

# **Wither, or Whither, Agricultural Crop Subsidies?**

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## Abstract

There is and always has been virtual consensus among economists that many agricultural crop support programs cause inefficiency. Equally true, economists also know that whenever there is inefficiency, there is "room for a deal" that mitigates it. However, the standard political explanations for the persistence of these inefficient programs rely on the strength of the farm lobby relative to the diffuse and difficult-to-organize consumers that pay for them. This is unsatisfactory because, by the logic of economics, there is an opportunity for a deal that would benefit the farm lobby in exchange for shedding the inefficient programs. If the farm lobby could itself benefit, then we have no explanation for the persistence of the inefficient programs. I examine this puzzle, and conclude that increased political sophistication on the part of agricultural economists could have a high social payoff in terms of reduced program inefficiencies over time.

## **INTRODUCTION: THE PUBLIC INTEREST AND OUR PROFESSION**

The opportunity to offer a keynote address to this audience is a great honor, and I am thankful to you and especially to Susan Offutt for inviting me to do so. Since I am not an agricultural economist myself, it is also somewhat challenging. Who am I to tell any of you about agricultural crop subsidy programs?

I have spent my career exploring the intersections between economics and public policy making. I have been on the faculty of UC Berkeley's Goldman School of Public Policy for 30 years, teaching graduate students microeconomics and how it applies to the analysis of public policy issues. I have always maintained the hope that through the course of their professional careers, they will be a positive and worthwhile influence on public policy—that is, on balance they will contribute to the public interest, even though that may be difficult to define in any specific situation. This is, I imagine, not unlike the way many of you feel about yourselves or your graduate students who enter careers in government service or who try through their research and perhaps testimony to influence policy—that on balance you and they make positive, beneficial contributions.

If our hopes are so, then the persistence of agricultural crop subsidy programs in the United States, where professional policy-analytic advising is far more advanced than in other developed economies, sticks out like a sore thumb. There has been virtually complete consensus within the profession about their historical inefficiency. This consensus has been conveyed to virtually every college student who has read any economics principles textbook written in the last 50 years. If professional economic advice can influence anything, then surely it ought to be able to influence the design of those programs.

Hopes for this probably reached a high-water mark in about 1997, in which the Economic Report of the President opined about the 1996 Federal Agriculture Improvement and Reform (FAIR) Act: “once the 7-year [production flexibility] payments run out, they are not expected to be renewed” (p.229). But rather than decreasing as scheduled, agricultural subsidies increased substantially as the century turned, and they appear to have a sustainable future with the passage of the Farm Security and Rural Investment Act of 2002 (henceforth 2002 Farm Act). Laura Tyson, writing in *Business Week*, described this bill as “dreadful economic policy” and “a \$200 billion disaster.”<sup>1</sup> Similarly, Joseph Stiglitz in thinking about its international repercussions said “We’ve lost all credibility all over the world.”<sup>2</sup> It would be quite natural to conclude that the long-run influence of professional economists on these policy designs must be near nil.

I first considered this apparent lack of influence in a 1998 Presidential Address delivered to the Association for Public Policy Analysis and Management, and later published in its journal.<sup>3</sup> This was, of course, shortly after FAIR and before the circumstances that led to the 2002 Farm Act. Susan Offutt suggested that I might revisit this issue with you today, and I am pleased to do so. While I cannot hope to offer detailed insight into programs that you know far better than I, I hope that I can offer some insight into what explains the effectiveness or ineffectiveness of professional advice-giving on these matters, and perhaps how to improve that effectiveness.

To the extent that economists care about microeconomic policy issues, it is generally because we believe that it is a good or beneficial thing to foster efficiency, and to

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<sup>1</sup> Laura Tyson, “The Farm Bill is a \$200 Billion Disaster,” *Business Week*, June 3, 2002.

<sup>2</sup> See *The New York Times Magazine*, June 9, 2002, p.25.

<sup>3</sup> See Friedman [1999].

root out and prevent needless inefficiency. When we testify or write normatively about crop subsidy policies, or air pollution policies, or airline and trucking regulation, it is invariably to draw attention to efficiency consequences. We know that normatively other things also matter, and there is nothing unusual, for example, about economists recognizing that there may be equity-efficiency tradeoffs. We can understand that, at least in principle, the public interest might be to allow some amount of inefficiency if it is necessary to achieve a reasonable social safety net. However, as a professional matter we do not claim to know how the society should make that equity-efficiency tradeoff. Thus many economists feel that their professional policy expertise on the normative side is to identify efficiency consequences and to stop there, so that whatever the policy outcome, it has at least been reached with knowledge of the efficiency consequences.

We are each individual citizens as well as professionals, and many of us as individual citizens have strong feelings about various public policies. In my social safety net example above, I was suggesting that even we economist-citizens might think it normatively desirable to have a social safety net that causes some inefficiency, at least compared to not having one at all. However, it is probably more common to observe some policy outcome that creates or continues inefficiency, knowing that some of our colleagues have pointed out these consequences in testimony or other public forums, and to respond as individuals with a scornful “well, that’s politics for you.” In other words, as individuals we are often dismayed by political outcomes because of their apparent disregard for efficiency consequences.

