



Introduction: Agricultural Economics

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Short introduction of the lecturer



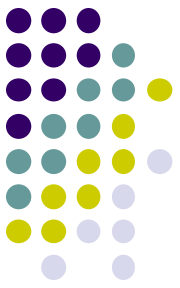
- Background
- Experience
- Motivation

Introduction: The rules of the game



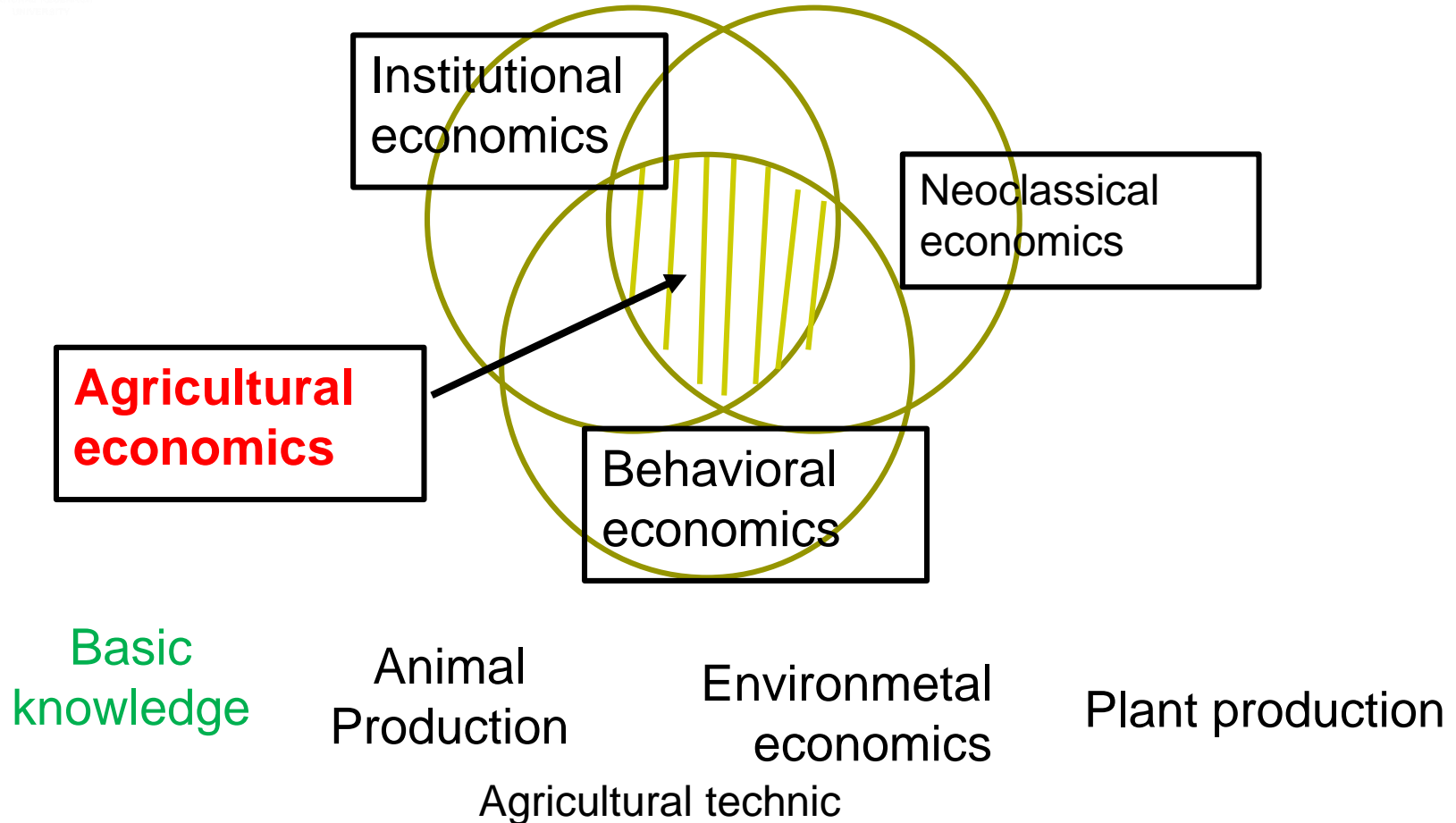
- Allocation of responsibilities
 - The task of the lecturer
 - The task of the participants
 - **General principle: The lecturer is supposed to serve you. He/she needs signals how to serve best. You have to articulate your desire and raise questions if you do not understand or disagree..**

