by Mancur Olson

AGRICULTURAL EXPLOITATION AND SUBSIDIZATION

There Is An Explanation

> ➢ **Agricultural products are normally underpriced and many types of urban production subsidized in developing countries. In developed countries agriculture normally shares in the system of subsidies, and in developed countries without comparative advantage in agriculture many farm products are overpriced. The explanation for this difference is related to opportunities for collective action. In developing countries, conditions are not favorable to collective action by farmers. In contrast, collective action is easier in developed countries, and protection makes possible large subsidies to agriculture in those countries with relatively little good land in relation to population.**

THE treatment of agriculture is totally different in the developing than in the developed areas. While most of the developed countries raise agricultural prices with price supports or tariff protection, the less developed countries use their public policies and institutional arrangements to make their agricultural prices *lower* than those in international markets. With government marketing boards, multiple exchange rates, special taxes on agricultural exports, or price controls they usually make the return to agriculture lower than it would otherwise be.

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They normally also use tariffs, quotas, and exchange controls to subsidize manufacturing and other urban industry. This not only raises the prices that farmers must pay, but also reduces the amount of a country's currency that is supplied to purchase foreign goods, thereby raising the value of the national currency and discouraging agricultural exports. They often also subsidize consumption in the capital city and provide disproportionate amounts of social overhead capital to the people who live in the major cities.

In addition, urban wages are usually much higher in relation to rural earnings than would be the case in competitive labor markets. The high urban wages generate unemployment.

So conspicuous are the real wage differentials and the associated unemployment rates that one of the better-known models in development economics—the "Todaro model"—is devoted to explaining how the flow of labor from rural areas to major metropolitan centers could continue in spite of the low probability of employment in the modern urban sector. W. Arthur Lewis's famous model of "unlimited supplies of labor" to the modern and mainly urban sectors of the developing economies also explicitly assumes significantly higher returns to comparable labor in the modern sector than is available in the traditional and mainly agricultural sector.

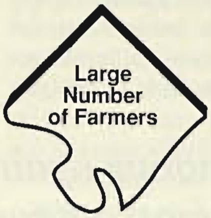
In an entirely unconstrained labor market, the unemployed and low-wage labors would have an incentive to offer to fill the jobs of the high-wage workers for somewhat less and the employers would have an incentive to accept such offers. Thus the high wage premiums and unemployment rates in the major cities of most developing countries indicate that there are collusions or cartels of relatively fortunate workers, either tolerated or encouraged by the government, that generate higher-than-competitive wages. These wages come in large part at the expense of potential entrants from the agricultural sectors and thereby lower the returns to labor in agriculture.

Developed Countries

In the developed countries, by contrast, agricultural interests are normally among the major beneficiaries of tariffs, quotas, price supports, and other subsidies. This is especially the case for the developed countries, such as the highly industrialized nations of Europe and Japan, that do not, mainly because they have relatively little farmland, enjoy a comparative advantage in agriculture. These countries could, for the most part, obtain most their food most efficiently by importing it. In fact, in these countries the subsidization of agriculture is exceptionally lavish, and probably far higher than the levels of subsidies to many of the principal manufacturing industries in those countries. As T. W. Schultz graphically puts it, many of these countries have carried agricultural protection nearly to the point of "greenhouse agriculture."

The subsidies to agriculture are relatively smaller in the developed nations with a comparative advantage in agriculture, such as Australia, Canada, New Zealand, and the United States, and the agricultural interests in these countries (especially in Australia and New Zealand) lose substantially from various forms of protection or subsidy to various urban industries. Nonetheless, even in those developed countries that profit from agricultural exports farmers receive a significant share of the existing subsidies. In the United States, for example, the total government subsidies to agriculture are in many years very large even in relation to total farm income. There are in addition subsidies that do not show up in the government budget. The producers of some farm products, such as fluid milk and sugar, are systematically given supra-competitive prices at the expense of consumers.

The Numbers Paradox



There is strength in numbers. In democratic countries, the more numerous interests obviously have more votes than the less numerous. Even in nondemocratic countries, the potential physical and social force of more numerous groups should, when other things are equal, give them more power than less numerous groups.

Why, then, is agriculture exploited in countries where farmers or peasants constitute the great bulk of the population? And subsidized in countries where farmers constitute only a tiny minority, and often less than five percent, of the population?

Is the Exploitation of Agriculture Required for Development?

In many circles, the explanation of the paradox I have posed will seem obvious. Many people believe that, in order to become developed, the poorer countries should subsidize and promote industries of the types that are most prominent in the economically advanced countries and discriminate against those industries, like agriculture, that have become relatively minor parts of the advanced economies. Because the less developed countries mainly export primary products, they are often perceived to be the hewers of wood and drawers of water for the economically advanced nations and they naturally strive to escape from this apparently subordinate and unrewarding role.

Much more is known about how individuals can get ahead than about how nations can advance. So let us ask what the low-income individual would do if he approached his personal advancement the way so many people, in rich countries and poor countries alike, are advising the less developed nations to do. He would observe, for example, that rich people consume more champagne and caviar than poor people do. By analogy with the precept that developing nations should try to imitate the developed countries by having more industry and less agriculture, he would then conclude that the way to get rich was to consume more champagne and caviar!