Perhaps this is the way most of us feel about inefficient crop subsidy programs. We have used our expertise to inform the policy process of the efficiency consequences, but we are not at all happy with the outcomes.

I suppose the central question that I wish to discuss with you today is this: to what extent are we—the professional economists who wish to influence these outcomes--responsible for what we get? And my answer is: more than you think.

There is of course an important branch of economics that tries to explain these outcomes—the theory of public choice. This branch has contributed enormously to our understanding of various political processes. For example, the theory of rent-seeking has been used to understand the behavior of public bureaus as well as lobbying and other special-interest groups.<sup>4</sup>

While I find the theory to be of high value, it is important to today's discussion to recognize that, like all theories, it has its limits. Consider, for example, the theory of the rent-seeking bureau. By this theory, it is not difficult to explain the existence of, say, the Economic Research Service (ERS) of the Dept. of Agriculture. Anything to make the Department larger is fine. But to explain the actual behavior of ERS, and especially to wonder if this behavior might best be described as serving the public interest, would be much more difficult. That is, the theory would not help us to see any systematic reason for the economists in that agency to behave in the public-spirited way that I suggested earlier—seeing an important part of their mission as advising on efficiency consequences, and striving to root out needless inefficiencies. Instead, no matter what the economists there, or at other public agencies like the Congressional Budget Office (CBO), may think they are doing, the theory informs us that they are simply tools to enhance the rent seeking of the agency, and that is the way we should understand their professional contributions.

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<sup>4</sup> De Gorter [1994] contains some review of this literature in the agricultural policy area.

Of course most of us do not accept any theories like this as fully explaining our own professional behavior, even if we do recognize kernels of truth in it now and then. One way that we reconcile the two realities—our concepts of ourselves as professionals, and our beliefs that there is substantial merit in our public choice theory—is to recognize that the theory is really intended to explain a subset of important forces, and not to be a complete empirical explanation of all important behavior in the political setting. The theory is useful because it systematically explains some of the variation in behavior that we observe, not all of the variation.

I would think it profoundly wrong not to recognize the public-spirited purpose with which we as professional economists participate as in the policy-making process. A good analogy is to the medical profession, in which each physician is trained to put the welfare of the patient before any other interest. Physicians often have financial incentives that may run counter to the patient's interests, and they respond to them to some extent—but most of them do not completely ignore the patient's interests, even if it means foregoing some profit. There may be more Caesarian births than natural ones because Caesarians are more profitable, but many doctors perform natural childbirths most of the time because they know they are better for the mother's health. A model that focused only on the financial incentives would predict far more Caesarians than we actually observe. Economic incentives matter, but so does professional training.

Both physicians and economists practice in many different organizational settings. The different organizational settings vary in the strength of the non-professional incentives that are used to motivate us. A chief economist for a private corporation may know that the corporation's health is the number one priority, whereas the ERS economist may have more

leeway in giving priority to the health of the overall economy. But when we are called upon or volunteer to participate in some policy-making process, our profession teaches all of us to do so with the health of the economy in mind. Even when we unabashedly represent a special interest, as might the corporate economist, we are unlikely to advocate for public policies that we know to be harmful to the economy. Rather, in that situation most of us do our best to identify policies that are beneficial both to our firm and to the economy.

In short, I am going to assume that our professional training matters, and that we who participate in policy-making processes do so with at least some public-spiritedness. That is, we believe that through our participation we are helping to further the public interest, and not to hinder it. We believe that we have some leeway for considering policy options to do this; that our recommendations are based at least in part by our application of professional principles and not completely dictated by other interests. The balance of this address will focus on our understanding and knowledge about our professional effectiveness with respect to this public interest objective. I return to agricultural policy.

## AGRICULTURAL POLICY AND RECENT REFORMS

The record on policy changes in crop subsidies is far more mixed and subtle than I have conveyed to this point. It will be instructive to review several aspects of it, at a level of detail that I hope is just enough to make us think harder about the effectiveness or ineffectiveness of professional policy-advising economists.

### **The Normative Case Against Agricultural Crop Subsidy Policies is Compelling**

I have referred somewhat easily to the public-interest case against agricultural crop subsidy programs. I have referred to their inefficiency, and while I believe much inefficiency remains, I also believe it has been substantially reduced over the past twenty years. Nevertheless, even with a generous assessment of the efficiency improvements, I do not think there is any strong public interest rationale in favor of these programs. I do not mean to focus upon this, but only to clarify that my somewhat-favorable-assessment to come of the role of professional economists should not be misunderstood as support for the existing crop subsidy policies.

As you all know well, policies of economic support for many agricultural crops were introduced as part of the New Deal legislation following the Great Depression. Most continue today, although they have been modified frequently over the years. Wheat, cotton, rice, corn, soybeans, dairy products, tobacco, sugar, peanuts, and other crops each have different support programs, although many have common characteristics. Direct U.S. governmental support for farm crops in 2003 is projected to be \$17.6 billion<sup>5</sup>, and this figure does not include indirect costs like the sugar program's price supports that cost consumers many billions more.