Focus on fallacies and case studies

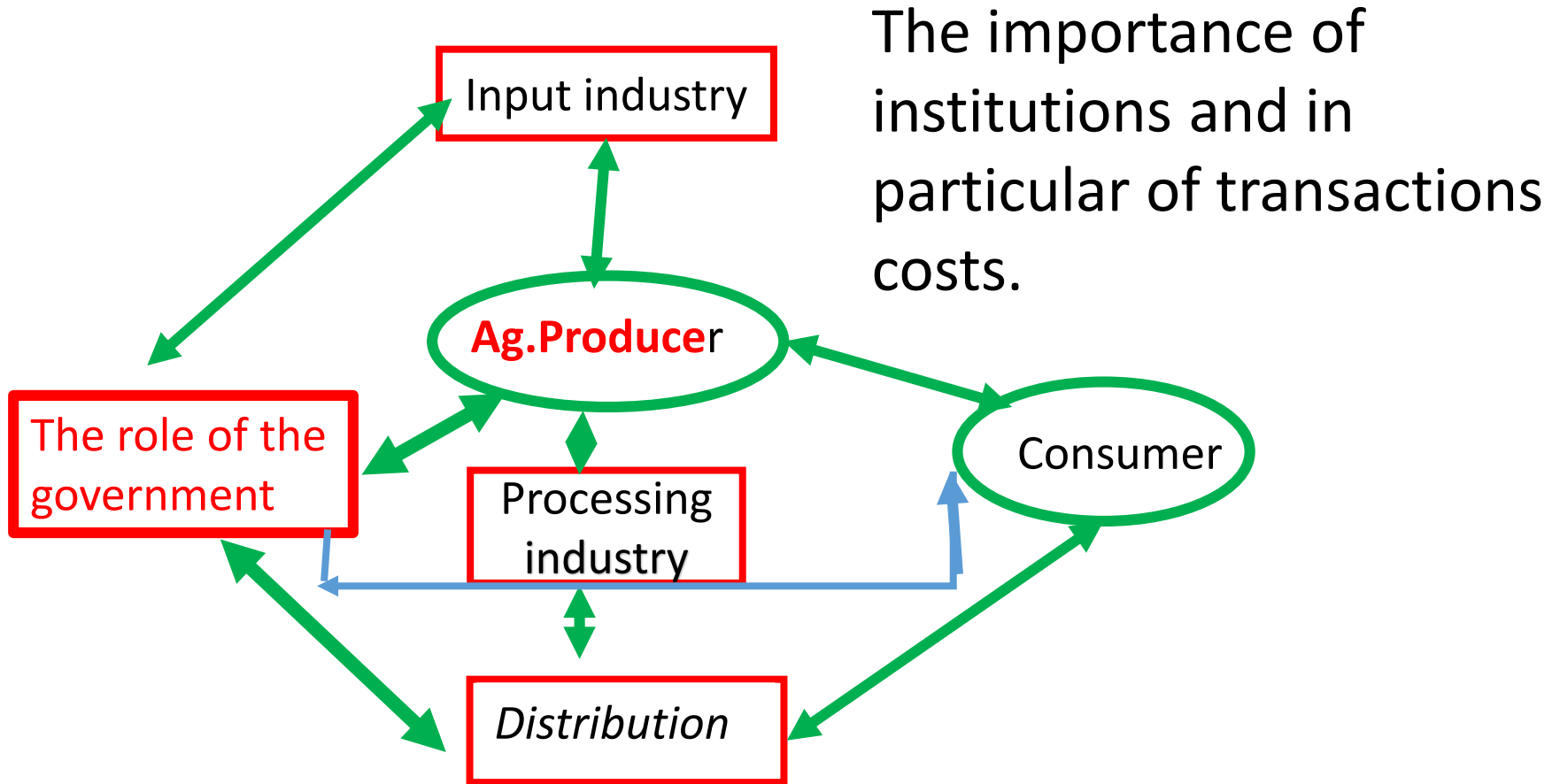


A fallacy is an erroneous argument dependent upon an unsound or illogical contention. There are many fallacy examples that we can find in everyday conversations and in economics. Fallacies in economics are often statements which seem to be true, but **they may only be true if specific assumptions generally reflect the reality.**

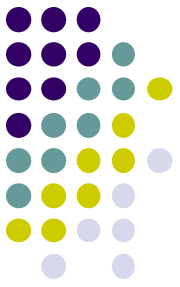
Agricultural e economics and related field of research



Important actors along the supply chain



Part I: Methodology in economics and the role of agricultural economics



The methodology applied in economics depends largely on the definition of economics. Hence, we start with the definition of economics and the **way of discovery in science.**

Definition used in this course



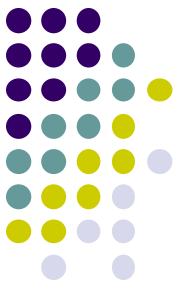
Economics deals with possibilities and problems of **social cooperation** aiming at mutual benefits.

The focus is on **exchange** and on **productive interactions**.

