Latvian Price Reforms and Their Effects on the Production and Sale of Foodstuffs

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LATVIAN PRICE REFORMS AND THEIR EFFECTS ON THE PRODUCTION AND SALE OF FOODSTUFFS

In the past, Latvian agriculture has been characterized by low output increases and rapidly growing production costs. This cannot be regarded as the result of bad producers' work, but as the consequences of a poorly administered management system. Before 1990 Latvian agriculture was strictly dependent on the All-Union centralized producer prices set for all agricultural products and on the centralized redistribution of production inputs.

State-guaranteed producer prices were fixed and remained stable for a longer period of time, usually for five years, but production costs grew constantly. As a result, commodity prices did not correspond with commodity values. This deepened the disparity between the income levels of various branches, particularly between industry and agriculture. Prices no longer reflected the final result in the economic activities of the agricultural enterprises.

In 1983 the differential producer prices and a number of extra payments above producer prices served to stimulate agricultural production. In subsequent years the volume of agricultural production grew by 20 percent. Farm incomes increased as well, and the number of nonprofitable farms decreased rapidly.

Income levels of nonprofitable and low-profit farms increased because of price differentiation according to the zones established for producer prices for dairy and meat products (price zones) and by the extra payments added to producer prices. This extra payment is made to low-profit farms, at a rate of approximately 50 percent extra for increased volume of product sales compared with the average level during the previous five-year period. On some farms, the sum of extra payments constituted 90 percent of all income, but the volume of foodstuff production on these farms failed to grow and the level of prime costs increased rapidly. That led to the conclusion that the production of agricultural products had to be stimulated: first, agricultural products should not be subsidized; second, consumers should not be subsidized; and third, there should be a transfer to free market prices based on demand and supply.

Because of the complicated economic and social situation in the republic, the government decided to implement price reform in two stages.

The First Stage

Beginning in January 1991, the entire price formation policy was radically changed in all sectors of foodstuff production; that is, in agricultural enterprises, through producer prices for raw materials, and, in processing plants, wholesale prices for the ready product. All state budget subsidies for agricultural producers were removed.

The policy of retail price formation also changed. Consumers bought foodstuffs at prices that corresponded to the actual commodity value. Thus, a buyer was no longer subsidized when he bought a commodity, but later, when he received as compensation a part of the increase over retail prices.

The goal of determining a radically new price formation mechanism, was to create the prerequisites for the transfer to a market economy, namely the gradual transfer to contract prices and free market prices.

The state-guaranteed producer prices are determined according to the following principles:

1. Uniform prices are set throughout Latvia and for all producers. Prices are differentiated only according to the quality of the products.

2. Prices include all extra payments above producer prices: extra payment for products sold to the state above the average level of the past five years, and extra payments to low-profit farms and differential extra payments that were in force from 1983.

3. The amount of profit is calculated in the price that is set, thus determining the profit margin needed to develop the respective branch.

The most significant influence on price formation policy in 1991 was the change in prices for raw materials and for material and technical resources used in Latvia but obtained from other former USSR republics. Because of this change in January 1991, wholesale prices for electric energy were raised 2.7 times, for heat-energy 2.4 times, for petrol 2.5 to 2.7 times, for gas from 0.3 to 4.5 times, for cargo transportation 1.5 times, for timber 4.8 times, and for building materials 2.5 times.

As a result of retail price reform, the retail prices of consumer goods increased an average of 2.0 times after April 2, 1991.

The structure of free and regulated prices has been altered as well. In accordance with the decision adopted by the Latvian Council of Ministers on March 28, 1991, the assortment of goods being sold at free prices expanded considerably. The share of free prices in total commodity output was 62 percent, but without foodstuffs was 90 percent. The share of regulated prices was 38 percent.

Foodstuff price formation was influenced by internal and external factors. Because the prices of prefabricated material and technical resources continued to grow, the government was forced to again raise the state-guaranteed producer prices for agricultural products above the levels set on October 15, 1990. This, in turn, necessitated raising retail prices for meat and dairy products.

On January 3, 1991, new retail prices for milk and dairy products and meat and meat products were introduced. Thus, the prices of these products grew 3.3 and 4.2 times, respectively. Because of the strained political and social situation in Latvia the government did not resort to further retail price increases.

The percentage of the budget assigned before 1991 to maintain the relatively low foodstuff prices and paid to food processing plants now was transferred to inhabitants in the form of higher pensions, grants, payments above normal wages, and so on.