There is no disagreement that many aspects of these policies are highly inefficient. Support prices above market-clearing levels result in consumers getting too little of the product, while at the same time farmers waste resources creating excess supply that then sits in costly government storage or is misallocated to low-valued uses. Regulations to restrict the excess supply by mandatory acreage set-asides simply induce inefficient production

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<sup>5</sup> This figure is from the Indicators table in the USDA Publication Amber Waves, June 2003 issue.



methods to raise yield on the planted acreage. This involves the overuse of pesticides and fertilizers that are the sources of a substantial groundwater contamination problem.

Since none of these aspects can be defended on efficiency grounds, are there other public-interest defenses? Several other farm policy goals have been put forth as possible rationales for the crop subsidy programs, and while the goals may be worthy, the crop subsidy programs are not the solutions. I mention them briefly.

One nonefficiency rationale is that the policies are an acceptable form of welfare, because they are not called welfare, to proud but poor farmers. However, the farmers receiving the subsidies have incomes higher than the U.S. average. Very few of the subsidy recipients are actually poor, and the vast bulk of the subsidies go to farmers with incomes well above the U.S. average [see Gardner, 1992; Gardner, 1995].

A second nonefficiency rationale, related to the first, is that the policies serve to stabilize farm income that would otherwise be grossly unstable. I think mechanisms to ensure more stable income are important, but the question is what type of mechanisms. Even if the crop subsidy policies succeeded, it would be questionable whether such a high cost to the rest of us is justified by the benefit of stabilizing income for those whose average income is well above our own. Empirical studies have tested this stability rationale for the historical policies, and the consensus is that there is no such link [see, for example, the survey by Gardner, 1992]. On the other hand, risk management strategies like options, futures markets and forward contracting have contributed significantly to reducing the uncertainty that

farmers would otherwise bear, and seem like far more appropriate mechanisms than crop subsidies for the stability goal.<sup>6</sup>

A third nonefficiency rationale is that the subsidies are intended to preserve an American way of life, the small family farm. Whereas 30 percent of the U.S. population resided on farms in 1920, that figure had fallen to 1.8 percent by 1992 and then further to less than 1.1 percent in 2000.<sup>7</sup> Furthermore, most of the U.S. agricultural output now comes from very large farms. According to one estimate, the top 20 percent (in sales) of U.S. farmers produce about 85 percent of all agricultural output [Gardner, 1995, p. 119]. Clearly the policies have not succeeded by this rationale either.

### **Many Crop Subsidy Programs Have Become Less Inefficient Since 1985**

There may be no public-interest case for the continuation of agricultural crop subsidy programs. However, there has been important progress in improving these policies over the past 20 years. There have been four major farm bills during this period: the 1985 Food Security Act; the 1990 Food, Agriculture, Conservation and Trade Act; the 1996 Federal Agriculture Improvement and Reform Act, and the Farm Security and Rural Investment Act of 2002.

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<sup>6</sup> U.S. crop insurance is another important mechanism, although it is less clear how well it works. It is heavily subsidized; Goodwin reports that for each dollar paid in by a farmer, \$1.88 is returned in claims. (See Goodwin [2001].) Thus it is subject to the same equity criticism of why taxpayers should be providing this subsidy, and as well the heavily subsidized rates create incentive for inefficient over-production. However, some authors think that the size effects will be quite small. See Young, Vandevier, and Schnepf [2001].

<sup>7</sup> The U.S. Census 2000 reports a farm population of 2,987,531 out of a total population of 281,421,906 or 1.06 percent.

Some analysts reported high hopes that the 1985 farm legislation would make a substantial break with the prior 50 years of crop subsidies [Gardner, 1995, pp. 5-7]. It was the middle of the Reagan revolution, with free-market ideology riding high. Federal deficits were high, the Gramm-Rudman-Hollings deficit reduction legislation was being debated, and federal outlays on farm programs had risen sharply from about \$2 billion at the start of the decade to \$19 billion in 1983. Nevertheless, the 1985 Food Security Act largely extended all of the agricultural subsidy programs, and federal payments soared to \$26 billion in 1986.

Yet amidst this extension were a few strange provisions that actually reduced inefficiency by a few degrees. There was a small reduction in a number of the support prices. The loan rates for cotton and rice (another form of price support) were set to move in relation to world price levels.<sup>8</sup> There were at least two provisions that worked to decouple partially the amount of income support received by a farm from that farm's production decisions.

One provision was to assign an unalterable yield number (a measure of the amount of crop produced per unit of land) to each farmer instead of using the farm's recent average. The higher the yield number, the greater the support payment. When based on the farmer's recent past yields, an incentive was created to make yields higher than justified by market crop prices (for example, through overfertilization that also exacerbates environmental problems from agricultural runoff). The use of the fixed number removed the inappropriate incentive.

The second partial decoupling in the 1985 Act was the so-called "50-92 provision." A farmer with land eligible for support of a particular crop had only to plant that crop on 50 percent of the land to receive 92 percent of the deficiency payment. Thus there was no reason to use more than 50 percent of the land to grow this crop unless the market price or the loan rate for it exceeded short-run production costs. So the support price used to calculate deficiency payments no longer stimulated as much excessive production and inefficient land use.

