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Rethinking the Role of Government in the Future Agri-Food System

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The original motivation for this paper grew out of the Food and Agricultural Marketing Consortium's recognition that 1996 marks the fiftieth anniversary of the Agricultural Marketing Act of 1946, a sweeping piece of legislation that forms a major underpinning for government activities to promote agricultural marketing in the United States. More broadly, the Consortium recognized that much of domestic food and agricultural marketing policy and many of our institutions date back even further to the 1920s and 1930s and have been recently viewed as outmoded to various degrees by different people. The Consortium posed the question: What set of government policies fits the current and future agri-food system? Another way to state this question is to ask what set of marketing policies for the agri-food system is in the public interest? The question is one of optimal policy design, if such a thing can be effectively defined.

Identifying the set of policies that fits current and future conditions is a formidable task, requiring as it does the consideration of how markets are operating and how they are likely to change in the future. The most difficult aspect of the task, however, is considering: 1) to which performance standards to which we wish to hold the agri-food system, 2) to what degree is some notion of fairness part of those standards, and, 3) if

fairness is important, what standard of fairness should we use?

Valuable treatises have been written on these subjects. However, I propose to talk about them more informally. In a session on marketing orders at the Consortium's 1994 meeting, Gary Fairchild posed the questions in this form:

If we did not have marketing orders today, would we want them and propose them? Could we get them approved?

The second question is especially timely since the relative size of the agricultural sector is now smaller than when many of the programs were originally passed. My purpose here is to address the questions posed above for all types of marketing policy.

Is the Agri-Food Sector Special (Different)?

The bedrock issue to consider in rethinking the role of government in the future agri-food system is whether the agricultural-food processing-food distribution sector is now, compared to the past, special or different in important respects from other sectors of the economy. If it is, it may require or

merit public policies different from those used in the general economy. If not, it does not.

My premise in what follows is that the agri-food system is not now generally special or different in meaningful ways that suggest the need for specialized marketing policy. This premise rests on three arguments. First, farming as a business is not unique from many other small, medium and large businesses run by individuals and corporations. While family farm values are real, family farming in its nostalgic form has largely faded. Nor are food processing and distribution industries unique in their characteristics. This does not imply that farmers, for example, do not face challenging and often difficult circumstances in making a living from their occupation. It simply says that a farmer faced with loss of market or tough competitive circumstances is not different from a textile manufacturer, restaurant owner or service worker faced with a similarly tough situation. Either both or neither should be the focus of policy attention.

Second, agricultural and food markets are in most cases mature enough to operate without a great deal of public policy input, especially when that input is at significant variance with that experienced in other industries. For example, the notion of orderly marketing of food products is not without merit, but do we worry to the same extent about the orderly marketing of steel, televisions or clothes? Every season, clothing stores mount big sales to dispose of stock that must only be the result of disorderly marketing of one kind or another. But we largely rely on markets to smooth out this disorderliness and do not view it as a government responsibility to assure that clothing stores earn a fair return on their investments.

A third, related point is that agricultural and food products are an obviously critically important necessity of human life. This special status does not, however, warrant special policies to control or influence demand and supply, although it does call for public policy to monitor and regulate some quality attributes such as safety. The United States can rely on its agricultural resource blessings and ability to buy on the world market to assure adequate supplies at affordable prices.

Lest I be misunderstood at this juncture, the above arguments are not in any way equivalent to a "markets always work perfectly" view of the world. What they say is that agricultural and food markets are not fundamentally different from other markets that require varying levels of regulation, monitoring and facilitation in a free market economy. Note that this is not equivalent to arguing for unregulated agri-food markets since the United States uses a broad array of policies to alter the operation of markets in all industries. It is arguing for comparable levels of intervention. For example, fairness in a market may not require a price support but rather some government specification of institutions that seek to ensure a fair bargaining atmosphere.

Market Failure Paradigm Limitations

Government's role in the economy has been under intense scrutiny in recent years. Familiar arguments center around the weight of regulatory burdens, the scope of regulation, and whether certain policies are forms of corporate welfare. The government's role is ultimately judged based on the social and political consequences of its actions. There is also a continuing trend toward

increased use of economic concepts and constructs in the evaluation process. In the first instance this involves a trend toward subjecting government policies and regulations to more consistent, stringent and demanding benefit/cost tests (for a flavor of the trend see, e.g., Belzer and Theroux).