Since the state-guaranteed producer prices for milk, livestock, and poultry meat were raised from the May 2, 1991 levels but retail prices were not revised, it was necessary to allot 218 million rubles from the state budget to cover the price gaps for milk, dairy products, livestock, and poultry meat.

The prices for farm products failed to compete with those of other branches of the national economy and as a result the price increases for farmers was 1013 million rubles in the first half of 1991.

The government was able to compensate farmers for a part of the rise in prices. First, they allotted 393 million rubles from the state budget to set up a compensation fund in case of a price increase. This money was distributed among the district agricultural departments for financing:

1. Formation and modernization of the necessary production infrastructure to successfully accomplish agrarian reform;

2. For making up for the losses in the branches of apartment and communal services;

3. For paying for liming the land; and

4. For maintaining the volume of particular products on those farms with low production potential.

Second, they reduced the social tax rate (37 percent):

1. To those employed in agricultural enterprises up to 18.5 percent; and

2. To peasant farms up to 19 percent.

Nevertheless, all these measures intended to stabilize the agricultural economy were efficient for a short period. Compared with 1990 costs, 1991 production costs for agricultural products rose on average 1.61 times, but real incomes of agricultural producers grew only 1.46 times. Farmers were asked to do away with the fixed state-guaranteed producer prices and, as in other branches of the national economy, to switch over to free producer prices for agricultural products.

On July 1, 1991, the Republic of Estonia switched to free producer prices and the Republic of Lithuania increased its state producer prices considerably: for sugar beets, 84 percent; for beef, 54 percent; and for pork, 53 percent. The Latvian government took the decisive step in December 1991; otherwise, it would have needed money to raise producer prices and compensate for the price gap.

The Second Stage

The Latvian Council of Ministers adopted a resolution on the liberalization of prices for all types of agricultural products. This resolution is based on the assumption of equitably regulated applied free prices, irrespective of the kind of property: collective farm, peasant farm, or small individual farm.

The objectives of price liberalization were to establish the necessary prerequisites for further development of production by all types of agricultural producers, including individual farmers, as well as to equalize the income brackets of agricultural producers with those of workers employed in other branches of the national economy. As the fixed producer prices of agricultural products lagged considerably behind the rate of price increases for industrial goods, the gap widened between the incomes of people working in these two branches. Therefore, radical changes in the way foodstuff prices are determined were a significant step towards a market economy.

However, it should be noted that liberalizing prices in all branches of the Latvian economy still does not mean a transfer to a market economy in the classical sense of the word because the issues of privatization of land and real estate have not yet been solved, and there is still a state monopoly of the processing of farm products and in commerce. Under these conditions, the regulating lever of competition cannot operate.

The government switched from producer prices to adopting a resolution on how to formulate contract prices for milk and meat. These prices would be set as a result of negotiations among all parties concerned: producers, peasant representatives, a collective farm representative, and a representative from a processing enterprise. At the same time, state-guaranteed minimum producer prices were set for the main agricultural products: crops, 1000 rubles per ton; sugar beets, 250 rubles per ton; flax straw, 2100 rubles per ton; milk, 1050 rubles per ton; beef cattle, 7300 rubles per ton (liveweight); and hogs, 7600 rubles per ton (liveweight).

Yet the government has set a profit margin related to charges for the processing enterprises. Dairy factories and meat processing plants are the same; the profit margin should not exceed 15 percent. The traders' profit rate has also been restricted, so that it should not exceed 25 percent for bread, 20 percent for dairy and dairy products, and 15 percent for meat and meat products.

This pricing system enabled agricultural producers to defend their interests. There was a steep rise in producer prices and on March 1, 1992 they exceeded 1991 average prices 7 times for milk, 4 times for beef, and 6 times for pork.

At the same time, the indexing results for the first quarter of 1992 indicate that agricultural production costs increased during this period an average of 10.8 times, but profits increased by only 7 times.

Agricultural producers do not have enough capital to develop and expand production, and production volumes are continuing to decrease. If for the first quarter of 1991 the total of cattle breeding and poultry farming was 85 percent of the total for the same period in 1990 and if in dairy farming it was 82 percent, then the results for the first quarter this year were 78 percent and 80 percent, respectively.

In order to protect agricultural producers from the effects of inflation, recommendations were made to revise the state-guaranteed producer prices. On March 6, 1992, the state-guaranteed producer prices were revised, and they were set close to the actual prices that existed at that moment: for beef cattle 25,000 rubles, for pigs 33,000 rubles, and for milk 6000 rubles.