The 1990 farm act was similar in many ways to the 1985 act. For the most part, it simply continued the historical system of subsidies. But like the 1985 act, it also added several provisions that reduced the inefficiency of these subsidies. One was to extend the use of the "world price" benchmark for setting loan rates to a number of additional crops besides cotton and rice: soybeans, oilseed crops, wheat, and feed grains.

Another significant change was to further encourage land use in accordance with market signals. Until 1990, the amount of land used (with the fixed yield) to calculate deficiency payments was based on a five-year average of actual acreage used for the crop, and the farm was generally required to forego present and future support payments if other crops were harvested on it. The 1990 act allowed up to 25 percent of the land base to forego support and to be used for any of a broad range of other crops (including other program crops), without affecting the size of the land base. While the 1985 act improved efficiency

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<sup>8</sup> These are nonrecourse loans made in advance of the growing season, with the crop as collateral. Typically the government expresses its terms ("loan rates") in the form of a price per unit of the crop. The farmer can choose to turn over the crop as full repayment. When the loan rate is above the market price for the crop, this is precisely what the farmer does.

by allowing some land to be idled when it was economical, the 1990 act improved efficiency by increasing land allocation to other, more highly valued productive uses.<sup>9</sup>

The most significant improvements were made in the 1996 FAIR Act. Some changes were specific to individual crops, like peanuts. The peanut support price was lowered by 10 percent, from \$678 to \$610 per ton. While still above the world price, which is closer to \$400, it reduced the underprovision to U.S. consumers and the misallocation of edible-grade peanuts to lower valued oil and meal.<sup>10</sup> Second, the valuable quota rights entitling the farmer to sell for domestic consumption were made transferable within a state. (Previously they were only transferable within the same county.) This increased production efficiency, because it allowed lower-cost farms to displace the higher-cost ones that had been locked in previously.

The most significant efficiency-enhancing economic change in the 1996 Act, however, was the virtually complete decoupling of farm support programs from the actual production decisions of cotton, rice, wheat, corn, and other feed grain farmers. Those farmers who had participated in the prior support programs for these crops were eligible to enter into seven-year production flexibility contracts. These contracts entitled them to receive a series of predetermined and declining payments based on their acreage and their historically fixed program yield, but farmers were free to use 100 percent of this acreage to plant almost any crop. (Fruit and vegetables remained the primary exclusion.) Additionally, the 1996 Act removed authority to require annual acreage idling from the Department of

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<sup>9</sup> Growing fruit or vegetables was not allowed, a provision that Gardner [1995, p. 143 n] attributes to the political influence of California fruit and vegetable growers.

<sup>10</sup> The latter occurs when quota rights exceed domestic demand, and the excess high-grade quota peanuts are given to the government, which then has them crushed for the lower-valued uses.

Agriculture. Thus, farmers were relying much more heavily on market forces to guide planting decisions.

In 1998 I said: “It remains to be seen how the equity or fairness aspects of this decoupling will play out,” and that “the jury is still out” on whether the scheduled decline in payments over time would occur. Recent history bears out this distributional concern. In fact the FAIR Act never did lead to reduced payments. If its passage was aided by high crop prices in 1996, then the collapse of these prices led to great pressure on Congress to increase the amount of the scheduled payments. Congress responded by doing exactly that, so that payments were doubled in 1999, 2000, and 2001.<sup>11</sup>

In 2002, Congress institutionalized the continuance of these supplemental payments by the passage of the 2002 Farm Bill. The total level of payments, about \$20 billion per year for the next five years, of course is higher than under the original FAIR schedule, but it is somewhat lower by about \$4 billion per year than the three years preceding its passage. Of particular importance for this discussion, it may be surprising how much of the decoupling of support from farm production decisions has been retained.

The two major funding mechanisms are direct payments, which replace the FAIR production flexibility contracts, and counter-cyclical payments. The amounts of these received by individual farmers do not depend on their current production decisions, and the freedom from acreage restrictions has been retained. One caveat to this is that the legislation allows farmers if they wish a “one-time” opportunity to update their acreage and yield levels, used in determining the payments, to the 1998-2001 averages. While this is still decoupled from current production, it may create expectations of more frequent future

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<sup>11</sup> For more detail on this recent history, see Orden [2002].

updating. Should that occur, farmers will recognize that their current decisions will influence

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the future update level, which in effect recouples subsidies with production decisions.<sup>12</sup>

The 2002 Farm Bill is complex, and it includes numerous other provisions that affect subsidies for particular crops. There are changes both “pro” and “anti” efficiency, and it will take detailed empirical work to sort out their magnitudes. In the peanut program, for example, the old and inefficient quota system has been scrapped in favor of the more efficient system used for most of the other crops. However, the marketing loan program for peanuts is based on the current production base, which thus can affect production decisions, and this same feature applies to new programs instituted for wool, mohair, and honey. Changes in the dairy industry, to be discussed shortly, were on balance pro-efficiency. But the inefficient sugar support program was continued at an effectively higher support price, and it alone had been previously estimated to cause a deadweight loss of \$.5 billion per year.<sup>13</sup> Overall, in terms of the efficiency of the crop subsidy programs, the 2002 Farm Bill is probably somewhat negative but surprisingly close to neutral.

