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# AGRICULTURE IN A TURBULENT WORLD ECONOMY

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Edited by  
Allen Maunder, Institute of Agricultural Economics, University of  
Oxford, England  
and  
Ulf Renborg, Department of Economics and Statistics,  
Swedish University of Agricultural Sciences, Uppsala

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INSTITUTE OF AGRICULTURAL ECONOMICS  
UNIVERSITY OF OXFORD

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Gower

GÜNTHER SCHMITT

*The Role of Institutions in Formulation of Agricultural Policy: Their Repercussions on the Challenges of an Agriculture in a Turbulent World Economy*

INTRODUCTION

In dealing with agricultural policy, agricultural economists traditionally either analyse the economic effects of various policy measures on allocation of resources and distribution of income or they model optimal policies by given policy objectives based on welfare economics. The design of such optimal policies has often been criticised as a 'Nirvana approach' (Demsetz 1969) due to its remoteness from real policy decisions of prevailing governments. Welfare economics as an instrument for evaluating and designing economic policies is strictly based on methodological individualism assuming that each economic agent (*homo oeconomicus*) is striving for a maximum of individual utility in terms of economic rents (Sohmen 1976). Consequently, the society as the aggregate of those individuals prefers those policies maximising welfare. Policy decisions contrary to those principles do not therefore reflect the true preferences of individuals and have to be changed towards optimal decisions according to economists' reasoning. In other words, they are in fact (at least implicitly) in favour of an 'omnipotent, wise, benevolent and wholly informed dictator' (Buchanan 1959). Fortunately in many countries policy decisions are not up to dictators. In other countries being governed by dictators, those dictators are mostly neither wise nor benevolent. In countries mentioned first policies of governments are made legitimate by a majority of citizens due to regular votes within the institutional framework of a democratic constitution. With respect to the role of economists as designers of an optimal policy, the basic question arises whether those government decisions based on the consensus of the citizens reflect the true and unfalsified preferences of those citizens. Economists deny this. However, given that this is actually the case, 'welfare losses' of society due to factual policies have to be interpreted as 'welfare gains' of the society contrary to traditional welfare analysis.<sup>1</sup>

However, those implications of real (farm) policies are not the problem we have to deal with here, at least at the moment. Instead, we have to deal with the role of institutions in formulation of agricultural policies.

But we have already demonstrated that, first, institutions do play a rather important role in policy decisions, second that institutional arrangements are unavoidable in organisation and formulation of public policies and, third, that the outcomes of the decision-making process depend to a large degree on the design and structure of the relevant institutional settings.<sup>2</sup> It has to be added, fourth, that in reverse the design and the structure of institutional arrangements do of course direct and determine individual behaviour and decisions.

Institutions, and this has to be kept in mind, are man-made. Therefore they are subject to changes which are often interpreted as 'institutional innovations' in terms of changes favouring welfare increasing reallocation of resources.<sup>3</sup> However, sometimes it is very doubtful whether institutional changes are directed towards such an objective in any case. With respect to this, it is rather surprising that economists have failed until recently to analyse the process of the design and change of institutions, although economic reasoning may be able to explain those processes. It is therefore even more astonishing that agricultural economists have neglected the economic aspects of the creation and change of institutions in the field of agriculture and agricultural policies. Farmers (as well as other members of society) make use of three different strategies in order to increase their economic status: first they may organise the economic performance of their farm businesses as efficiently as possible; second, they may increase their profits by restricting competition. Both strategies and the economic implications thereof are traditional subjects of agricultural economists' analysis. Farmers, however, may additionally try to influence the outcome of the political decision-making process *qua* pressure groups. But this strategy of political rent-seeking<sup>4</sup> by farmers within the existing institutional pattern or by changing it, has been almost neglected by agricultural economists.<sup>5</sup> This in spite of the fact that the basic question of which of the three strategies (or combinations thereof) is to be preferred as a matter of economic efficiency involves, besides their different benefits, costs of co-ordinating individual decisions. The adjustment of individual actions to prevailing and expected market conditions (reflected in relative prices) is bound to such costs of co-ordination as well as the mutual adjustment of individual decisions towards collective actions in order to restrict competition or to influence the processes of political decisions by interest group activities.