In the second instance, there is a trend toward a public policy philosophy of applying what I will call a "strict market failure test" to evaluating government's role in markets. Here market failures stem from the existence of externalities, public goods and common property resources. Under this approach, the government's role in markets is constrained to instances where there are bona fide market failures *and* it is reasonably certain government action in the market will result in improved performance over the market with market failure and no government role. What the strict market failure test ignores is a potential role for government in addressing market imperfections such as market power and inadequate information. What it also ignores is that the test is not generally applied across all government policies and its selective application makes for inconsistent policy.

Improved rationality in government policy can be pursued through use of consistent benefit/cost tests of policies intended to address cases of market failure, market imperfections or undesired market outcomes. Applying benefit/cost criteria to marketing policy is often complicated because the policy is meant to influence markets that for the most part exist, although with possible imperfections. In many cases "correcting" the imperfection implies a redistribution of value, e.g., income, between the market participants. A further complication is that government may identify imperfections that it could lessen by offering a service on a fee

basis, e.g., quality certification, that competes with potential private providers. Here judging the government role hinges on whether it has any special advantages, e.g., credibility, ability to control free riding, efficiency, competence, that argue for providing the service in competition with private providers.

What Performance for Which Beneficiaries?

What are the relevant performance dimensions for the agri-food marketing system? The tried and true economists' list with minor modifications is a good one. This list includes: 1) efficiency, including allocative and technical efficiency; 2) equity, including the impact of changes in the organization of the food system on producers, processors and consumers; 3) technical progress, including the impact of information systems on market performance; and 4) availability of safe and nutritious food.

Discussions of the target beneficiaries of public policy in the agricultural and food industries tend to identify two groups. Consumers are nearly always identified as beneficiaries in one way or another. Policies adopted must ultimately hinge on a rationale of improved food access, reliable supply and/or lower prices. Farmers, particularly family farmers, are the second, and some would argue the primary, target group of beneficiaries.

This focus needs modification. As argued above, farmers are not uniquely different from other small (and sometimes large) business people. The ultimate performance criterion should be refocused on the well-being of consumers, with a secondary focus on the well-being of all market participants

including those working in farming, processing and distribution. The agri-food system's claim to importance in the general economy is based on employment and sales in the entire vertical chain of distribution but the target beneficiaries of agri-food programs are often limited to farmers and consumers. A broader focus would address this mismatch.

Major Policy Levers

There is no definitive list of marketing policies for the agri-food system since marketing can be defined broadly or narrowly depending on the purpose and focus of the analysis. For our purposes here I have chosen a broad definition to include most policies that attempt to affect the price, quality and disposition of agricultural products as they leave the farm and move through the food processing and distribution system to ultimate consumers. The list of major policy levers includes:

1. Price, situation and outlook reports; other informational programs.
2. Marketing orders.
3. Grades, standards and inspection services.
4. Domestic and foreign advertising, promotion and market development.
5. Authorization and facilitation of cooperatives.
6. Trade practice regulation.
7. Antitrust policy.
8. Food safety and nutrition regulation.
9. Facilitation of research, particularly at U.S. Department of Agriculture and land grant universities.

This is not an exhaustive list but does include the main domestic policy options. The

list does not include U.S. trade policy, which has very significant impacts on the sector.

Marketing Policy in the Future

The current accepted wisdom (and reality) is that budget constraints, government downsizing, and shifts in regulatory philosophy will continue to generate pressure to redefine the role of government in the agri-food system. Work on the current farm bill has focused intense attention on farm programs, which are likely to change dramatically. In this context, there are several forces that are key to judging the desirability of continuing or altering particular marketing policies in the future. How are these forces being used to justify regulation or the lack thereof? Do these trends yield useful premises for identifying good policy?

Industrialization

The agri-food system is evolving to more closely resemble an industrialized system with consolidation of activity, more extensive reliance on contract production and vertical integration, and more international trade. This evolution poses challenges to analyzing the size and importance of these trends and their implications for the role of government.

The most significant challenge industrialization poses for policy is analyzing its causes. A theme that runs through many discussions of industrialization of the agri-food industries is that industrialization is consumer driven. I find this theme very perplexing. It implies that change in horizontal and vertical market structure is dictated by consumer demand shifts that are minor in comparison to the shifts in market struc-

ture and organization. The argument that industrialization is consumer-driven is a largely unsupported. Of course, consumer demand for quality, price and specific attributes guides companies' strategies. But in nearly all cases it is not determinative of market organization and structure. That is the purview of the companies and their efforts to organize activities in a manner as profitable as possible, taking into consideration production and transaction costs, and opportunities to create and use market power.