Note: This definition is in contrast to the approach of neoclassical economics.

It is not assumed that selfish actions always lead to the best outcome from the individual and the point of view of the society.

Maximize productive interactions

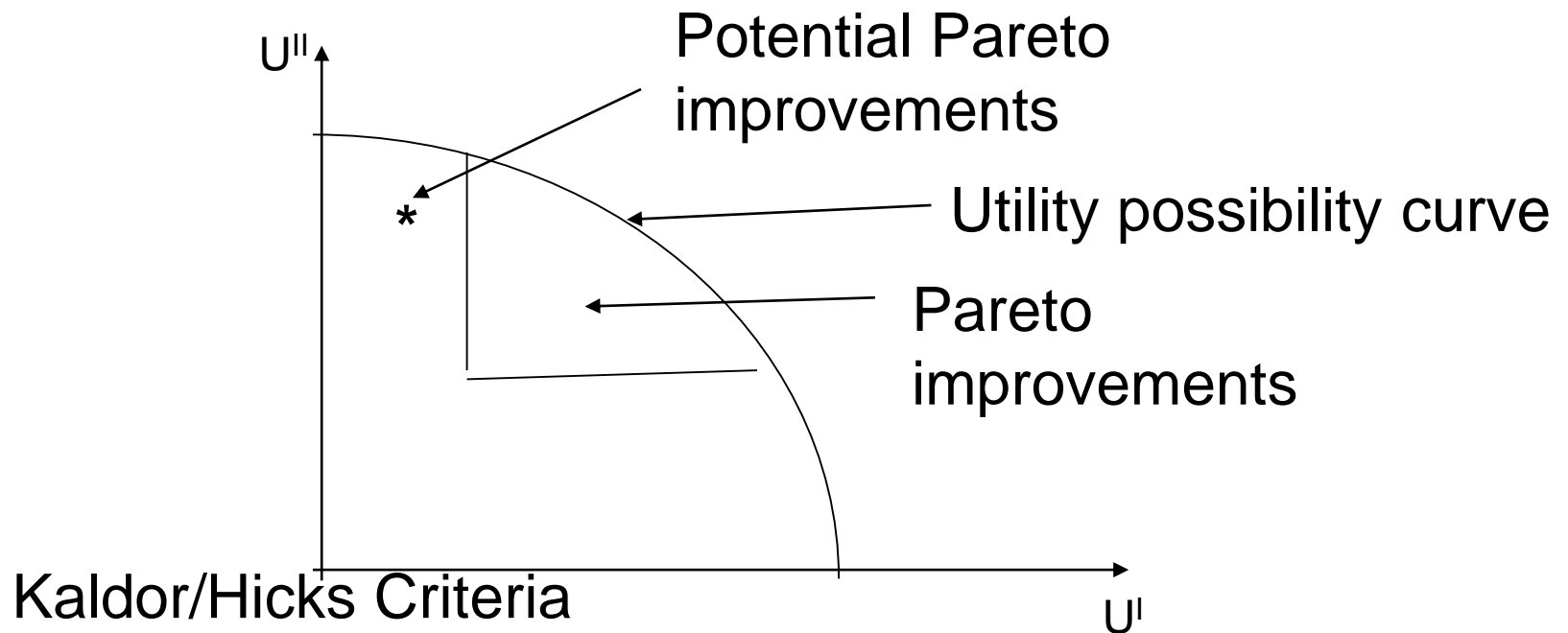


- **Productive interactions** lead to benefits for the involved parties **without affecting other members of the society negatively**, i.e. they lead to a gain in social welfare.
- It leads to a **Pareto improvement**. However, activities which lead to a **potential Pareto improvement** may also be considered as acceptable (**Value judgment**), at least for most economists. What kind of assumption is implied in the statement? (**social independent individual utility curves**)



Solutions

- Restriction to Pareto- improvements
- Application of potential Pareto improvements



Extension



- Implication: Changes which improve the economic situation of one person and do not affect the economic situation of others are not necessarily welfare increasing and cannot definitely be rated as ‘morally good’ or welfare increasing. **Why not?**
- What are the implications for political advice given by economists?