Mentioning such costs of co-ordination leads back to the 'transaction costs' – the term which was introduced by Richard Coase in his famous article on 'The Nature of Firm' first published in 1937. Transaction costs determining whether production of goods and services is co-ordinated by markets directly or by other types of institutional arrangements (such as firms, co-operatives etc.) has stimulated economic research in analysing the role of institutions. Furthermore, it has also stimulated a bundle of new branches of economic sciences such as Modern Economic History,<sup>6</sup> the Theory of Property Rights<sup>7</sup> and the New Political Economy

(Economic Theory of Politics),<sup>8</sup> which are now summarised as the New Institutionalism. New Political Economy has enabled economists to analyse and to explain political decisions as collective actions subject to relative economic costs and benefits to individuals (public choice).

In this line of the economic theory of politics we have to describe and analyse the decision-making process with respect to agricultural policy. We have to restrict this analysis to parliamentary democracies as the institutional framework (constitution) of those decisions. The principle of those democracies is that political decisions are the result of elections in which (as a rule) the majority legitimates a government to use its power based on a corresponding majority in the parliament.<sup>9</sup> With respect to farm policy, the basic question to be answered is the following one: in developed countries farmers and farm populations constitute only a minority of total population as well as of constituency. According to our definition of democracy as the dominion of the majority it has to be expected that farmers do not have any chance to exploit the majority (of consumers and taxpayers). However, the contrary can be observed, as stated above. Consequently we have to explain this obvious paradox that political decisions in a democratic society are in favour of a minority of farm population by protectionistic measures, subsidies, tax reliefs etc. We will next try to explain why agricultural policy in those societies is as it is, and is not as it should be according to agricultural economists arguing in terms of economic welfare. Next, we will discuss the implications of the result of our analysis on the (new) economic theory of politics and, in relation to this, the role of (agricultural) economists as analysts and advisors of public policy. Third, we will consider the implications of those political decisions on the challenges of an agriculture in a turbulent world.

#### FARM POLICY DECISIONS IN A DEMOCRATIC SOCIETY

Formulation and application of (farm) policies in a democratic society is a complicated and interrelated process determined by numerous factors and forces. These factors are among others the specific structure of institutions, their mutual connections, rights and competences, the quite different influences of voters, political parties, pressure groups, bureaucracies, parliaments, committees and experts, partly regulated by constitutions and laws, restricted by national and international regulations (such as GATT or the Rome treaty) etc. Therefore, it is not astonishing that there are quite a number of hypotheses concerning the explanation of the privileged position of agriculture in most developed countries subject to a parliamentary democracy. These hypotheses have in common that agriculture is competing with other (organised) groups on the political market in order to enforce favourable decisions, by policy-makers. However, the answer to the crucial question why the farm population as a minority as compared to other groups seems to be more successful in its political rent-seeking differs rather widely among those

theories: Most prefer the relative strength of interest groups,<sup>10</sup> others consider farmers as marginal voters attracting all political parties in order to gain majorities of constituency,<sup>11</sup> still others emphasize the role of bureaucracies,<sup>12</sup> whereas only few have some ideological (agrarian) 'fundamentalism' in mind common to all voters, politicians and political parties.

We are convinced that all these hypotheses offer some insight; but are only of a partial nature. We therefore think that a more integrated and holistic 'theory' is needed which includes all those partial elements. Such a holistic model of the process of public legitimation of farm interests has to be based, first on the theory of the role of agriculture within economic growth, rather familiar to agricultural economists.<sup>13</sup> This theory, explaining factors affecting 'income disparity' of agriculture such as a secular attribute of the farm sector, seems to be the basic source of political preferences of society in favour of agriculture. Next, the economic theory of democracy originally founded by Schumpeter (1942) and Downs and further refined by Herder-Dorneich and Knappe has to be used in order to analyse the steering capacity of general elections with respect to farm populations respecting farm policy decisions of the government and Parliament. Third, the economic theory of political competition among various interest groups set forth especially by Posner, Stigler, Peltzman (1976) and more recently by von Weizsäcker has to be used in order to evaluate the impact of the organised interests of farmers on farm policy decisions. Finally, the economic theory of bureaucracy put forward by Tullock, Downs, Niskanen and Roppel may demonstrate the reactions of bureaucracy to the claims of agriculture.