Since knowledge about personal affairs is less ideological and based on more experience than popular knowledge of development economics, everyone knows that imitating the behavior patterns of the rich is not the best way to become rich. Almost everyone realizes that it would be better to note what those low-income people who became rich did *when they were becoming rich;* it is better to take note of the hard work, the investments in education and other assets, and the profitable innovations (often in combination with good luck) that made some individuals earn a lot of money. Similarly, developing nations ought to examine what the presently developed nations did *when they first began to develop economically.*

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There is not nearly enough space to go into this here, but I believe that a careful examination of the economic history of the developed nations shows that the discouragement and exploitation of agriculture is by no means the way to bring about economic development. Indeed, our knowledge of economic history and economic theory is already sufficient, in my opinion, to show that the notion that the developing nations can best develop by protecting heavy industry and discriminating against agriculture and primary production is one of the most onerous burdens that the hundreds of millions of poor people in the developing nations have to bear. But that is another story that I have told in my book on *The Rise and Decline of Nations* and so I will not repeat it here.

Discriminating against agriculture...is one of the most onerous burdens that the hundreds of millions of poor people in the developing nations have to bear.

Nonetheless, beliefs are realities even when they are illusions. Thus the belief that the exploitation of agriculture and the subsidization of industry is necessary for economic development, even if it is (as I claim) wrong, may still help to explain agricultural policy in developing countries. So long as the governments of developing countries, and the foreign advisers and intellectual elites that influence them, *believe* that the underpricing of agricultural products is necessary for economic development, this belief can influence public policy. Though my main explanation of the discrimination against agriculture in the developing countries is quite different, I think that the prevailing belief that the protection of manufactures at the expense of agriculture is good for economic development is part of the explanation for the systematic exploitation of agriculture in the less developed countries.

Agriculture in Pre-industrial Europe

But the belief that the development of poor countries is promoted by the subsidization of industry at the expense of agriculture is *not* the *main* explanation for the exploitation of agriculture in the less developed areas. This becomes clear when we look at policy toward industry and agriculture in western Europe (and especially in Britain) in pre-industrial times. When these presently developed nations were undeveloped, pre-industrial areas, they did not have any plans or policies to bring what we would today call economic development about. They did not think sustained and substantial increases in per capita income were possible. What some historians call the "idea of progress" was largely still in the future. It was usually taken for granted that the overwhelming majority of the people in every country would always remain poor. Malthus's apparent demonstration that this *must* be so, because of population pressure and the finite supply of land, was promptly and widely accepted.

The British in the late eighteenth century not only had no plans to promote an industrial revolution; they did not even really understand that one was going on: it was the 1880's before Arnold Toynbee even coined the phrase "industrial revolution." Thus any promotion of industry at the expense of agriculture in pre-industrial Britain and in the rest of Western Europe at this time could not possibly be explained as due to any belief that this was necessary for economic development

Yet the institutions and government policies in Britain and the rest of Europe before the industrial revolution definitely and strongly overpriced many industrial goods and commercial services and underpriced many agricultural products. This is evident not only from modern work in economic history, but also from the observations at that time by exceptionally perceptive observers such as Adam Smith. The whole emphasis of the mercantilistic policies of the national governments, as well as the guild rules of the towns, was to encourage profit from commerce and manufactures at the expense of agriculture and unskilled workers.

There is a striking similarity between the pro-urban policies of the European nations before the industrial revolution and those of the developing nations that are at a somewhat similar level of economic development today. The pro-urban and anti-rural policies of pre-industrial countries of Europe could not possibly be explained by any desire to imitate the patterns in more developed countries—in those days there were, after all, no such countries. The underpricing of most agricultural products in most poor countries must accordingly be explained by the inherent characteristics of poor or developing societies.

Collective Action

How do the inherent characteristics of low-income societies, whether those in the developing areas today or in Europe before the industrial revolution, generate a tendency to underprice agricultural products and overprice certain industrial products? And how does this tendency disappear as a country becomes developed? And sometimes even lead to a reverse tendency in developed countries without a comparative advantage in agriculture?

My explanation begins with the difficulty of collective action, especially for large groups, which I explained in a book on *The Logic of Collective Action*. Suppose any group of firms, workers, or farmers should strive to act collectively to lobby for a tariff, price support, tax loophole, or any other legislation that favors them, or act collectively in the marketplace to restrict supply and thus obtain a supra-competitive price or wage. The benefits of the favorable legislation or the monopoly prices or wages would automatically go to everyone in the relevant industry, occupation, or category, whether or not they had borne any of the costs of the lobbying or the output restriction. It follows that in sufficiently large groups, the benefits of collective action offer no inducement to individuals to engage in collective action—they would get the benefits of any such action whether or not they participate in it, and any typical individual's contribution will have no significant impact. Thus some large groups with common interests, such as the consumers, the taxpayers, the unemployed, and the poor are not organized in any society.