Unproductive interactions

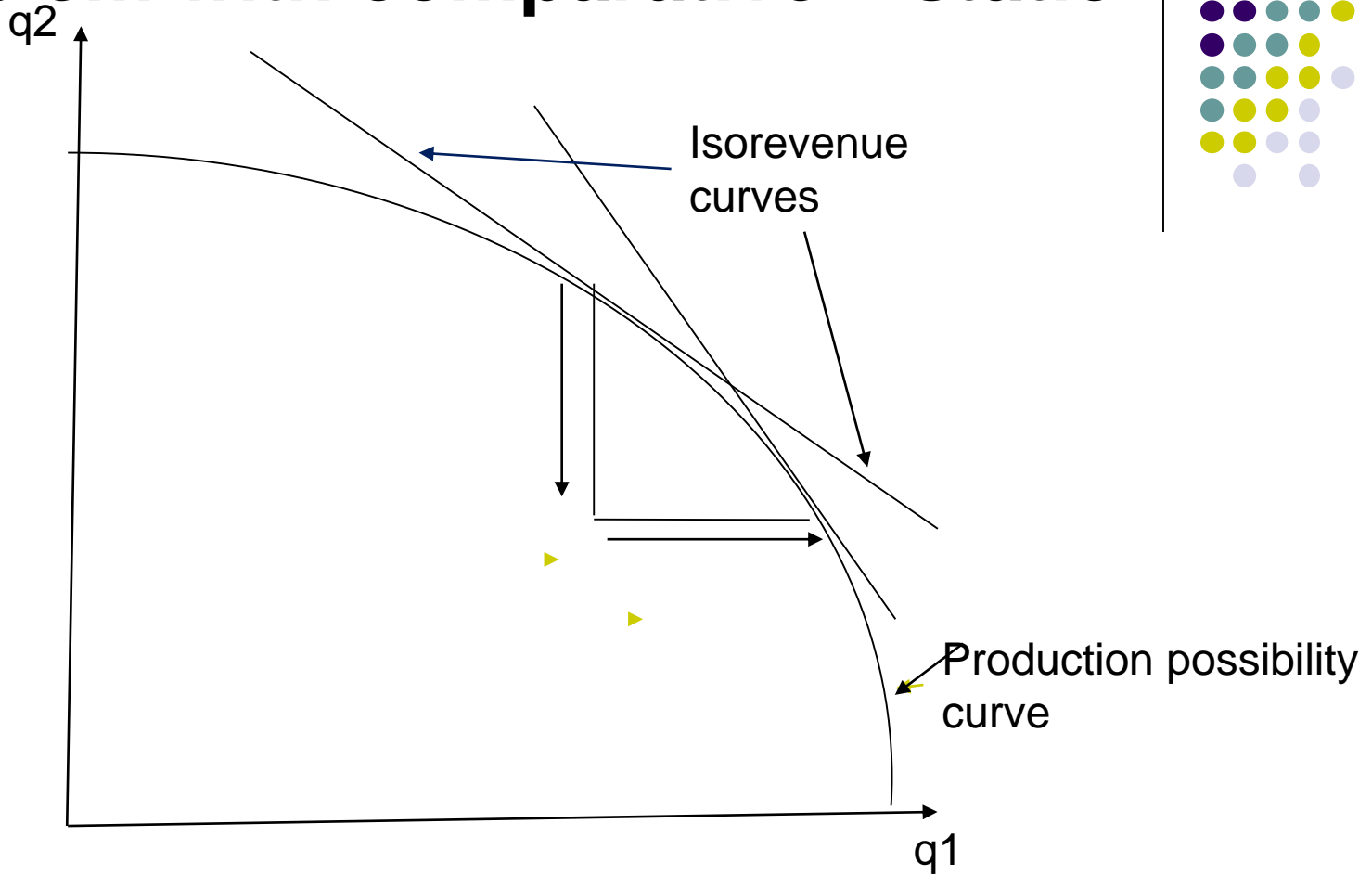
- Unproductive interaction: At least one party gains, but the other involved party may lose or others who are not involved in the interaction may lose in material welfare or **just feel worse**, i.e. **unproductive interactions lead to a loss in social welfare. Liberalization of trade.**

Fallacy 1: The effect of trade liberalization

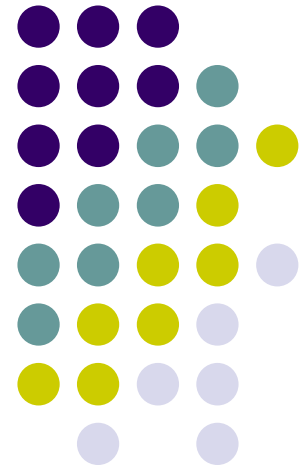


- **“Theory does not ‘say’ – as is often asserted by the ill-informed or badly taught - that ‘free trade is best’. “ (Corden M. 1976.**
- **Comparative static analysis may be misleading**