Such an integrated theory may take into account the mutual interdependences and influences of all participants, actors and institutions being relevant on the economic as well as on the political market. We have analysed the elements of such a theory explaining the politically privileged position of agriculture mentioned above elsewhere in more detail (Hagedorn and Schmitt 1985; Schmitt 1984, 1985). Space available only allows one to summarise the findings such as:

1. The distribution of economic costs and benefits of structural adjustment of agriculture within economic growth is asymmetrical in so far as the benefits are transferred to consumers whereas the costs have to be borne by farmers (sunk costs of disinvestments).
2. The coincidence of rather low opportunity costs of resources used in agriculture and the institutional regulation of resource allocation in agriculture result in the well-known intersectoral income disparity.
3. Agriculture as a social group of many 'small' farmers is confronted by the free-rider problem in organising effective interest group activities. However solidarity seems to be rather strong among farmers due to agriculture's situation as described above.
4. Farmers in most Western countries are characterised by more or less strong identification with (conservative) political parties. Therefore

the 'political mobility' of farmers as voters seems to be rather weak. Consequently they do not behave as median voters and their impact on election results is rather negligible.

5. At best agriculture is able only to steer farm policy decisions rather roughly by political election. Agriculture therefore is incapable of a fine tuning of farm policy in the sense of a choice between competing policy measures.

6. The optimal strategy of income distribution according to the model of a pure democracy does not in reality provide politicians with a stable majority of voters and, consequently, there are no stable farm policies.

7. Theoretically the majority of consumers and taxpayers and their greater political mobility (between competing political parties) should result in policy decisions discriminating against farm populations because the political opportunity costs of privileging agriculture are basically most expensive to those voters.

So far, agriculture seems to be in a rather weak position in enforcing its interests on the political market. However, those disadvantages are obviously compensated by specific *advantages* of agriculture as an interest group:

1. The coincidence of irreversible investments and the economic pressure on farm income and structural adjustment leads to intensive as well as homogenous political preferences by farmers. Selective incentives (offered by organised interest groups) and an ideology result in solid group behaviour as a base of the institutional organisation of group interests.

2. Organised agriculture is able to formulate, represent and articulate fundamentalistic ideologies which are not restricted to the farm population. These ideologies are used in order to justify and to back up the consensus of society and the approval of the majority to policy decisions favouring agriculture. The arguments put forward by agricultural interest groups according to which farmers are supplying cheap and healthy food, that they are responsible for a secure food supply, that farmers are conserving the landscape, that they are rather poor and underprivileged, that they only ask for 'parity income', that they are politically stable etc. are forceful 'weapons' in order to manipulate public opinion. By neglecting or discriminating against agriculture, society may lose those 'public goods' supplied by agriculture. The exercise of solidarity, justice and stability of the majority of voters as well as political parties as against farmers offer some sort of satisfaction to the general public.

3. Ideological commitments of the majority with the minority of farmers are the basic motives for policy decisions favouring agriculture in advanced economies subject to a democratic decision making process. Farm pressure groups play a major role in so far as they have to strengthen and to revive those ideological commitments by demonstrating the specific position of agriculture within and with

respect to the more or less consistent sets of normative statements as to the best or preferred state of the world – usually defined as ideologies. But very often an additional ‘power’ is acting in the same direction as agricultural interest groups: the farm bureaucracy. The farm sector is usually administered by a bureaucracy specific on agricultural matters. On the top of this agriculture-oriented bureaucracy you will find in most of those countries a specific ministry of agriculture contrary to most other sectors or branches of the economy which are not administered by their own political departments. The officials of these administrative bodies (especially of the ministry) including the ministers (Secretaries of State) themselves are *ex officio* responsible for agriculture’s well-being. In order to reach the consent of their clientele as well as the financial resources and competences by governmental and parliamentary decisions (which of course are status symbols) farm bureaucracy uses similar arguments although on a more sophisticated level.<sup>14</sup>

4. It seems that the mechanism described above enables agriculture to protect its own political preferences and to neutralise opposing preferences of voters in the course of political decisions. In reverse, the mechanics of control of constituency and of competition between various political parties are open to agriculture as an effective instrument to influence those policy decisions: agriculture is consequently more efficient as compared to other groups or branches with respect to the ‘production’ of political power.

