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**Market failures and government failures: A theoretical model of the common agricultural policy.**

*Paper for the EUSA Ninth Biennial International Conference March 31 – April 2, 2005 in Austin, Texas (panel 12F)*

**Abstract**

Economic theory has tried to explain the characteristics of the Common Agricultural Policy on the basis of certain economic peculiarities of agriculture. However, by overlooking the so-called government failures of the political system as an independent variable in explaining the Common Agricultural Policy it is impossible to explain, for example, the strong agricultural lobbyism. The theoretical model of this article integrates economic as well as political actors in order to explain the characteristics of the Common Agricultural Policy. The proposed theoretical model is not “tested”, but the criteria for such a test are presented.

**Keywords:** Rational choice, institutionalism, welfare economics, agricultural economics, Common Agricultural Policy, CAP, European Union, agriculture, government failures.

10.000 words.

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## **1. Introduction: In search for a theoretical model of the common agricultural policy**

The aim of this article is to propose a theoretical model for analysing the Common Agricultural Policy (CAP) of the European Union. The arguments for proposing a specific theoretical model for the CAP are several: a) The co-operation in the agricultural policy field of the European Union is the oldest and the most developed area of supranational co-operation which has created a large number of characteristic path dependencies, b) the CAP is based on an economic sector with some rather peculiar economic characteristics which have to be considered in the theoretical model, and c) the CAP also has some specific characteristics as far as the interest organisations in the sector are concerned.

Whether or not a theory is a good theory depends on the criteria against which theories might be evaluated. Burchill (1996: 24) has proposed a set of criteria for an evaluation of an international relations theory: its understanding of an issue or a process, its explanatory power, its success at predicting events, its consistency and coherence, its scope, and its capacity for self-reflection and engagement with contending theories. At the end of this article, the usefulness of the proposed theoretical model will be evaluated against these criteria.

Analysis of European Union affairs often has its roots in the neofunctionalist integration theory. Neofunctionalism was built around the proposition that an international society of states can acquire the procedural characteristics of a domestic political system (Rosamond, 2000: 56) through a number of “political” and “technical” spill-overs. Already Lindberg noted that groups “may change their political organization and tactics in order to gain access to, and influence, such new central decision-making centres as may be developing”

(Lindberg, 1963: 9) as a result of European integration. Later on it was noted that neofunctionalism failed to acknowledge the importance of external factors for European integration (Hansen, 1969), and that it failed to identify the dependent variable of functional economic integration (Haas, 1971). Both of these criticisms will have to be taken into account in the proposed theoretical model of the Common Agricultural Policy in this article.

Neofunctionalism has also been criticised by the intergovernmentalist. But whereas this criticism focused on the so-called history-making moments such as treaty revisions or major crisis in the European Union it has itself often neglected the day-to-day politics within the European Union political system. Hence, more and more scholars have argued for a greater use of public policy literature (for example Hix 1999, Pollack 2003, Richardson 1996) due to the fact that the EU political system has become more and more a “normal” political system. This can be seen from the fact that the policy-making process in the European Union is more and more characterised by conflicts over redistribution, regulation, and stabilisation with the active participation of interested actors as well as Member States and where, so far, the regulatory functions have been dominating (Majone, 1996).

Clearly, in the analysis of the European Union, institutions become important, partly because the Union is itself a highly institutionalised form of co-operation, partly and more fundamentally, because institutions are necessary preconditions for understanding how actors can conduct higher proportion of positive sum bargains which can be seen as an updated and more narrowly defined version of the spill-over concept. As a matter of fact,

the European Union with its rich mixture of formal and informal institutions is often seen as an ideal testing ground for various forms of institutional analysis.

Generally, institutional analyses are subdivided into historical and rational choice variants (Bulmer, 1994). Rational choice institutionalism tends to define institutions as formal legalistic entities and sets of decision rules that impose obligations upon self-interested political actors. In a European context this focus often seems reasonable because it reflects the fact that formal institutional set-ups and decision-making rules play such a dominant role in the European integration discourse.

On the other hand, historical institutionalists are normally associated with a more “broad” interpretation of the influence of institutions as they also govern the wider context within which political action occurs. Among other things, historical institutionalism stresses the tendencies of institutions to create path dependencies. In the context of European integration, historical institutionalists tend to argue that the construction of supranational institutions and a specific set of supranational policies were rooted in a very particular historical context. At the same time, the very act of creating particular sorts of institutions with particular sorts of instruments unleashed logics that could not necessarily be predicted at the time (Rosamond, 2000: 117). Again, this can be seen as a way to put a new label on the classical spill-over concept.