In sum, I hope I have conveyed some pattern of long-run progress, albeit with some bumps along the way, in rooting out and reducing the inefficiencies associated with agricultural crop subsidy programs. I now turn to our understanding of why and how this happened.

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<sup>12</sup> A similar problem occurs with incentive regulatory methods used for some public utilities, particularly in telecommunications. A “price-cap” mechanism that is decoupled from the utility’s costs is used to determine allowed revenues. This is intended to give the utility incentive for least-cost production. However, if the regulatory authority adjusts the price-cap too frequently in order to keep revenues at a “fair” level above costs, then the utility will recognize that the price-cap is in effect coupled to costs and lose the incentive for efficient production.

<sup>13</sup> See Beghin et al [2003].



## **WHAT MAKES PROGRESS DIFFICULT BUT, AT LEAST TO SOME EXTENT, POSSIBLE?**

To understand why and how this particular amount of progress occurred, I seek an explanation that combines three elements. The first element is ordinary microeconomics in order to retain a clear focus on the public interest in efficiency and to evaluate how reforms affect it. The second element is an understanding of the political and organizational forces that constrain and shape any reforms. The third element is an assessment of the influence (or lack thereof) of participating public policy professionals. I divide these explanations into two groups: those that emphasize the difficulties of making progress, and those that suggest how progress was made.

### **Why Progress Is Difficult**

#### *It Is Not "Concentrated Benefits, Diffuse Costs"*

Given the size of the farm population earlier in the century, the original adoption of crop subsidy policies may well have been explained by popular sentiment. However, the persistence of these policies throughout the 20th century and into the 21<sup>st</sup> requires a different explanation. Easily the most plausible, given the concentration and organization of growers who stand to benefit, is the political power of their interest groups relative to that of the diffuse consumers and taxpayers who bear the policies' costs.

However, the standard concentrated benefits-diffuse cost theory just mentioned has a general and critical flaw. Ridding ourselves of the inefficiencies that make crop subsidies a serious public policy problem would have benefits that substantially outweigh the costs. Every economist has heard or uttered words like these: "if the benefits outweigh the costs, that means it is possible for the gainers to compensate the losers and still come out ahead." Ever since I started teaching in public policy 30 years ago, I have continued with words like these to my students: "in the public policy setting, your cleverness in structuring the distribution of benefits and costs from a proposed change will determine its political feasibility." This is important advice, but it does not go far enough.

The flaw of the standard theory is that the inefficiency creates an opportunity for a change that will benefit the concentrated, special-interest group as well as the diffuse-cost bearers. Since the gains from reducing the inefficiency exceed the losses, the special-interest group can formulate a proposal that more than compensates itself for making the change. That is, *it is in the self-interest of the crop growers themselves to propose changes that satisfy efficiency criteria.*<sup>14</sup> Not only can they benefit, but they can avoid or minimize opposition by structuring their proposal so that the current cost bearers gain as well. Therefore, their interests do not explain continuing inefficiency. Since this is the case, we must ask again: "Why do these inefficient policies persist?"

I will mention two lines of thought that provide some insight into this question. These lines of thought do not resolve the issue, but I hope that they motivate us to engage ourselves and our students with them

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<sup>14</sup> To my knowledge, Becker [1993] was the first person to point this out in a policymaking context.

### *The Un-Credible Commitment*

One pessimistic answer to the question of why inefficiencies persist was offered by Joseph Stiglitz [in 1998] with respect to artificially high milk prices, which were only modestly affected by the 1996 FAIR Act. A variety of policy provisions in effect then kept the price of milk substantially above competitive levels and inefficiently reduced the quantity of milk consumed. In principle, the provisions could be ended and dairy farmers more than compensated out of the gains to consumers.

Suppose the government proposes direct payments to the dairy producers (not linked to production) that leave them somewhat better off than under the inefficient policies. Stiglitz says the dairy farmers object because these payments are visible, whereas those from the then-existing policies that raise price indirectly are not. They fear that political pressure due to the visibility will lead to cuts down the road. In other words, the dairy farmers do not believe that the government's commitment to an efficient alternative is credible. The government has no way to guarantee the continuation of the new program.

Stiglitz considers a way around this objection. Suppose the government offers each dairy producer one lump-sum payment equal to somewhat more than the present discounted value of continuing current policies. Because the government does not have to make any future payments, it has solved its commitment problem. The difficulty with this, Stiglitz notes, is that the milk producers cannot credibly guarantee that they will not try to reinstitute price support policies in the future.

Stiglitz leaves the example at this point. I wrote earlier that it is not clear to me that the problem he posed was insoluble. I think making a credible government commitment in

the agricultural policy context depends upon the cleverness, imagination, and efforts of analysts or other interested parties. A somewhat similar problem arose in the context of the 1991 Clean Air Act amendments. In order to create a new market in pollution allowances, it was critical that the government issue known and credible allowance rights that apply over a long period. The ability to sell these streams is crucial in order to get the utilities to invest in expensive but cleaner generating plants for the future. Based on the success of this policy, the government's commitment clearly has been taken to be credible [this success is reported in Joskow, Schmalensee, and Bailey, 1998].