It has to be added, of course, that the specific type and structure of the existing institutional settings of the decision-making bodies differing between various countries may accentuate or mitigate the efficiency of agriculture in influencing the output of those bodies. For instance, it might make a difference whether we find a two-party system or numerous parties in a country, whether the country is subject to a centralised system of government or federally organised, whether we have a presidential type of government or a system more similar in Western Europe, whether some countervailing power outside parliamentary control, such as independent central banks, is established or not, etc. However, as far as we can see, there is a lack of theoretical as well as of empirical studies in terms of international comparative analyses, especially with respect to the formulation and execution of agricultural policies.

However, the present agricultural policy of the European Community offers an impressive example of the influence of institutional arrangements of decision-making bodies in policy output, quite diverging from that found in Western parliamentary democracies. We have analysed this elsewhere (Schmitt 1984; Hagedorn and Schmitt 1985) in detail. In summarising our findings, the following may be said: Farm policy decisions are made exclusively by the Council of Ministers of Agriculture, not being subject to either parliamentary control (by the European Parliament) or by Ministers of Finance or by a medium-range budget



planning process (as in the case in fiscal policy decisions in most member countries). Furthermore, financial resources of the CAP are so far unrestricted and only partially related to farm policy decisions as financial contributions to FEOGA (the farm budget of EEC) are to a large extent dependent on the size and growth of the national income of member states. Finally, decisions of the Council of Ministers are subject to unanimity, exposing each country to a position of blackmail. It has to be added also that member states are free to execute national farm policy measures outside the common price policy, especially in the field of social and, to a limited extent, structural policy. For most member countries such complementary policies are advantageous because the output effects can be externalised by FEOGA due to the budget regulation of the CAP. As a consequence of this 'unusual' type of institutional setting (which has to be analysed in relation to the fact that within the Community there is no common or harmonised economic and monetary policy), the CAP is hypertrophic compared to farm policies within the institutional framework of 'normal' parliamentary democracies. The specific outcomes of EC decisions on farm policies are well known and have been analysed by agricultural economists often and extensively.<sup>15</sup> We will come back to some implications in the last part of this paper.

#### THE IDEOLOGICAL FOUNDATIONS OF FARM POLICY DECISIONS: WHAT AGRICULTURAL ECONOMISTS CAN DO ABOUT IT

The central finding of our analysis of the factors affecting decisions on farm policies within the institutional arrangements of a parliamentary democracy privileging farm populations to an exceptional extent, has been the ideological commitment of the participants of the decision-making process. With respect to those ideological commitments two basic questions arise to (agricultural) economists. The first is related to the role of agricultural economists as analysts and advisers of policy authorities, given that farm policy decisions of 'society' in fact reproduce the undistorted preferences of society's members: are economists still authorised to apply traditional welfare economics in analysing farm policy outcome, given that welfare economics refers to maximisation of individual and pecuniary utility? The next question to be answered refers to the problem of analysing ideological commitment in terms of cost-benefit relations determining the (political) decision of all participants of the decision-making process. Since both questions are highly inter-related, we will start with the question mentioned last.

The second question is related to the problem whether the ideological commitment of public policy decisions has to be interpreted as of a purely altruistic nature. In this case, economists have nothing to add to what political scientists and sociologists have to say about ideologies as something which does play an important role in policy decisions but being quite of an irrational nature which cannot therefore be analysed by

sciences based on the rationality of human behaviour and decisions.<sup>16</sup> However, until recently the economic theory of politics was merely restricted to the view that political decisions (especially in the field of economic policy) are exclusively determined by pecuniary (materialistic) costs and benefits to the participants of decision-making. Since every (economic) policy produces transfers of wealth in one way or the other, it is always possible to relate with certainty political outcomes to these distributional impacts. This approach, in fact, leaves open the question whether the behaviour and results we observe in the political arena are the product of something else than the paradoxical pecuniary interests of affected parties. Probably the most basic proposition of economic (capture) models of state regulations is the assertion that the altruistic, publicly interested goals of individuals are such insignificant factors in processes that they are empirically uninteresting and dispensable.