The problem with comparative – static analysis



Part II: The economic way of discovery in economics

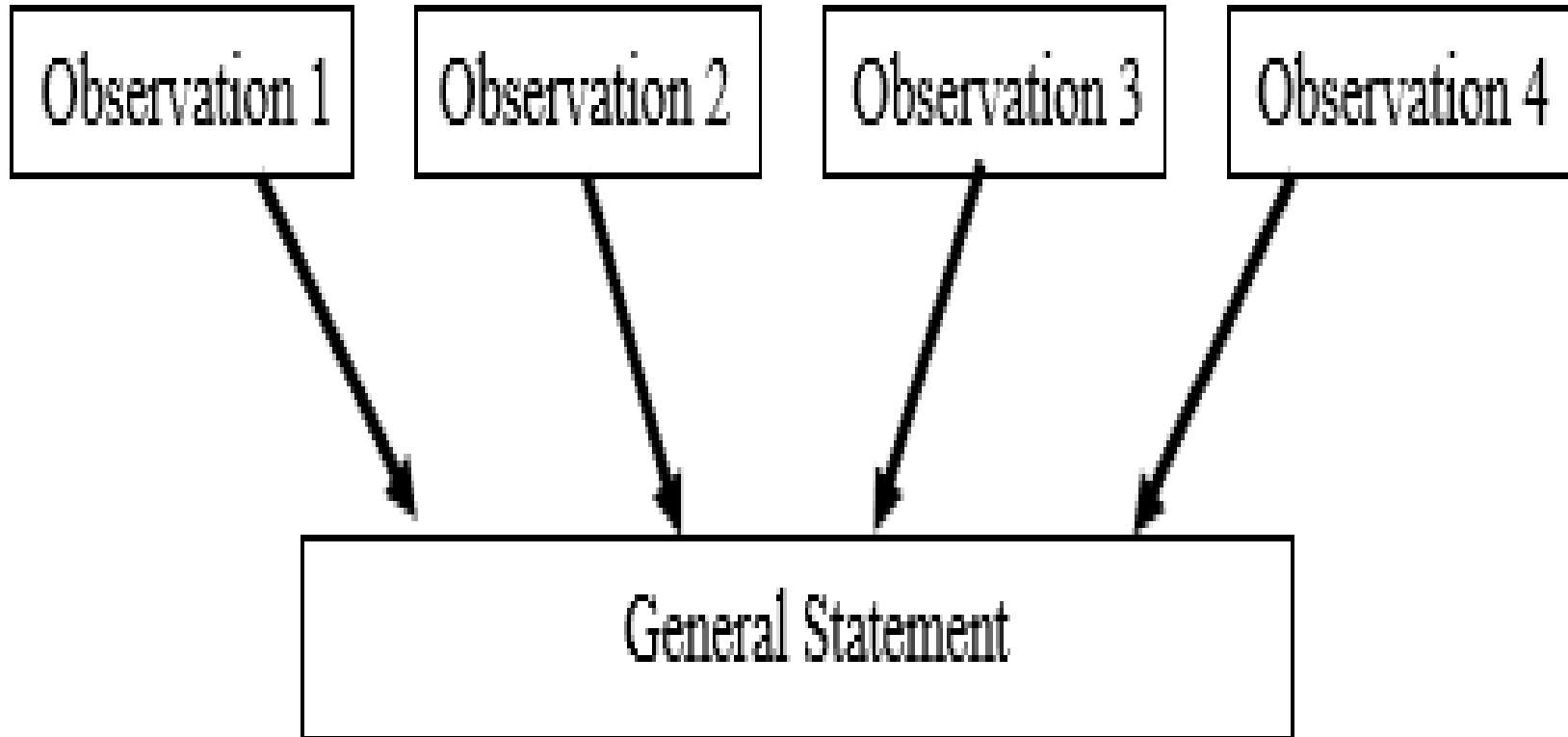




The method used

- **Inductive method:** General (true!) statements are derived from observations (Darwin, von Humboldt).
- Widely accepted that this method cannot lead to general findings. **But may be the starting point, in particular for applied science.**
- **Deductive method:**
 - Starts with premises which include assumptions, definitions and hypotheses.
 - Reveals the premises and concludes with a statement which might be true or not.
 - **Falsification** is possible but not **verification**.

Deductive method of discovery



The structure of economic discovery



- Premisses:
 - Definition
 - Hypotheses
- Logic elaboration
- Logical test
- Empirical test
- Normative statements versus positive statements.
- What is a scientific statement?



Collection and observation of facts

Elements of economic theories

1. Premise

Definitions

Hypotheses

Change in
premise

2. Creation of a theory

Unfolding the premise leading to logically deduced hypotheses or conclusions

3. Steps of tests (Chain of reasoning)

Logical test of conclusions

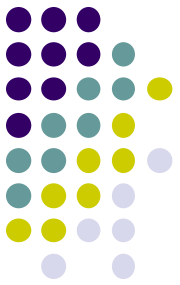
Logically correct or incorrect

Attempt to falsify (no verification)
= Empirical test based on data

Tentatively correct Institute for agricultural studies 2020

An example:

The quantity theory of money



1. Premise

- a. Definition: $P \cdot H = M \cdot V$ with P =price level of produced goods (GDP), H = Volume of produced goods, M = Money in the economy, V = Velocity
- b. Hypothesis $V = \text{constant}$.