I also suggested that perhaps something in between a bond and an allowance could be credibly offered in the dairy case: long-term "rights" to fixed annual payments per farm, unlinked to actual production levels, and described as "dairy contracts" rather than "welfare." This is what the 1996 FAIR Act accomplished for many other agricultural products, and the Stiglitz argument does not explain why dairy was an exception in terms of government credibility. My 1998 response was that the real problem may not have been credibility but revenue: the government would have to substitute an "on budget" direct support program for the "off-budget" program of indirect support.

One of the pro-efficiency changes made in the 2002 Farm Act, passed at a time in which revenue problems were not high on either the Presidential or Congressional agenda, was to make a move in this direction: the Dairy Market Loss Payments. While this has the flaw of basing the payments on current production levels, it also has a cap on the amount of milk production covered per farm, and more than 2/3 of milk production comes from farms above the limit. Thus for most milk producers this will be a pure income supplement with no marginal production effects. Nevertheless, as we study the problem of the persistence of

inefficiencies and of designing more efficient reforms, I think we would be very wise to pay more attention than we have to the problem of making credible policy commitments.

### ***High Political Transaction Costs***

A second way to explain the persistence of inefficiency, given the self-interest of all to eliminate it, is high political transaction costs.<sup>15</sup> To make this point, let me contrast the consummation of an efficiency-enhancing agreement in the marketplace with a similar agreement through the political process.

In an unfettered marketplace, a landowner who believes correctly that she can produce peanuts (or more peanuts) at a profit neither needs nor seeks the approval of any current peanut farmer. She simply starts producing peanuts. Under the old peanut price support program, for the same efficiency-enhancing action to occur, the new or expanding farm would have to purchase quota rights from an existing farm that has them. This is in itself a significant extra transaction cost. If the quota rights are nontransferable, then legislation would first have to be passed to make them transferable.

The story does not end at this point. Suppose that, due to historical reasons, there is a concentration of quota rights in one county. Suppose further that, due to technical changes over time, the most efficient peanut acreage is no longer in this county. The county's peanut farmers may be happy to sell their valuable rights to high-bidding farmers from other locales. However, there is a network of peanut distributors in the county who will lose

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<sup>15</sup> An interesting short book with this general theme is Dixit [1996]. Dixit does not offer the specific line of reasoning suggested in the text, but his attention to transaction costs is similar.

substantial revenue if the quotas are transferred elsewhere.<sup>16</sup> The distributors lobby their elected representatives to prevent the legislation that would make the quotas transferable.

We all pay for the extensive and expensive negotiation costs. In a competitive marketplace, upstream and downstream interests that may be affected by an economic trade are not consulted. But in the political process, these upstream and downstream interests all have standing. Sometimes we may be glad for the results, for example, if workers who will suffer unemployment win job retraining or relocation benefits. But other times high transaction costs will simply frustrate the attempt to remove the efficiency.

It is even worse if we allow for bounded rationality and other legislative constraints in this setting of high transaction costs. There may be so many interests that it is difficult for anyone to see how to formulate a proposal that reasonably shares the gains from increased efficiency. As in the Prisoner's Dilemma, due to internal bickering over shares, no one may know how to prevent a political coalition from falling apart. The legislature, deluged with many complex national issues demanding its attention, of necessity allots very little time to each simply in order to make the many required decisions. During the sometimes frenzied process of political negotiation, changes may be made that inadvertently worsen rather than ameliorate existing inefficiencies.

### **Why Progress Is Possible**

The difficulty of making a credible commitment and the existence of high political transaction costs offer rationales for the persistence of inefficient policies. But they do not

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<sup>16</sup> They consider buying the county quotas themselves, but doing so would not be profitable.

then explain the source of the limited progress that I believe is a good characterization of the past 20 years of policy with respect to crop subsidies. How has this been possible? I offer three explanations.

### ***Creative Packaging and Political Entrepreneurship***

Gordon Rausser [1992] emphasizes creative packaging and political entrepreneurship. He describes agricultural policies as falling into one of two categories: PESTS, which is his acronym for the crop subsidy types that are inefficient and inequitable, and PERTS, which is his acronym for the socially productive ones like agricultural research that yield public goods. He believes that some PEST policies may have been continued as a quid pro quo for the expansion of PERT policies that raise agricultural productivity but threaten a loss of income to some farmers.<sup>17</sup> This political insight influences his interpretation of some of the proefficiency changes as well as the prospect for future reforms.

Rausser believes "one of the major messages is that policies can be packaged so vested interests may acquiesce to one policy in exchange for another" [Rausser, 1992, p. 152]. He cites approvingly the political entrepreneurship that emerged in the 1985 and 1990 farm legislation which resulted in increased land-use flexibility to farmers and greater reliance upon market price signals to influence the choice of what crops to plant. The lower support prices and loan rates in these acts make farmers worse off, but the increased planting flexibility makes them better off and makes the entire package feasible. More political

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<sup>17</sup> Farmers who are late adopters or nonadopters of the new technology will lose, and for those farming crops with highly inelastic demand, even efficient adopters will have reduced revenue.

entrepreneurship, as well as creative packaging, may make alternative, more efficient programs of wealth transfer feasible.