However, such a proposition is obviously inconsistent with respect to farm policy decisions as we have demonstrated above. Altruistic motives play a decided role at least in farm policy decisions. They might be in the form of a sense of civic duty, that is, a duty to serve the interests of the public. Pursuit of such a duty therefore is a consumption activity that yields utility in the form of a warm glow of moral rectitude. A number of recent studies have suggested that policy-makers' self-defined notions of 'public interest' are dominant explanatory factors in their voting behaviour.<sup>17</sup> It has therefore to be asked whether the same should not be relevant for all political decisions of the participants involved.

Political ideologies are more or less consistent sets of normative statements as to the best or preferred states of the world. Such statements are moralistic and altruistic in the sense that they are held as applicable to everyone. Accordingly, political ideologies are to be taken in our context, as statements about how governments can best serve their proponents' conception of the public interest. Behaviour in accordance with such statements has the appearance of altruism in the actors' preference function. The returns from the furtherance of an ideology appear either in the form of satisfaction to individuals of knowing that they have concretely improved the lot of others or in the form of deriving satisfaction from having done the 'right thing'. Political behaviour based on ideology may arise from either the public by interested objectives of constituents or the publicly interested objectives of their representatives. In any case, the pursuit of ideologically based objectives gives satisfaction similar to the pursuit of materialistic objectives. No difference can be seen between the rationality of 'economic' decisions of individuals as compared to 'political' decisions of those individuals directed by 'altruistic' motives exclusively or in connection with economic incentives.

We are consequently, as economists, not authorised to blame ideologically motivated decisions by the participants of the (political) decision-making process as 'irrational'. The question is, however, whether the output of the decision-making process reflects the real preferences of the constituency, including preferences towards altruism.

And these preferences, given that they are not distorted by the decision-making process,<sup>18</sup> include not only the objectives of public policy – most economists are willing to accept that these objectives reflect the true preferences of society; but they reflect also the policy instruments used by the government to reach the objectives. Such a view of public policy is, of course, contrary to the traditional application of welfare economics as a method of formulating and defining optimal policy instruments as well as evaluating prevailing policies. This seems to be the real source of the mutual misunderstanding and misinterpretation of real farm policies (and farm policy-makers) on the one hand and agricultural economists on the other.

#### ON THE ROLE OF AGRICULTURAL ECONOMISTS AS POLICY ANALYSTS AND POLICY ADVISORS

Some final remarks have to be added to the last statement according to which farm policy decisions on parliamentary democracy are the result of the 'real' preferences of the society, being not only restricted to individualistic and pecuniary cost-benefit calculations. These remarks are directed to the role of agricultural economists within this policy-making process. In general, agricultural economists have analysed relevant farm policy by the application of welfare economics. These analyses have in most cases resulted in the findings that the prevailing farm policies are third-best solutions and society would be, of course, better off by changing policies towards first-best or, at least, second-best solutions. Based on this perception, agricultural economists implicitly asked for the 'dictator' mentioned above, ignoring the fact that society is willing explicitly to pursue ideological oriented objectives and policies and even renounce economic advantages. With respect to our reasoning from above, it might possibly be true that these third-best solutions are in fact first-best solutions in relation to the political preferences of the constituents.

Does this mean that agricultural economists are misconceived in arguing within the boundaries of traditional economic reasoning?<sup>19</sup> We do not think so. We are convinced that agricultural economists have to return to the old tradition of social science, that is the old tradition of enlightenment by demonstrating the real costs to society of the pursuit of ideological objectives. Arguing in the tradition of social sciences, agricultural economists can and will contribute to a more rational world, to more rationality of the political decision-making process, which of course leads to benefits for all members of society.