2. Conclusion

- $dP/P + dH/H = dM/M$
- $dP/P = dM/M - dH/H$
- If $dM/M > dH/H$, there will be inflation
- How to test a theory?
 - Using logic. Why did the logic fail during the financial crises?
 - Using empirical data which may lead to falsification



Note:

- There is no possibility to create definitive truth.
- All knowledge which we create is preliminary right.
- There is no absolute truth in science.
- Science “may” search for truth, but cannot be certain to have identified truth!

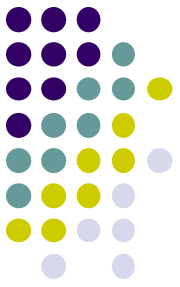
Value judgments and scientific statements



- Definition of a value judgment: A value judgment is a normative statement.
- Statements about facts are positive statements.
- What is a scientific statement?
 - Answer includes a value judgment.
 - Necessary condition: intersubjective verifiability of logic.

Discuss: Can theories which cannot be falsified be part of science?

Examples of value judgments



- “Incomes are **too** low or **too** high”. Obviously, the speaker must know the **right** level of income. If the audience do not know what the speaker considers as **the** right level of income the statement is not an objective information for the audience.



The problem with value judgments is that others than the speaker do not know ‘why should it be like that’? Or why does the speaker consider incomes as too low or too high?

Value judgments are often hidden. Even the speaker or writer does often not know that his statement expresses his personal values.

Example: The Government should provide free education or should provide cheap credit for agriculture.

The listener or the reader does not learn ‘Why should the government do ‘this’ or ‘that’.

Location of value judgments I



(1) Diagnosis: Is there a need for policy change?

**Diagnosis is based on a comparison
'what is' or 'will be' with
'what **should** be'.**

There are many alternatives with respect to 'what should be'.

Planners in a planned economy had different opinions on what should be than policy makers in a market economy. **Importance of mental models.**

Marx had different ideas than Adam Smith and so on.

Is there any chance to find out **what should be**?

Location of value judgments II



(2) Diagnosis: What will happen without a policy change?

The analysis depends partly on the approach of the policy analyst.

(3) Recommendations of the therapy:

- Selection of the instruments
- Taking into account side-effects (by-product distortions)

Value judgments and science



- Statements including value judgments are called **normative statements**.
- Statements which only include facts are called **positive statements**.
- Should scientific statements only include positive statements?
- The answer includes a **value judgment**.

How to cope with value judgments?



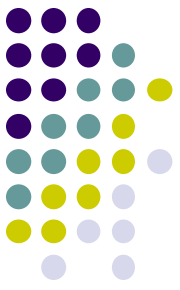
- Policy analysts **have to** include value judgments in any policy analysis **if** they want to contribute to an improvement in the society as much as possible .
- **Discuss: Where do value judgments enter the policy analysis?**
- **What is the problem with CGE (Computable general equilibrium) models?**

Position of economists



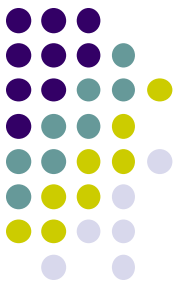
- Most economists agree that value judgments can be included in scientific work, but they have to be transparent.
- **Criteria of intersubjective traceability has to be observed.**

Transparency of value judgments I



- **Alternative I:** Start with personal specification of value :
I personally think that income of people should be at least 350€ per month. Hence, the income of this person which is only 300€ is **too** low. The audience learns why the speaker or analyst considers the income as too low. The statement can be falsified inter-subjectively.

Transparency of value judgments II



Alternative 2: Introduce value judgment in the form of an if-clause:

“ If we assume that the income of poor people should be at least 350€ per month, the income of this person is too low .“

“Salary of people should be related to the time needed for education, hence, university teachers should earn more than skilled blue collar worker” **and more than teachers at public schools .**

Specific value judgments in policy analysis I



- Specification of objective(s) and indicators
 - Economists prefer to apply only one objective and one indicator.
 - Maximize Utility
 - Indicator: Income of the population
- Basis of comparison: What are the real alternatives? Economists often assume that there are no political constraints. Policy makers are often constrained by past decisions and the actual situation. Budget implications may play a significant role.

Specific value judgments in policy analysis II



- Analysts often neglect distributional effects at least in the first step. They are often called ‘**efficiency artisans**’. Discuss! What is the justification?
- Interpersonal comparisons of utility are not possible according to our present state of knowledge.
- Significant constraints for policy analysts.
- **Lawyers deal differently with the problem.**

Implicit norms if markets are accepted as coordination mechanism



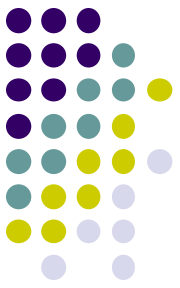
- Individual freedom has priority as long as others are not negatively affected.
- Situation of agents can be improved by markets better than with any other mechanism of coordination.
- Commitment to fairness which says that remuneration of individual is related to contribution to overall well-being and that remuneration is acceptable by other members of the society.