By contrast, the large firms in a concentrated industry, where the numbers are small enough so that each firm will get a significant share of the benefit of collective action in the interest of the industry, will usually be able to make a bargain to engage in collective action without exceptional difficulty. Large groups will be able to organize for collective action only when they can work out special "selective incentives" that punish or reward individuals in the group that would benefit from collective action according as they do or do not support the collective action. The most conspicuous example of a selective incentive is the compulsory membership and coercive picket lines of labor unions, but all large groups that are able to organize for sustained collective action have analogous, if often very subtle, selective incentives that mainly account for their membership.

There are often particularly interesting examples of this in the agricultural sectors of the developed economies. In the United States, for example, much of the membership of the major farm organizations arises because membership dues are more or less automatically subtracted from the patronage dividends of farm cooperatives or added on to the premiums of mutual insurance companies associated with the farm organizations. Various tax advantages given to cooperatives and various complementarities between farm organizations and certain types of business organizations can make such arrangements viable even in highly competitive environments. Sometimes farm cooperatives themselves will, in effect, function as lobbying organizations as well as firms.

Because collective action by large groups is inherently difficult to organize, it will emerge only slowly and in favorable conditions, when these groups have the imaginative leadership and good luck needed to arrange the necessary selective incentives.

Once they are organized, organizations for collective action will strive to obtain more of society's output for their own clients through distributional struggle. They normally have no incentive to produce anything, but rather an incentive to lobby governments for subsidies and protection from imports, or to use their powers of combination to raise the prices or wages they receive. The organizations for collective action normally have an incentive to persevere in distributional struggles even when the costs to society are very large in relation to the amounts that they win by distributional struggle. In this they are fundamentally different from firms, individuals, and democratic governments in environments free of lobbying organizations and cartels.

My argument helps to explain why long-stable societies that have had time to accumulate many of these organizations, such as Great Britain, have in recent times been growing less rapidly than expected. It also helps to explain the economic miracles in Germany, Japan, and Italy after World War II, for totalitarian governments and occupying armies had eliminated or transformed most organizations for collective action.

Collective Inaction in Rural Areas of Poor Societies

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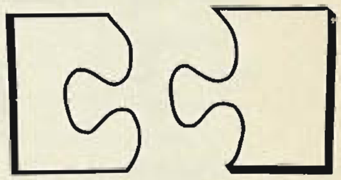
What are the favorable conditions that are needed before collective action by large groups is likely to emerge? Clearly organizing requires that people communicate and sometimes meet with one another. The success of private cartelization or collusion will depend on the costs of insuring that all members adhere to the collusive agreement. Thus collective action by large groups will be less likely the higher the costs of transportation and communication. These costs depend on such things as distance, the technology of transportation and communication, and the degree of literacy. Private cartelization will be dependent not only upon the numbers that must combine but also upon the distances that picket lines or other forms of collusive enforcement must cover. Since organizing large groups for collective action takes a lot of time even in favorable circumstances, the likelihood large groups will be organized also depends on the frequency with which organizations are destroyed by the upheavals and repression that are common in unstable societies.

Because farmers and peasants are obviously spread out over more space than people in urban industries, their capacity to organize will be particularly dependent on the costs of communication and transportation. In rural areas of low-income societies without dense, modern networks of transportation and communication, such as Europe before the industrial revolution or many developing countries now, sustained large-scale collective action is normally impossible. This is especially true if the society is politically unstable, as most developing societies are. The small numbers of firms in manufacturing or major urban activities will, on the other hand, often be able to organize even in the pre-modern economy, because of the advantages of small numbers and proximity to each other in cities. Thus my argument predicts that some urban industries and occupations in the pre-modern economy will be organized to lobby and collude, and that the goods and services they sell will be overpriced, and that main agricultural industries will by contrast not be organized and their outputs by comparison will be underpriced.

Agricultural Policy in Developed Societies



As transportation, communication, and the levels of education improve and the political system becomes stable, the great difficulties of collective action are overcome even in the rural areas. Thus farmers are among the groups organized for collective action. Farmers in such societies are, accordingly, among the beneficiaries of tariffs and government subsidies. This is the main reason why agriculture in the developed nations shares in the system of subsidies, even though agriculture is systematically exploited in the less developed and pre-industrial countries.

Even in the most developed countries, however, agriculture cannot, benefit from extra-governmental or privately organized cartelization, such as that proposed by the National Farmers Organization in the United States. Cartelization remains infeasible for agriculture because of the distances that picket lines or other forms of cartel enforcement must cover.

In those highly developed societies, like Japan and most of the countries of Western Europe, that do not have comparative advantage in agriculture, tariffs and quotas can be used to support agriculture. The social costs of the overpriced agricultural products that result from this protection will be far less conspicuous than the social costs of open subsidies from the public treasury or compulsory measures to keep productive land idle.

Thus developed countries, at least if they have a pattern of comparative advantage that leads them to export manufactured products and to import farm products, normally greatly overprice agricultural products in comparison with manufactures—and do so at the same time that the developing countries systematically exploit their rural people.