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THE FOOD INDUSTRY, LABOR, GOVERNMENT AND CONSUMER

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Discusses some of the necessary ingredients for an effective governmental regulatory policy.

The force of the consumer in our society should be more apparent to you today than it was a year ago when I talked with this group. Pressures continuously exist in Washington for increased regulation of business. The economic stabilization program and all the attendant regulations of food prices, unleashing of food production from production constraints and liberalization of marketing order administrations are illustrative. Consumers have been major motivators of many environmental constraints that have been instituted. Increased anti-trust activity, stricter labeling requirements, control of food additives, control of growth stimulant, pesticides and other chemical residues as well as higher standards for cleanliness and food handling. We need to recognize that the consumer is, in fact, the major motivator of many of the increased regulatory activities that we have seen over the past year.

Expanded welfare programs represent another dimension of this concern. The fact is that over 50 percent of the USDA budget is now spent on consumer welfare programs. Namely, the food stamp program. If not constrained, this could rapidly move to 75 percent within two years within the existing legislative framework. We have therefore, moved to a new plateau of concern for the consumer.

Clearly the Department of Agriculture will never be the same and I am sure many other Government agencies could say exactly the same thing. The upshot

of this, is that more and more regulations of increasing severe and restrictive nature are being clamped upon business. In doing so, there is a tendency to apply a very basic legal principle of remedial action. This principle recognizes that, where a problem already exists, regulations imposed must be more restrictive than if they were applied voluntarily or before the problem became pervasive enough for regulatory agency action. There is sort of a punishment connotation, if you will, in the new regulatory environment in which we live. You have not acted in the past so, therefore, in addition to remedying the basic problem itself, we will punish you. Thus pollution regulations today are more restrictive than they would have been if we had acted earlier to clean up the environment. Labeling regulations are and will become more restrictive than if industry had taken the leadership itself. Are these trends toward greater regulation moving us in the right direction? That, of course, depends on one's perspective, one's values, and one's belief's.

The Adam Smith economist would probably be appalled at the situation. It seems quite clear to me that the competitive system of Adam Smith simply is not working well and has not worked well. The guiding hand of the consumer has taken a back seat to the special interests of big business, big labor and yes even big Agriculture. Farm producers frequently find themselves on the short end of the stick when it comes to the market place. However, a similar argument could not be made for their political potency in Washington. They were favored with large farm program payments, exempt from labor laws, exempt from provisions of the anti-trust laws as well as from transport regulations. A balancing

of consumer with producer labor and government interests was probably inevitable. It has descended upon us in full force. It is a force which must be reckoned with. But the danger always exists that we will over react. We may get so swept up on current causes of consumer activism that we forget about the need for a balanced approach to all problem solving. Over reaction can get us deeper and deeper into regulations with the eventual inability to extract ourselves.

Why this tendency to over react or over regulate? Let me suggest three reasons: first, Government seldom moves until a crisis exists. By then the cumulative effects of abuses not checked by a more timely action must be remedied. I would say business seldom will move until a crisis exists either. I do not mean to restrict this to Government. The slowness to react initially is frequently accompanied by slowness in the regulating. Thus, we frequently keep regulations long after their positive contribution has ceased. Bureaucracies are not only inflexible but they are also indestructible.

Second, there appears to be a great tendency to develop programs in a framework of incomplete models. Such models may be incomplete in terms of either the nature of the problem, the objectives of the program or the means of reaching the objectives. Again, let me illustrate. EPA has embarked on a program to clean up the environment. The automobile has been found to be a major polluter. Strict standards for exhaust omission have been established with obviously little attention given to the effects such standards have on gasoline consumption. Our society is sufficiently complex in terms of goal interdependency at trade-offs that a single unconstrained goal will no longer suffice for any regulatory program or agency of government. Thus, even the Department of Agriculture will increasingly be called upon in its programs to reflect the interests of its many clientele as well as other agencies of Government.

Third. Our analysis of the reactions of people to a regulatory program may be incorrect. Thus, in the economic stabilization program it is now abundantly clear that a cost of living council misjudged the magnitude of the reaction of farmers to the freeze on meat prices. This tendency to misjudge has gotten us deeper and deeper into a general food shortage problem, a problem which would likely have been less severe if we had never embarked on a food price stabilization program.

What about the effects of regulation on productivity? Productivity is used here in the normal context of the quantities of production per unit of input. Before analyzing the effect of regulation on productivity, however, there is the question of how important productivity really is in our society. To the production manager who is judged by his unit costs of operation such a question may be an insult. What could be more important? The fact is, that our abundant supply of nearly all raw materials and products combined with our ability to purchase, has made us complacent about the importance of productivity. At one time the primary determinant of the performance of the firm or market was efficiency in the utilization of inputs. But the concern about efficiency eroded away. Even in the economics profession it became so bad that in 1973 in a paper highlighting the problems of scarcity of resources a noted economist, Harold F. Frymeyer, played down the importance of high farm productivity and the regulation results in reduced productivity. This is something that we have not adequately recognized. If we are in an era of relative scarcity, productivity implications of regulatory activities will need to be more carefully evaluated and balanced against other regulatory goals. Let me give you four illustrations.