What **may be** considered as fair and/or just?



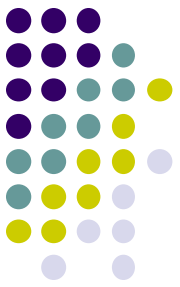
- Intellectual experiment by Rawls (Theory of Justice): How would a constitution look like if it had been agreed by and for those who had no stake in it at the time of agreement.
- Differences in income may be acceptable if everyone has the same chance and reflect the contribution to overall well-being.
- Differences in income have to be related to achievement.
- Taking over of risk is also an activity which deserves remuneration.

Part III: Markets and Morality



- How to define morality or what individual action may be called ‚good‘ or ‚bad‘.
- Is it important what the individual thought he should do based on his personal values?
- Ethics of conviction versus ethics of responsibility.(motivation versus consequences)
- **Economists assume that the consequences are more important than the motivation.**

Excurses: Pareto improvement and morality



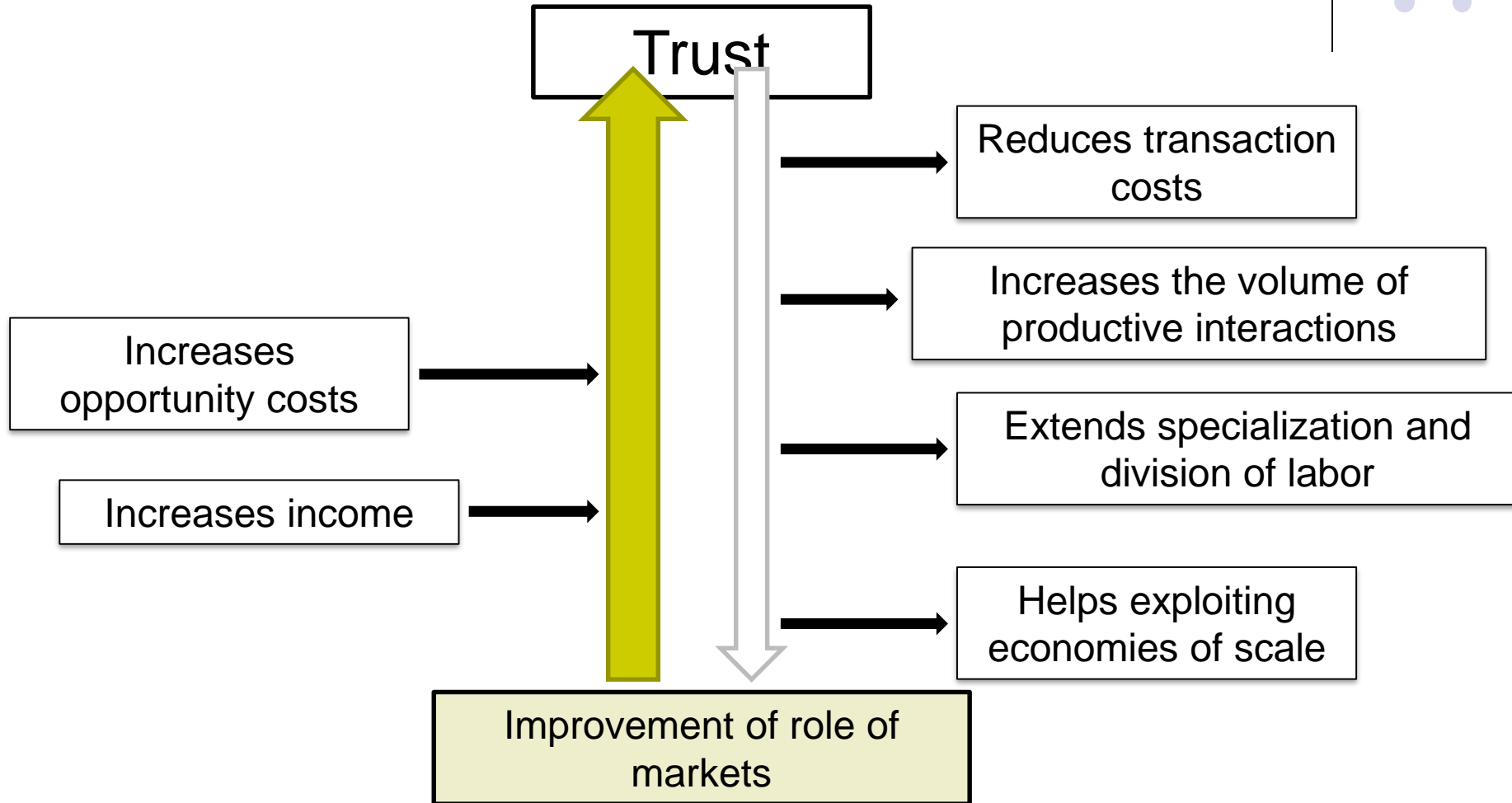
- What is morally good behavior?
 - Value judgment
 - Depends on the norms of the specific society.
 - What counts? The motive (intention) or the consequence?
- What utility function is implicitly assumed if a Pareto improvement is considered as morally good?
 - Socially independent utility functions: Individual utility does not depend on utility of other individuals.
 - How realistic is this assumption?