### ***The Power of Ideas***

Might not the progress be explained by the same "power of ideas" argument that has been offered as explanations for other policies, like the 1980 passage of trucking deregulation and the 1986 tax reform? It is true, I believe, that ideas matter. From the work in support of this theory, we gain an appreciation of the incredible variety of sources of ideas, as well as how they sometimes gain popular currency independently of the political process itself [a good early reference is Lynn, 1978]. For example, in their book on trucking deregulation, Martha Derthick and Paul Quirk [1985] convey the idea that a general disposition in favor of free market competition helped to make the legislation possible. Perhaps this same general disposition aided the crop subsidy reforms.

### ***The Power of Hard Work by Public Policy Professionals***

The trouble is that even in the case of trucking deregulation, the power of ideas does not suffice. As Dorothy Robyn [1987] has argued, the legislation was unlikely to have been successful without the sustained effort and method of organization of the public policy professionals involved. *The quality and quantity of analytic resources matter*, and it is surprising to me that we have so few studies with evidence on this subject.



One of the more interesting aspects of the trucking deregulation effort was the formation of an ad hoc coalition by the deregulation analysts and those on the political front line. The coalition members included representatives of every administration office contributing to the analytic effort, staff representatives from congressional committees, and representatives from major proderegulation interest groups (including, among others, Common Cause, Consumers Union, and the National Retail Merchants Association). While Congress was deliberating the reform, about 30 members of the coalition met once a week to communicate and coordinate. This ensured that collectively the analytic offices covered the range of issues that arose without unnecessary duplication, and that their responses were communicated through politically effective channels. Thus we learn from Robyn something valuable about the relationship between the organization of analytic effort and its effectiveness.

### **Public Policy Professionals Respond to the Complexity of Achieving Public-Interest Reforms**

Let me try to sum up this very quick review of both difficulties and sources of progress. Progress is retarded by the complexity and difficulty of formulating public-interest policies that have sufficient political support. Yes, there are factors beyond our control that bear heavily on actual outcomes: the general political and economic climate, the ideas that have popular currency, the constellation of particular interest groups, the occupants of key

political positions. But in addition to all of these factors, the degree of progress is a function of the quality, magnitude and organization of work of public policy professionals.<sup>18</sup>

I believe it is too easy for us to ignore the effects of our own efforts by blaming the result on others. By blaming on others something that we cannot control, we avoid honest self-evaluation as well as efforts to improve our effectiveness. In order to understand the effects of our actual efforts, we have to understand what the outcome would have been without our efforts. What do we know about our own effectiveness? This is the final question that I will comment upon in this address.

## **EVALUATING THE AMOUNT OF PROGRESS**

We have seen that over the past 20 years there have been some accomplishments in reducing the amount of inefficiency associated with agricultural policy. We have also seen that the existence of strong special-interest groups is not by itself a factor preventing or slowing progress. Rather, it is the complexity of identifying a public-interest improvement that has sufficient political support. Wrestling with this complexity is the job of public policy professionals. How well or poorly have we professionals done?

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<sup>18</sup> I would like to understand better how public policy professionals can and do confront the political and organizational forces that make rooting out inefficiency difficult (as in agricultural policy). Some valuable contributions addressing this point in any policy area are from those with PhDs in public policy. These studies are primarily helpful for improving the work of an individual analyst, whereas Robyn's study also addresses the organization of analysts to achieve efficiency gains. In addition to Robyn [1987], some examples are Foster and Hahn [1995] and Hausker [1992] on the realities of achieving efficiency gains in air pollution markets; Mendeloff [1979, 1986] and Viscusi [1983] in the area of occupational safety and health; and Friedman and Weare [1993] on practical obstacles to more efficient utility rate designs.

The best that I can do is to offer a crude guess, and some suggestions for further research that might shed light on this as well as many other policy areas. In my crude guess I use the logic of benefit-cost analysis, and begin with benefits. Various past studies have estimated the deadweight losses associated with our agricultural subsidy programs, and since the bulk of the reduction in them came through the 1996 FAIR Act, let's focus on that. I believe a rough, order-of-magnitude figure for deadweight losses before the 1996 FAIR Act would be in the range of \$5-10 billion per year. I find it hard to imagine that the gains from FAIR (reduction in deadweight losses) were not at least \$1 billion per year.<sup>19</sup> This reduction in inefficiency is the benefit of the legislation.

It could be that public policy professionals deserve full credit for this achievement.<sup>20</sup> It is they who had been advocating decoupling; CBO analysts produced crucial estimates that were used in Congress to shape the political agreement; and it is analysts who pointed out the benefits of making peanut quota rights transferable. However, suppose we only give them credit for half: \$500 million per year. The costs of all of the public policy professionals who work in this area could not possibly be as high. Even if we used the full-time equivalent of 200 professionals per year with generous support, this would only cost something like

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<sup>19</sup> Total receipts for the grain crops were in the \$40 to \$50 billion range. One 1995 study reported that 41.9 percent of these receipts come from direct or indirect government support, implying total transfers in the \$17 to \$21 billion range [Gardner, 1995, p. 231]. The deadweight losses that I have seen cited for different commodity programs have been in the range of 10 to 30 percent of transfer payments, which is \$1.7 to \$6.1 billion for the grains. I believe the FAIR Act removes the most important sources of inefficiency for these crops, so that an estimate of a \$1 billion reduction in the deadweight loss is probably conservative.