First, in the anti-trust area. The Federal Trade Commission and Justice Department are charged by our anti-trust laws with taking action designed to increase competition. But, such action also has the effect of reducing productivity or at least cutting off channels for increased productivity in many cases.

Illustrative was the 1967 ruling by the Federal Trade Commission which declared backhaul allowances to retailers for products picked up at a supplier's dock would likely be in violation of the Robinson, Patman Act. As a result, many trucks returning from making store deliveries or some other hauling duty drove back to the retailer's warehouse empty even though convenient pickups for inbound shipments to retailers existed. The adverse effect on productivity was direct and should have been obvious to the Federal Trade Commission. The food industry studied by the Commission on Productivity concluded that this ruling could have increased transportation costs as much as 250 million dollars per year. As a result of efforts of the Commission and the Cost of Living Council in December 1973, FTC regulations on backhauls were substantially relaxed. This is just one of several illustrations in the food industry productivity study where anti-trust laws stood as major barriers to increased productivity.

A thorough study of both the productivity and pricing effects of anti-trust rulings would appear to be in order. Particularly in areas where either efficiency gains appear to be substantial or pricing effects of anti-trust enforcement dubious. Robinson-Patman, joint ventures, merger guidelines and supply arrangements are illustrative of areas which in my opinion need immediate study for their productivity reducing effects.

The second topic I want to discuss is zero tolerance. In the late 1960's and early 1970's several books, popular, semi-popular and professional articles were written linking various agricultural chemicals, food additives and gross stimulants to various diseases, particularly cancer. DES, DDT, PCT's, BAE's, and others, as well as nitrocinibins became a part of many man-on-the-street vocabularies. The momentum of the movement rose to a frenzy. Laws were enacted which prohibited the presence of those substances in even the most minute trace amounts. As our ability to test

for the presence of these substances improved, their use became more and more restricted. Eventually, they were banned with little or no consideration of the costs in terms of reduced agricultural productivity. Thus, we entered the age of zero tolerance. Economists had no role in this age. The costs of using the substances were by definition infinity. But the movement was not limited to carcinogens. It expanded to calls for banning agricultural chemicals, food additives, antibiotics and growth stimulants even though the scientific base of proof of harmful effects did not exist, zero tolerance became the cause of many environmentalists and consumer advocates.

Today the frenzy fortunately appears to have subsided. The cost of zero tolerance in terms of our food supply and level of living became more apparent. People began to awaken to the principle that costs of eliminating potentially harmful substances rose at a geometric rate as the tolerance level of zero was approached. The conflict between goals such as conserving energy, in cleaning up the environment, eliminating residues and adequate food supply, thus became more apparent. We now appear to be in an era where we can more carefully and intelligently assess all aspects of the costs and benefits of tolerance levels before they are established. At least I hope we are.

Risk and uncertainty - Over time it becomes increasingly clear that an important adverse impact of the new regulatory era on productivity is increased risk and uncertainty of investment decisions for equipment to cope with the regulations. One literally does not know if, when a decision is made to invest several thousands or even millions of dollars to meet an existing pollution standard that that standard might be changed one or more times before the facility is completed. There is presently no way a decision maker can protect himself from this risk. Increased concern must exist for this problem. Firms who have invested in good faith must receive increased protection against near term regulatory changes which make their government induced investments obsolete.

Let's turn now to structural effects. Some of the most profound effects coming out of the current regulatory upheaval in the environmental, sanitation and health area could well be the effects new regulations are having on the structure of American industry and the markets which determine the prices we pay. These effects can best be seen in the current energy crisis, where independent stations and fuel suppliers are gradually being forced out of the industry. Historically, the independent, whether you look at the food industry or the petroleum industry has been a prime source of competition. His absence will surely directly affect the prices we pay. But the effects are obviously not limited just to energy. Larger firms are best able to cope with the requirements for new investments. They can utilize the economies of scale associated with pollution control equipment most effectively. They have the resource bases that allow them to adjust to limitations on the use of particular inputs or processes.

Smaller firms frequently do not have the same capabilities. They lack investment capital, scale and research talent. If standards are not applied in consideration of this fact, smaller firms throughout our economy could be eliminated by regulation as an effective source of competition. In the long term this can only adversely affect our desire for increased productivity, as well as improve pricing efficiency. In conclusion the challenge for each and every regulatory agency should be apparent to strike a balance between goals such as economic growth, increased productivity, adequate food supply and a healthy environmental base for living. Striking such a balance is not easy in our decentralized bureaucracy and in an era where everyone has a cause. This, in my view, is the major challenge we face in attempting to arrive at an optimum regulatory policy.