



The political economy of agricultural liberalization in Central and Eastern Europe: An empirical analysis



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ABSTRACT

We examine the effect of upcoming elections and government ideology on agricultural liberalization in Central and Eastern Europe countries in the post-communist period. Our results suggest first that prices and markets liberalization and land market privatization are manipulated in pre-election periods to secure re-election by favouring farmers. Second, we find no evidence that reforms in the agro-process industry, rural finance or institutional environment are affected by upcoming elections. Third, we demonstrate that right-wing governments protect the interest of the agricultural sector more than left-wing governments by affecting the speed of price and market reforms, privatization in the agro-processing industry and land market privatization. Finally, we demonstrate that liberalization the agricultural sector is partly retarded by nationalistic governments.

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Introduction

Since late 1989, when communism collapsed, most Central and Eastern European countries (CEEC's) have gone through some considerable democratic reforms. One popular view is that the establishment of democratic institutions has stimulated economic liberalization in the post-communist world, especially in the agricultural sector (cf. Johnson, 1995; Kennedy, 1999; Rozelle and Swinnen, 2004; Swinnen and Rozelle, 2009; Swinnen, 2002; Deininger, 2003). Agriculture in Central and Eastern European countries is a much more important component of the economy than in industrialized countries. It traditionally accounted for 15–20% of GDP and total employment, compared to only 2–3% in the EU.

In the pre-reform period, agriculture was heavily subsidized in a number of CEE countries, such as the Czech Republic and Hungary, to stabilize farmers' income, ensuring food security and protecting farmers from import competition. Conversely, in a number of other CEE countries, the agriculture sector was heavily dominated by state ownership and taxation of the production (Cungu and Swinnen, 1999; Macours and Swinnen, 2002). In the beginning of the 90s, most CEECs began to open up their agricultural markets and start declining government involvement. From that point onward, trade was more liberalized, price distortions were

removed, property rights were privatized and the level of support provided to agriculture declined drastically.¹

Meanwhile, agricultural reforms are not always taken to spur development only but also for political purposes (cf. Park and Jensen, 2007; Klomp and De Haan, 2013). Incumbents have powerful incentives to affect voters' behavior by using socio-economic reforms to secure the support of particular constituencies. This is especially the case when elections are at hand and voters base their behavior on the recent past (Nordhaus, 1975). According to Anderson and Hayami (1986), there are two main arguments why the incumbent government may protect or support the agricultural sector for re-election purposes at the expense of other voter groups. First, in view of the size of the agricultural sector, farmers have an organizational advantage over other diffused interests and may therefore be more successful in mobilizing campaign contributions and votes. Second, when income support is given to lower prices for agricultural products, this increases taxpayers' real income and thereby making the total tax burden associated with agricultural protection socially affordable. Thus, if a general election is approaching, the government may be reluctant to implement structural liberalization reforms on farmers that have very high short-term costs (Pitlik and Wirth, 2003). This view is empirically supported by Thies and Porche (2007) who find a

¹ According to Swinnen and Rozelle (2009) and Bjørnskov and Potrafke (2011) some countries chose shock therapy, others succeeded in implementing more gradual reforms, while a few either took no reform measures or rolled reforms back swiftly after beginning to implement them.

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positive and significant effect of upcoming elections on the degree of protection of the agricultural sector. Likewise, [Klomp and De Haan \(2013\)](#) and [Park and Jensen \(2007\)](#) demonstrate that agricultural income support increases in (pre-)election years.

In addition, agricultural reforms may not only be affected by upcoming elections but also by the government's ideology. According to the traditional partisan theory, left and right-wing political parties have different preferences as to the size and scope of government influence ([Potrafke, 2011](#)). Likewise, they may have different views on agricultural policy. Empirical evidence suggests that right-wing governments follow more protectionist policies and provide more support to agricultural producers than left-wing governments due to constituency motives ([Olper, 2007](#); [Swinnen, 2010a](#)).

Up so far most studies explore only the political economy of agricultural protection or land market reforms (cf. [Thies and Porche, 2007](#); [Klomp and De Haan, 2013](#); [Giuliano et al., 2013](#); [Swinnen, 1999](#)), thereby neglecting reforms in other policy areas. In our study we argue instead that agricultural liberalization consists out of multiple policies related to (1) price and market liberalization; (2) land market privatization; (3) agro-processing and input supply privatization; (4) rural finance liberalization and (5) market institutions liberalization. Our contribution to the empirical literature is by examining whether election cycles and the government ideology affect the multiple dimensions of agricultural liberalization in CEE countries. It is well possible that these cycles have diverse or even opposite effects on the various dimensions of liberalization since some reforms improve the welfare of farmers by reducing production costs through enhanced efficiency, while others may harm farmers through a loss of trade protection or financial support. To explore these impacts, we apply a dynamic panel model including about 20 Central and Eastern European countries over the period 1996–2005. We use the different dimensions of liberalization reported by the World Bank which refer to the five dimensions outlined above. We address the potential endogeneity problems by presenting a system-GMM model.

