy of the Finnish authorities.

ANNE BRUNILA: *Competitive restrictions: the big bad wolf in competition policy?*

This article discusses problems arising from competition policy based on the common notion that competition is the best mechanism producing maximum efficiency and welfare in a market economy, and if necessary, it should be protected by an effective policy. Competition policy relies very often in the assumption that the greater the pressure of competition, the greater is the level of efficiency and welfare. Since the level of competition is neither directly measurable nor observable, it has often been proxied by market structure, e.g. concentration. Inferring competitive behaviour of market participants from market structure alone is, however, often question-

able. More importantly, the postulated positive relationship between competition and efficiency is by no means clear or even unanimously accepted.

According to recent theoretical work the impact of concentration, horizontal cartels, dominant firms, vertical integration and vertical restraints on efficiency and welfare are highly controversial. When informational imperfections, product differentiation, economies of scale and scope, sunk costs and/or qualitative aspects of production and consumption are taken into account, competition may not be the mechanism leading to efficiency. Since the same market structure and competitive restraints may, in different circumstances, be beneficial or adverse in their impact, we should principally look at their con-

sequences, rather than their form. Consequently, competition policy should not adopt the view of prohibition of a certain market

structure or conduct per se, but only their adverse consequences, a matter which is essentially an empirical market-specific question.

JOUKO YLÄ-LIEDENPOHJA: *Marginal tax rates and tax reform*

The government promised after the 1987 general election to reduce every taxpayer's marginal income tax rate (MTR). The reform was planned to be of the base-broadening-cum-rate-reduction type. In addition, many deductions which in the pre-reform system accounted for discrepancies in the ability to pay due to the differing characteristics of the taxpayers were lifted and amalgamated with the rate schedule. The focus of the article is on the latter aspect of the tax reform — how successful the government has been at achieving its target during the term of 1988—1991.

As the rate schedule is expressed in terms of the residual taxable income, that is, after all deductions, every year's rate schedule is converted to the one expressed in terms of true income. Thereafter, the rate schedules of the years of 1987—1990 are all brought to the level of the forecast 1991 level of earnings so that they can be directly compared. Tables 1A and 1B report how a *single person's (without children)* MTR changed in 1988—1991 in contrast to the year of 1987. It is observed that in the income brackets

- (i) 39200—76700 marks (USD equals currently 3.6 marks),
- (ii) 98100—124400 marks, and
- (iii) 154100—160400 marks

the MTR has been every year at least as high or higher than in 1987, and in the income brackets

- (iv) 76700—98100 marks, and
- (v) 124400—154100 marks, and
- (vi) over 160400 marks

the MTR has been permanently lower in 1989—1991 than in 1987.

Tables 2—6 report on the rest of the taxpayers except pensioners. It is observed that in the lowest income bracket (i) those *taxpayers with children* have experienced a higher increase in their MTR than a *single person without children*. In the other income brackets their MTRs have developed similar to a *single person's*. Since the tax base of gross income was broadened in 1989, it would show an additional increase (or a lesser reduction) in the MTR if taken into account.

The article also comments on the official Ministry of Finance calculations, which showed that every taxpayer would earn a reduction in his MTR and average tax rate, too. It is argued that those calculations do not take into account the rise of real earnings, which pushes everyone upwards along the pre-reform rate schedule. Therefore, the official calculations overestimate the reduction of the MTR in the post-reform rate schedule. In addition, the year of comparison of the official calculations is 1988, when the rate schedule was imperfectly inflation-indexed.

RISTO VAITTINEN: *Some Notes on the Support of Agriculture in Finland*

In this article the agricultural policies and its economic cost in Finland are discussed. Some comparisons to Nordic countries and the EC

has also been made. Large and increasing support to agriculture, primarily in the form of market price supports, has been characteristic of agricultural policy in Finland during the past ten years. A number of policy instruments has been put in place to implement the

policy of high producer prices. The main instruments have been the trade policy measures, such as quantitative restrictions, variable import levies and duties, of which the quantitative restrictions is the most important.

Due to a variety of trade policy measures the degree of protection has been measured by implicit tariffs, which are the percentage difference between domestic producer and international reference prices. The degree of protection has increased from 139 per cent in 1979 to 253 per cent in 1989. There is a striking disparity in the evolution of protection with respect to Norway and Sweden, where the nominal rate of protection, during the same period, has remained at a constant level, or to the EC, where the rate of protection has clearly declined. This can largely be explained by the comparatively unfavourable development of agricultural productivity relative to other sectors in Finland.

PETTERI HAHLE: *Forecasting the Changes of the Gross Domestic Product with a Transfer Function Model*

The article describes the results of author's master's thesis. The aim in this study was to find out, without any ex ante theoretical restrictions, the approximate lag structure of different explanatory variables using simple one equation transfer function analysis. On the left side of the equation is the annual logarithmic change of the gross national product and on the right side there are a constant and annual logarithmic changes of different demand factors. The estimation period is 1978/I—1987/IV (40 observations) and the forecasting period is 1988/I—1992/IV.

In the course of the study seven statistically significant explanatory variables were found. These variables can be divided into internal and external factors. Internal factors are public sector demand (approximate lag

The dead weight losses due to production and consumption inefficiencies are estimated to be 4.7 billion marks, which is one per cent of GDP. The figure is twice as large as obtained in comparable studies of EC countries. The chosen framework used in the calculations is partial equilibrium model. There is international evidence that this approach presumably underestimates the costs of agricultural support. It is also pointed out that the costs and benefits are not distributed equally to different consumer and producer groups, which limits the applicability of a model where representative producers and consumers is an assumption. The major part of the benefits seems to be going to the large and relatively productive farmers. This seems to be an explanation to the reluctance of farmers pressure groups to accept proposed liberalisation of agricultural trade which would be compensated by direct income support.

one year), the money supply (approx. lag one year) and the real interest rate (approx. lag two years). External factors are the price of oil (approx. lag one year), competitiveness of Finnish exports (approx. lag one and a half years), export demand of western countries (approx. lag half a year) and export demand of (former) socialist countries (approx. lag half a quarter).

The model can forecast the period 1988/I—1990/III rather accurately. However from figure 1 it can be seen that the forecasts for 1988—1989 tend to be somewhat under and for 1990 slightly over the realized outcome. This is mostly due to very rapid growth of the construction of houses in 1988 and 1989. In 1990 the construction of houses declined because of oversupply. These changes in the production of the construction industry can approximately be explained by the changes in the price of housing (figure 1 B).