If, during the first three months of price reform, agricultural product prices were not restricted by anyone, it was the producer who set them, especially in areas where the Farmers' Centre had a strong influence. Now, due to limited markets both at home and abroad, the big processing plants try to maintain the state-guaranteed producer prices. However, the prices for material and technical resources are continuing to increase.

Thus, by May 1, 1992, the price for electricity increased 25-fold, for diesel fuel 46-fold, for fertilizers 24- to 93-fold, and for agricultural machinery 10- to 20-fold compared with 1991 prices (Table 1).

The forecast for 1992 production cost increases is 31 billion rubles, or 7.2 times more than last year. This means that the state-guaranteed producer prices for primary agricultural products ought to be increased by 1.5 to 2 times. The result will be an inevitable increase in retail prices for foodstuffs.

By May 1, 1992 (compared with December 1991), retail prices had increased 2.3 times for milk, and 3 times for beef and pork. It should be noted that after revising the state-guaranteed producer prices, the producers' prices and the wholesale prices set by the processing enterprises became stable, and retail prices continued to grow. For example, in May 1992 they had increased 1.2 times for milk and dairy products and 1.14 times for beef and beef products, as compared with March 1992 (Figures 1, 2, 3).

A new price increase for agricultural products was instituted June 1, 1992, when the government lifted restrictions on profits for processing enterprises and eliminated the turnover tax restrictions for traders. The prices for foodstuffs in June 1992 increased an average of 70 percent. The minimum wages from June 1 to July 1, 1992, increased by 50 percent.

The analysis of indexes of the average wage increase and those of retail price increases for the main foodstuffs indicate that the growth of the latter is much faster than the average wage rate in industry: about 2.8 times, compared with the average wage rate in agriculture of about 4 times (Figure 4).

Because of the present relationship between wages and commodity prices, the purchasing power of the population has reached a critical point. The decrease in sales volumes testifies to this fact. During the first quarter of 1992 (compared with the first quarter of 1991) the sales volume of foodstuffs decreased: for meat and meat products by 43.6 percent; for dairy products by 52.9 percent; for butter by 38.5 percent; for eggs by 44.3 percent; and for bread and bread products by 31.1 percent. In 1991, 260 tons of dairy products were sold in Riga in a day, but in April and May 1992 sales dropped to an average of 100 tons a day. For butter, the corresponding figures are 29 tons and 8 to 12 tons, and for sausages it is 70 to 80 tons and 50 to 60 tons.

According to the Latvian Ministry of Agriculture forecasts, with present inflation rates price increases for energy and other resources in the second half of 1992 will be about 6.6 billion rubles. This will cause higher foodstuff prices that will trigger chain reactions in other branches of the national economy. Therefore, to stop the constant price increases and to equalize agricultural income levels with those of other branches, price stabilization measures should be taken. Naturally, this requires definite state subsidies.

In order to maintain the minimum income level for agricultural producers with regard to actual cost increases as of May 1, 1992, proposals were submitted to revise the state-guaranteed producer prices for the fall crop of the primary agricultural products (grain, sugar beets, flax).

Using the prices of production means and services on May 1, 1992 as the base, the state-guaranteed producer prices for agricultural products should be increased, on average, 98 times. If the present inflation rates continue, costs may increase up to 1.3 times before October 1992.

Subsidies

If we compare agricultural production with other branches of production, its main features are a slow turnover of assets and seasonality. This means that producers' prices cannot be the sole source of income for agricultural producers. The income of agricultural producers should be regulated by state-guaranteed producer prices, by tax exemptions, and by subsidies.

The newly created individual farms need help because they do not have enough money for construction or to purchase material and technical resources. To slow down inflation rates and to balance the incomes of agricultural producers with the solvent demand of the population, a certain part of price increases for material and technical resources should be paid to producers as subsidies.

It would be useful to reduce production costs to subsidize the energy resources of diesel fuel, petrol, and fertilizers. According to the Latvian Agricultural Ministry's estimates, the price increases for these resources in the second half of 1992 will be 1892 million rubles or 29 percent of the projected price rise. By allotting this sum to farmers as subsidies, the state-guaranteed producer prices for agricultural products could remain at the estimated level.

The subsidies for production resources will help stabilize agricultural production and restrict the rapid increase in foodstuff prices. These agricultural production subsidies could be temporary until:

- Peasant farms stabilize;
- Privatization of processing and trading enterprises is implemented;
- The main production means, land, becomes a commodity; and
- The prerequisites for a market economy have been established.