#### THE REPERCUSSIONS ON THE CHALLENGES ON AGRICULTURE IN A TURBULENT WORLD ECONOMY

Agricultural economists have analysed the consequences of regulation on income distribution, resource allocation and stability of agricultural

markets by governmental and parliamentary decision very extensively. The implications of non-market interventions such as social and structural policy measures have been less intensively studied. However, we are also informed on those implications although in a more qualitative sense. We need not therefore repeat here the relevant findings. Instead, we will concentrate on the implications of institutional arrangements steering and directing farm policy decisions on the specific causes and consequences of the present situation of agriculture in a turbulent world. With reference to the geographical dimension, i.e. the world, we have of course to include institutional arrangements which relate to international trade relations, such as:

1. National policy decisions in the field of agriculture very often have world-wide consequences in so far as farm policy measures by various countries stimulate other countries to protect their own farm sector. The history of protectionism demonstrates the fact that the introduction of protectionistic measures by some importing countries has led other importing as well as exporting countries to counteract those policies by import restricting and/or export stimulating policy instruments (Luard 1984). As a consequence of this, international division of labour in agricultural resource allocation is highly distorted and world markets are characterised by great instability. This instability of world markets seems to be still further accelerated by the fact that some countries are transferring their internal instabilities in food supply to world markets to a rising extent. This is to be observed so far as socialist countries are concerned. Within the context of a liberal world market, the impact of this 'structural' change would be rather limited. However, in the context of the present world market conditions subject to import restricting and export subsidising policies of many countries, instability of world markets are enhanced to a great extent (Runge 1984).
2. As a consequence of what is called 'the turbulent world', reflected in economic instability with respect to economic growth, employment and inflation, governments are under pressure to enlarge protectionism of national agriculture. This pressure is the consequence of expected instability of world food supply, the implication of inflation on agriculture's income situation, the deficits in external trade balances as well as the restricted outflow of farm labour due to general unemployment. These tendencies towards extended protectionism by tariff and non-tariff restrictions of international trade, by increased subsidies, tax reliefs but also by voluntary export restraints etc. of course accelerate the instability of world markets of agricultural products, again stimulating state intervention by importing as well as exporting countries (Johnson 1973).
3. Of course, there are some international institutional arrangements, which aim to control or to prevent these implications of national policy measures directly or indirectly. In this respect we have to mention first

GATT, but also international agreements concerning stability of exchange rates such as the Bretton Woods agreement. However, the latter has disappeared and the former has become increasingly irrelevant to international trade of agricultural products. So far these international institutions have shown themselves to be increasingly inefficient in countervailing national policy measures, special bilateral or multilateral trade agreements, etc. As a consequence of an increasing 'demoralisation' of international trade behaviour and performance, stability of world markets has to a large extent been reduced. This in reverse has stimulated protective measures by governments still further. A reform of these international agreements is urgently needed (Schuh 1984). However, the chances of realisation of such reforms are very poor, because the direction of such reforms is subject to very large controversies.

4. Necessary reforms of international agreements relevant for trade in agricultural products directly (such as GATT) or indirectly (such as a system of international monetary policies) are furthermore bound to a high degree to reforms of national farm policies. However, as stated above, present political and economic turbulence in the world economy as well as world agriculture is the pretext for the conservation and the expansion of national protectionism. The best example to illustrate this automatism is given by the European Community where the increasing economic problems confronting national authorities have resulted in a further retreat into protectionistic policy by national governments especially in the field of agriculture ('renationalisation' of farm policies). Additional distortions in factor allocation, international trade and income distribution are the direct outcomes; the stagnation of the process of integration of the EC is an indirect one.