Better functioning markets may improve morality

- Higher welfare → less poverty
- Less poverty → Improved morality
- More commercialization → More morality
- There is empirical evidence that morality of the members of a society is related to the average income and the distribution of income.
- Markets may also directly improve morality. History shows that commercialization improved probity and punctuality (Netherlands and Great Britain):
Reputation is a valuable asset.

Mutual Interdependence between trust and markets



Main elements of good moral behavior



- **Honesty**
- **Trust**
- **Reliability**
- **Fairness**
- **Willingness to cooperate**
- **Respect of other people, independent of religion or ethnic origin.**

	TOTAL	Country Code				
		Australia	Germany	Lebanon	Poland	Romania
Most people can be trusted	31.9%	51.4%	44.6%	9.8%	22.2%	7.7%
Need to be very careful	64.7%	47.8%	53.8%	80.3%	75.6%	91.4%
DE, SE: Inapplicable; RU: Inappropriate response; SG :Missing	0.2%	-	0.2%	-	-	-
No answer	0.6%	0.7%	0.1%	-	-	0.2%
Don't know	2.7%	-	1.3%	9.8%	2.2%	0.7%
(N)	(14,630)	(1,477)	(2,046)	(1,200)	(966)	(1,503)



	Country Code			
	Russia	Sweden	Ukraine	United States
Most people can be trusted	27.8%	60.1%	23.1%	34.8%
Need to be very careful	66.2%	37.2%	70.3%	64.3%
DE,SE: Inapplicable;RU: Inappropriate response;SG :Missing	0.6%	0.3%	-	-
No answer	0.4%	0.8%	1.6%	0.9%
Don't know	5.0%	1.6%	4.9%	-
(N)	(2,500)	(1,206)	(1,500)	(2,232)

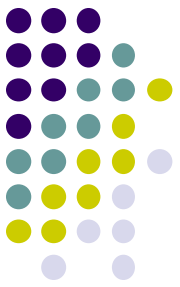
Selected samples: Australia 2012, Germany 2013, Lebanon 2013, Poland 2012, Romania 2012, Russia 2011, Sweden 2011, United States 2011

Markets may improve moral behavior

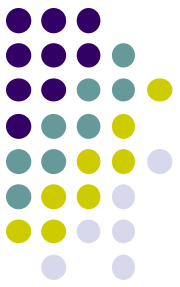


- Historical comparisons of countries show that commercialization of an economy improved moral behavior of people.
- Reputation is an asset which may earn a high profit. May be particular high for some professions.
- Introduction of market mechanism – such as quality control by independent controllers – enforces moral behavior. (The case of SGS, amazon; Bitcoin)

Contribution of research in agricultural economics to the standard of morality



- Moral behavior cannot only rely on individual insight as implications are not always clear.
- Task: **Improve incentive compatibility.**
- The individual who acts in its self-interest should act in the common interest at the same time.
- **Economic incentives and sanctions are important.**
- **The task of the Government is to define, to set and to enforce the rules of the game.**



Markets and Morality

- Neoclassical economics shows that an individual who maximizes his / her utility does not necessarily harm others. He / she **may** behave ethically acceptable.
- Why is, nevertheless, the market mechanism in many countries not well appreciated and economists, in particular in transition countries, are not well respected?



Focus on fallacies

- A fallacy is an erroneous argument dependent upon an unsound or illogical contention. There are many fallacy examples that we can find in everyday conversations and in economics. Fallacies in economics are often statements which seem to be true, but they may only be true if specific assumptions generally reflect the reality.

Fallacy



- The share of the agricultural sector in total GDP of an economy will decline with overall growth due to Engel's law.
- The agricultural sector suffers less from a recession than other economic sectors of the economy.
- Price stabilization in a country may lead to instability in farmers' revenue.



Fallacies

1. It is immoral to waste food.
2. Speculation with food products has to be judged negatively from a morality point of view as it contributes to increasing volatility and jeopardizing food security.