A related blind spot in most discussions of industrialization is an overemphasis on the importance of transaction costs in determining organizational structure. It is as if after being overlooked for years, transactions costs are suddenly thought to be everything. They are clearly important, but not everything. Understanding the nature of industrialization is crucial to assessing the role of government in the new, more industrialized agri-food system. An analytical approach that ignores relative market power and overemphasizes the role of transaction costs has a built-in tendency to see current market outcomes as ideal.

Increased international trade and foreign direct investment in the agri-food system also have an impact on the role of government policy. Trade agreements are increasingly guiding what is acceptable policy at the national level as they try to produce freer trade by circumscribing subsidies and non-tariff barriers to trade. But it is also the case that trade agreements are a blunt instrument for exercising this type of control and governments continue to have great latitude.

In terms of government's role, increased trade and foreign direct investment have an effect similar to that of the forces that have been labeled industrialization. They tend to

diminish the role of government in price/income support programs and emphasize its role in designing and facilitating market institutions.

Shifts in Relative Market Power

A major traditional rationale for a government role in agricultural marketing is to address situations of unequal market power, particularly the perceived inferior bargaining power of farmers. In markets in which "industrialization" has not yet occurred, unequal bargaining power remains an issue but one, I argue, that should be addressed mainly through cooperatives or other initiatives to improve bargaining position. Again, situations of unequal bargaining power permeate the economy. Government's role in these situations in agriculture should be comparable to its role in other industries.

In markets in which "industrialization" has occurred or is in process, the nature of the bargaining problem has shifted. Contracts typically specify multiple process or product attributes in addition to price, making effective public reporting and monitoring difficult. The potential for processing companies to exploit their stronger market position when facing producers with large fixed investments is evident. But this situation exists in many industries in which suppliers are captive to major buyers whose decisions influence their survival. Even though this is the case, in this area I argue for an exception to my equal treatment argument and a continued role for government. This role is not in information collection or direct market regulation but in authorizing and facilitating formation of cooperative bargaining associations that can address the power and information gaps as long as significant gaps persist.

Information Availability

Information is generally becoming more easily accessible, with private services and web sites proliferating. However, significant information problems remain, including the lack of information on contract terms. I argue that government should be involved in making available data that it needs to support a) governmental decision making or b) fair operation of markets. Using Petzel's breakdown, this would include information that is publicly collected and paid for, and information that is publicly collected and privately paid for (on a fee-for-service basis as discussed below). It should also include a category not delineated by Petzel, privately collected data that should be available for purchase for public uses. The latter point addresses a problem that is increasingly developing as private information services collect data useful for policy analysis but refuse to sell it to public users at any price. New policy should assure reasonable access to such data.

The Issue of Competing Services

For those policies and programs that cannot be justified as in the public interest, should government provide them on a fee-for-service basis? I argue yes, as long as there is a demand for the service. For example, for grading services that the government is more credible in providing than private suppliers; fee revenue covers costs; and the government is technically able and has the resources to lead rather than lag developments in the market.

Government Role in the Agri-Food System

Using a broad brush, my assessment of the role of government in the future agri-

food system is summarized below. This assessment is based on the arguments that the agri-food sector is not different from other sectors of the economy and should have a comparable level of government policy involvement; government policy should address market failures, market imperfections, and other undesired market outcomes; and consumers should be the primary beneficiary of policy, with producers, processors and distributors being the secondary beneficiary. Based on these arguments and trends in the agri-food system, my score sheet on government policies can be summed up as follows:

Programs to Phase Out

1. Marketing orders, with exception noted below.
2. Information programs that could be provided by private services or that do not support a) governmental decision making or b) fair operation of markets.
3. Advertising, promotion and market development beyond cooperative efforts noted below.]

Programs to Keep

1. Information programs that support a) governmental decision making or b) fair operation of markets (including public access to privately collected data widely sold to private buyers).
2. Marketing orders that focus on assessments for research, advertising and promotion.
3. Authorization and some facilitation of cooperatives and bargaining associations.
4. Some trade practice regulation.

5. Antitrust policy.
6. Food safety and nutrition regulation.
7. Facilitation of research, although further downsizing may be warranted.

Fee-for-Service Basis Programs

Where private alternatives are inferior, these fee-for-service programs can be offered:

1. Grades and standards and inspection services to support them.

NOTES

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