5. Compared to markets and relative prices steering the adjustment of resource allocations, institutions are extremely inflexible towards necessary changes. The rigidity of institutions is reflected in an inflexibility of decisions to be made within the existing institutional arrangements. Therefore the repercussions of institutions on the rapidly changing conditions of the turbulent world economy (partly a consequence of rigidities of institutions and the decision-making process therein) are to be seen not only as the consequences of those institutions exclusively, but also as a consequence of the incapability of flexible reactions of the decision-makers. Changes in demand and supply in the short run as well in the long run do most often find an inadequate and insufficient reaction of institutions which are theoretically free to respond adequately. The most striking example may be found with respect to the reaction of the policy-making process to the rapid increases in agricultural production in Western countries due to technological innovations. Instead of practising a restrictive price policy, passing productivity gains of technical progress to consumers, political decision favoured a more income-oriented price policy (especially in the EEC). This resulted in misallocation of factors not

only with respect to farm inputs but also with respect to investments in agricultural research, thus stimulating technological innovations (Schmitt 1985). The reverse, a lack of investment in research can be observed in less developed countries (Pinstrup-Andersen 1982).

These final remarks on the repercussions of institutions in formulating farm policies in a turbulent world bring me back to the role of agricultural economists within the process of framing those farm policies mentioned earlier. They have, as we would like to put it, to remind policy-makers as well as the public that very often and to a rising extent the implications of the decision-making process in farm politics are socially unacceptable. Due to the fact that these policy decisions are to a large extent determined by the institutional framework, institutional innovations have to be asked for by economists in order to come to better policy decisions. Of course, such changes will not be reached in the short run. Therefore, agricultural economists have to repeat their messages again and again. Furthermore they have to analyse the functioning of prevailing institutions in the field of agricultural policies in order to design institutional settings which will result in policy decisions better suited to the challenges of a rather turbulent world.

## NOTES

<sup>1</sup>The basic problem whether the voting process reflects the true preferences of the constituency is questioned since the rediscovery of the *Condorcet-Paradoxon* by Arrow (1963). See especially Bernholz (1985) with respect to the present state of that discussion.

<sup>2</sup>'Institutions' are quite differently defined. We are following here Ruttan and Hayami (1984, p. 3f.) by defining institutions as 'the rules of a society or of organisations that facilitate coordination of people by helping them from expectations which each person can reasonably hold in dealing with others. They reflect the conventions that have evolved ... regarding the behaviour of individuals and groups relative to their own behaviour and the behaviour of others ... Institutions provide assurance respecting the actions of others, and give order and stability to expectations in the complex and uncertain world of economic (and social, G.S.) relations'. It has to be added perhaps that institutions in general and in politics especially are regulating such relations in order to prevent 'Hobbesian' anarchy. They are based, at least in democratic societies, on a general consensus of the societies' members as well as on the consent of people involved in particular institutional arrangements. Institutions are not restricted to organisations but also include the rules of interpersonal relationships either by law or conventions (traditions).

<sup>3</sup>See especially Ruttan and Hayami (1984) and quotations.

<sup>4</sup>See among others Tollison (1982).

<sup>5</sup>Exceptions are Rausser (1982) and de Gorter (1983).

<sup>6</sup>See especially North (1981).

<sup>7</sup>See for instance Furubotn and Pejovich (1974).

<sup>8</sup>See among others Mueller (1979) and Frey (1974).

<sup>9</sup>Sometimes governments are only backed by minorities and tolerated by parts of the opposition.

<sup>10</sup>See Rausser (1982), de Gorter (1983) and Haase (1983).

<sup>11</sup>This is discussed in more detail by Hagedorn and Schmitt (1985). See the quotations therein.

<sup>12</sup>See especially Tullock (1965), Downs (1967), Niskanen (1971) and Roppel (1979).

<sup>13</sup>See Schmitt (1972) and references.

<sup>14</sup>See Schmitt (1972) and references.

<sup>15</sup>See among others Koester (1977).

<sup>16</sup>In order to be quite clear on this concept of rationality it has to be remembered that rationality is not identical with profit or utility maximising behaviour, see Schumpeter's basic paper on 'rationality in the social sciences', written in 1940, published first in 1984 (Schumpeter 1984).

<sup>17</sup>Several investigations of such a type (in the field of economic policy) are quoted by Kalt and Zupan (1984).

<sup>18</sup>See footnote 1.

<sup>19</sup>This of course is not equivalent to welfare economics which is subject to valid criticism as far as transaction costs etc. are neglected.

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