<sup>20</sup> Many people work to produce the legislation as a whole, but I am focusing solely on the efforts to reduce inefficiency. It is like asking what the 1996 legislation would have looked like if, say, all public policy professionals packed their bags after the passage of the 1990 legislation. To give analysts full credit for the actual achievement is equivalent to assuming a simple renewal of the 1990 legislation without them (or equivalently, a modified package that has offsetting efficiency consequences).

\$30 to \$40 million. That is in the range of a 15:1 benefit-cost ratio. Should we judge these public policy professionals as failures because we do not like the inefficiency that continued?

I am of course aware that my crude calculations are no substitute for careful study. A careful study, among other things, would measure the amount of public policy professional effort on the design and effects of agricultural subsidy policies. It would account for the ebbs and flows of this effort that correspond to the legislative cycles. It would also account for the accumulation and timing of the efficiency gains achieved. But I think even my crude calculations help to make the point that we have not thought very carefully about our own effectiveness. And I think they suggest one approach to measuring our effectiveness that, at least in some cases, could be illuminating.

There are many other approaches, both qualitative and quantitative, that we can use to learn about our own effectiveness.<sup>21</sup> I have already mentioned one qualitative study, Robyn's work on trucking deregulation, as one example that illuminates the effects of public policy professionals as a group. If I think about a qualitative study that might be interesting for agricultural policy, I am drawn to a point that focuses upon the training of analysts. Agricultural analysts are almost all trained in agricultural economics programs, and not in the public policy schools. This seems to me somewhat of a historical accident, in that the agricultural training programs were well-established long before the public policy schools got started. One hypothesis that flows from this training difference is that as a group the

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<sup>21</sup> For some very interesting thoughts about agricultural research effectiveness, see the symposium "Measuring the Benefits of Social Science Research" in the December 1997 issue of the *American Journal of Agricultural Economics*. For thoughts about agricultural policy research specifically, see Gardner [2002]. For thoughts about the sustainability of reforms including those in agricultural policy, see Patashnik [2003].

agricultural analysts are strong on economics but weak on politics. It would not surprise me to learn that the progress from 1985 to the present might have been greater and occurred sooner if the group had a higher level of political skill with which to start. Experts on the politics of using analysis could certainly examine this issue through interview studies of those involved in the policy-making process.

There are other quantitative types of studies that would be very useful to have. In the agricultural policy area there have been some important quantitative studies that explain the variation in subsidy per crop as a function of economic conditions and interest-group political strengths. With some modification and additional data gathering, it might be possible to build on these to address the effectiveness question I have raised. The dependent variable would be a continuous efficiency measure, like the change in deadweight loss per crop caused by new legislation.

## **CONCLUSIONS**

I will conclude this address by summing up briefly what I see as the three broad general issues that I have raised for your consideration.

First, let us acknowledge and even take pride in the public-interest objective in a healthy economy that is part of the bond that holds us together. We do more than offer advice to anyone who wishes to influence public policy for any purpose. We strive to contribute positively to the public interest when we consent to advise on policy matters.

Second, I have contrasted two different ways of reacting to public policies that seem both persistent and not in the public interest. One way is to shrug our shoulders and say “oh

well, that's politics." I have urged, and tried to identify a basis for, greater responsibility on our part for the outcomes. Recognizing that gross inefficiency is often a major part of the situation that we wish were different, I have pointed out that there is no inherent reason why the powerful special interests should necessarily oppose such a change. Indeed, it is in their interests to seek it as well. Policy improvements are possible, and with regard to crop subsidy policies, we have begun to make them. There is no profession better qualified than this one to identify, design, and create feasible improvements in this area. There is no other group who has the expertise to keep a clear focus on the efficiency gains that are possible, and who would lead an effort to achieve them. In order for us to make best use of our economic skills, we need to think harder about the political setting into which our advice is offered. How can we structure a proposal so that the necessary political commitments will be both feasible and credible, and the public interest enhanced? Some modest additional political training in our programs could have a high social payoff.

Third, let us recognize that we have a lot yet to learn about the effectiveness of our policy-advising efforts and how to improve them. I have speculated that the special strengths in economics of agricultural policy analysts could have a higher social payoff if supplemented with some attention to political and organizational skills. As well, the sheer number of public policy professionals working in this complex area ought to help explain the timing and degrees of progress. Both qualitative and quantitative studies can instruct us on how to improve our collective effectiveness.

I know that we have a long way to go in overcoming the policy problems with which we are confronted. I hope that my remarks might help to renew our energies and inspire

greater effort toward these important and worthy tasks. Thank you for the honor of allowing me to offer this keynote address.

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