Credits

A resolution of the Supreme Council of Latvia, adopted in January 1992, sets conditions for allotting credits to individual farmers from the state budget and establishes the terms of repayment.

The annual interest rate for long-term credit to purchase agricultural machinery and buildings, for expanding the purchase of residential houses and production buildings, and for buying cattle has been set at 7 percent for individual farmers, and at 12 percent on average for all other entrepreneurs.

The resolution also permits drawing money from the state budget in order to discount long-term credits by 50 percent if the farmer has used the money in a timely and purposeful manner. Presently, this credit situation is critical because waiting to grant long-term credit to individual farmers might seriously slow the process of privatization and agrarian reform. Individual farmers have requested 1 billion rubles in long-term credit for 1992. But the government has only been able to grant 25 percent of the total requested.

This means that a special stabilization fund should be established for farmers. This fund should come from state budget subsidies; state and local government nonbudgeted privatization funds; money from commercial banks, companies, and international finance institutions; and contributions from individuals.

Conclusions

The Latvian government should support the establishing and developing of individual farms by setting low interest rates on credit, by lowering taxes, and by subsidizing the farms with poor farming conditions.

The agricultural workers expect the Supreme Council of Latvia to adopt the law "On Privatization of Processing Enterprises." This law will help to establish producer and commodity groups much like American co-ops, where the farmers become the owners of processing enterprises and are interested in the final product.