After testing for the sensitivity of the results, we can draw a number of conclusions. First, liberalization in prices and markets is slowed down or partly reversed under the influence of upcoming elections in countries which subsidize the agricultural sector or have open markets. However, in countries where the agricultural sector previously was taxed or under state control, there we find a positive election impact on prices and markets reforms. This latter result can be explained that in these countries, farmers benefit from a more open trade system with less distortions. Second, governments stimulate land market reforms during an election year by allowing for more private ownership. Third, we do not find any evidence of electoral cycles in reforms in the agro-processing industry, rural finance and institutions as reforming these dimensions at a short notice is politically difficult or the individual benefits for farmers may be too small to signal competence of the cabinet. Consequently, reforms affecting these dimensions are less appropriate as a re-election instrument. Fourth, right-wing governments support or protect the interests of the agricultural sector more than left-wing governments. To be more precise, Former Soviet Union member states ruled by a right-wing cabinet open up their markets more often and decline the agricultural taxation, while in non-former Soviet Union member states right-wing governments start subsidizing farmers more. Fifth, nationalist-led governments are associated with slower transition speeds to re-enforce state control. Finally, it turns out that the effect of election cycles in price and market liberalization is partly conditional on the political system in place. In particular, the election effect is stronger under a mixed electoral system compared to a proportional system. Our interpretation of this finding is that a mixed system gives the incumbent a stronger incentive to target transfers to particular interest groups, like agricultural producers than under a strict proportional system.

The remainder of the paper is structured as follows. Section 'Theoretical background' reviews the theoretical background underlying our hypotheses. Section 'Data and methodology' describes the data and methodology used, while Section 'Main results' shows our results for the influence of election cycles and government ideology on reforms in the agricultural sector. Section 'Robustness analysis' presents a sensitivity analysis, while the final section offers the conclusions.

Theoretical background

Intuitively one could argue that if a country is democratic and rural dwellers constitute a large segment of the voting population, politicians have powerful incentives to cater to the interests of farmers. Conversely, when large shares of the population are poor and live in urban areas, they demand that the government protects their interests by adopting policies that lower the costs of food. However, according to the current empirical evidence these pictures do not represent reality. That is, in low-income countries the agricultural sector is often being taxed to the benefit of import competing sectors, the so-called development paradox ([Bates and Block, 2011a,b](#); [Swinnen, 2010b](#); [Anderson et al., 2013](#)).

Up so far most of the literature on the political economy of the agricultural sector is only focused on explaining differences in agricultural protection measured by the degree of price support (cf. [Olper, 2007](#); [Olper and Raimondi, 2004](#); [Olper et al., 2010](#); [Klomp and De Haan, 2013](#); [Thies and Porche, 2007](#)) or ownership in the rural land market (cf. [Giuliano et al., 2013](#); [Swinnen, 1999](#)).² In our study instead we combine the electoral and partisan cycle theories and apply these theories to the various dimensions of liberalization reforms in the agricultural sector. The influence of election cycles on agricultural liberalization is theoretical not directly clear. On the one hand, politicians are more likely to conduct liberalization reforms in the wake of elections when the majority benefits in economic terms. For instance, reducing agricultural price support may tend to impose short-term costs on farmers, while generate economic benefits for society at large. On the other hand, politicians who undertake economic reforms as elections approach, risk alienating constituents who will bear the near-term costs of this reform. Besides, politicians may fear the risk not leaving enough time for the majority of voters to realize the corresponding gains (cf. [Haggard and Webb, 1993](#); [Frye and Mansfield, 2004](#)). This problem becomes more severe if the short-term costs of liberalization are disproportionately borne by protectionist interest groups that are better organized, better informed, and more politically powerful than society at large, which is harmed by protection ([Olson, 1965](#)). The existing literature clearly indicates, that although, agricultural support in many countries benefits only a small subset of population, politicians may seek electoral support in the agricultural sector (cf. [Thies and Porche, 2007](#); [Klomp and De Haan, 2013](#)). For instance, [Thies and Porche \(2007\)](#) find a positive and significant effect of upcoming elections on protection of the agricultural sector in OECD countries.

One major limitation of the existing empirical studies is that it is only focused on the impact of political cycles on price support. However, according to [Csaki \(2000\)](#) the reform agenda in agriculture should address problems in at least five areas: (1) the removal of direct government intervention from agricultural markets and the creation of a market-compatible policy framework for the agrarian economy, including liberalization of prices and markets for farm products and inputs; (2) privatization of land and creation of new farming structures based on private ownership of land and productive assets; (3) creation of a competitive environment for

² For instance, [Giuliano et al. \(2013\)](#) conclude that democracy has a significant positive impact on the implementation of agricultural reforms in private ownership and market prices.

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