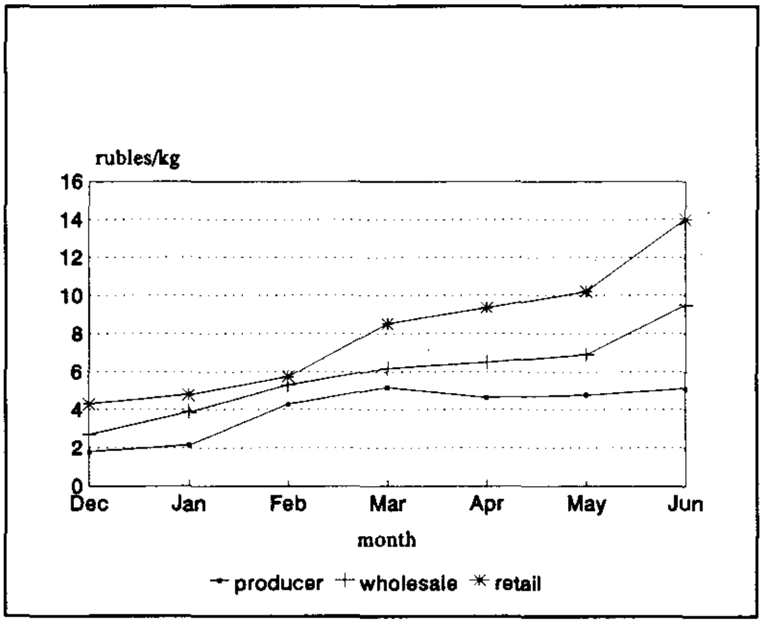

Figure 1. Average price of milk, 1991-92

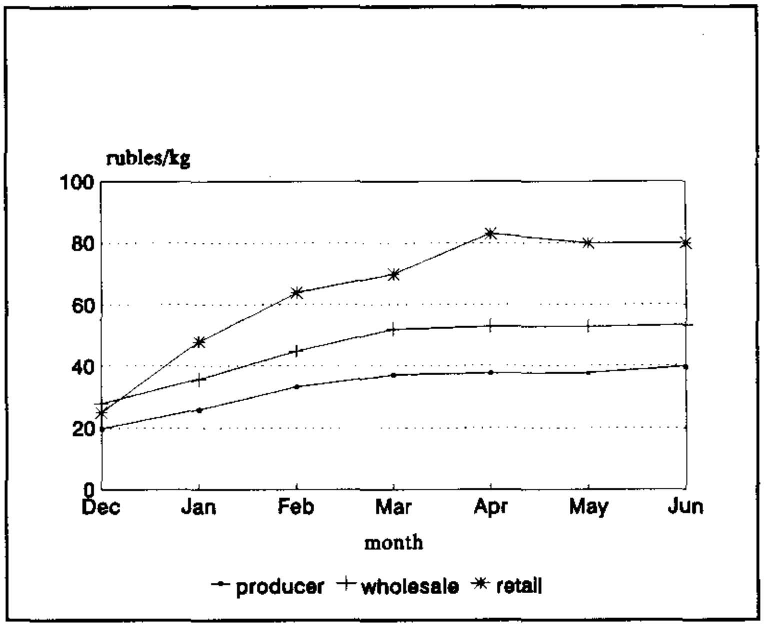

Figure 2. Average price of beef, 1991-92

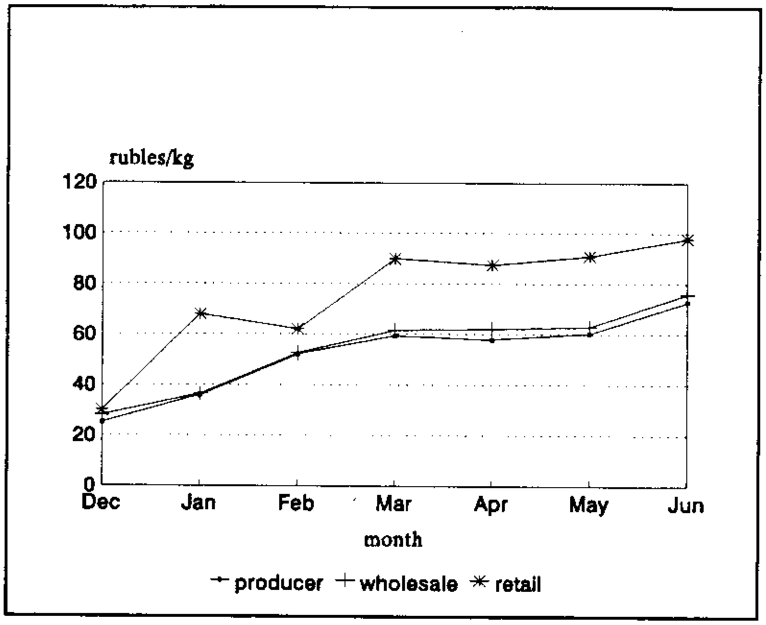

Figure 3. Average price of pork, 1991-92

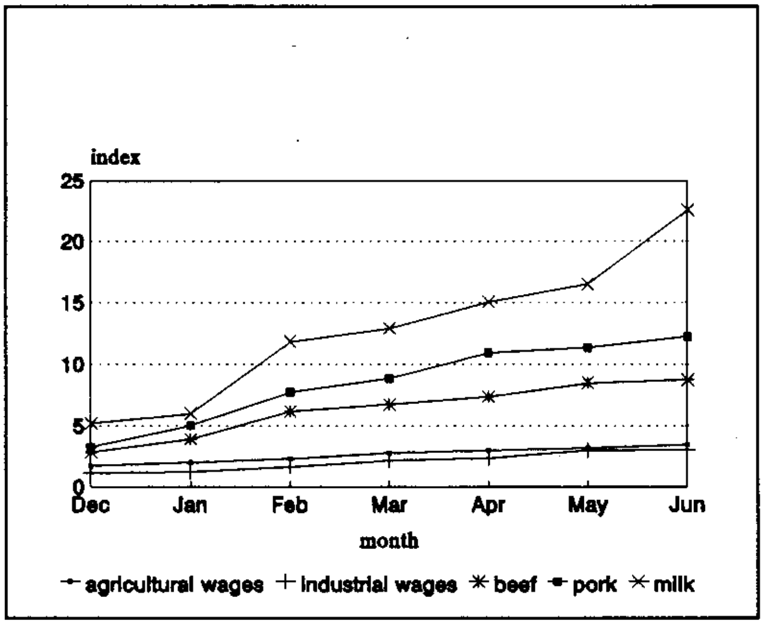

Figure 4. Retail prices and wages, 1991-92

Table 1. Price increases for materials and technical resources and services on May 1, 1992

Resource	Price-rise coefficient in comparison with 1992	
	1990	1991
Electric energy	53.3	24.6
(including agricultural uses)	120	30
Cargo transportation	14.7	11
Stove fuel	13.2	6.6
Diesel fuel	84.3	46.1
Petrol (gasoline)	80	30
Ferrous metals	22	11
Chemical production	17.5	5.3
Plastics	27.3	13.4
Agricultural machinery	20-60	10-20
Automobiles	20-154.2	10-76.2
Electric engines	10	3
Mineral fertilizers		
potash chloride	32.7	24
ammonium saltpetre	88.8	92.9
urea	68.3	67.3
superphosphate, ordinary	151.2	38.5
Food mixture	20	8.4
Wood	12	4
Minimum wage		3.9