However, there is no necessary incompatibility between rational choice institutionalism and historical institutionalism as, for example, the historically constructed institutions and the resulting path dependencies can be seen as exogenous constraints to the preferences of

actors in the processes of integration (Pierson, 1996). Following this line of argument, this article tries to demonstrate that, in order to create a theoretical model of the Common Agricultural Policy of the European Union, rational choice institutionalism will benefit from integrating the insights of historical institutionalism.

Basically, in this article it is argued that the Common Agricultural Policy can only be understood and explained if the economic analysis is coupled to an analysis of the political decision-making process and the political system as proposed in rational choice theory. Here, it has to be taken into account that the Common Agricultural Policy (CAP) means that the European Union can be considered as one multi-level governance system in the agricultural policy area where the Member States function as integrated elements of the internal decision-making asymmetries that are, according to the rational choice theorists, always found in democratic political systems. The theories mentioned are used in order to establish a theoretical model for analyzing the CAP covering both the economic and the political system.

In order to establish a theoretical model of the CAP, welfare economics and the concept of market failure becomes important as a precondition for explaining why such a strong regulatory framework of the CAP was set up. However, in contrast to much economics literature the independent variable in the explanation of the Common Agricultural Policy is not found in the economic characteristics alone. Therefore, in section 2 below the concept of welfare economics and market failure with regard to the agricultural economic is explained and proposed as a necessary, but not a sufficient condition for the political construction of the CAP. Hence, in section 3 the parallel concepts rational choice and the

government failures of the agricultural political system are explained. In section 4 the basic features of the theoretical model of the CAP is explained whereas the rest of the article elaborates on the various elements of this model.

## **2. Welfare economics and market failures**

Agricultural politics and agricultural economics have for many years been the object of study by economic theory in order to explain (and sometimes even justify) the existing agricultural policies and also to propose policy instruments which are the most optimal ones according to the theory. For example, based upon welfare economic theory, analyses have been made of which political instruments the governments should use in order to maximise economic welfare. According to welfare economic theory, market imperfections can be corrected through public expenditures and public regulations if only it is based upon a rational and scientific planning (Randall, 1985). Following this line of reasoning there are lots of proposals on how to solve the market imperfections of the agricultural economic system: direct income support, regional labour market policies, elimination of price support policies etc. These proposals have been on the table for many years as methods to correct the market imperfections in a rational, scientific and welfare economic optimal way. What is common to all these proposals is that they as traditional welfare economic theory, generally, have so-called market failures as their starting point.

Over the years, many economists have tried to explain the various agricultural policies of the developed countries on the basis of a variation of the welfare economic theory like, for example, public economic theory. Munk (2004) is a representative of this theoretical school. He explains the supportive agricultural policies as a more or less “pure” function of

two factors: a) whether or not a country is a net exporter of agricultural products (net exporters of agricultural products tend to provide support at a higher level than countries which are importers) and b) the level of difference between the income of farmers and non-farmers. The assumptions made in this explanatory model are that the behaviour of the political system is an outcome of the maximization of a social welfare function based on egalitarian value preferences and that these preferences are relatively stable.

This economic “functionalist” explanatory model of the agricultural policies, however, seems unable to answer a number of questions about the characteristics of agriculture in general and the Common Agricultural Policy in particular. If agricultural support is a “pure” function of certain economic characteristics, why should farmers then invest so many resources in lobbying the agricultural political decision-makers? At the same time, if the low incomes are the explanation, why do other low income groups not receive the same amount of support like the farming group? Besides, if claiming that low incomes is the explanation of the Common Agricultural Policy, how does this correspond to the fact that 20 per cent of the wealthiest farmers receive nearly 80 per cent of the total agricultural support included in the CAP? Finally, if the position as net exporter is the explanation, why are other net exporters not supported the same way as agriculture is supported. It seems as if the correlation between the position as a low income group and the position as net exporters is like the correlation between their numbers of storks and the new born children in the various municipalities of Sweden always mentioned in old introductory books on statistics. There might be a correlation between the number of storks and babies in the municipalities in Sweden, but the reason for this correlation has to be found somewhere else.

Hence, over the last 30 years, the welfare economic theory has been criticised with increasing strength as an insufficient basis for explaining the agricultural policies of the developed countries. When the theory of market failures is used as an argument in favour of public regulations and when it is used in favour of public interventions one risks disregarding the existence of so-called government failures or political failures (Besley, 2004). This concept was originally invented by James M. Buchanan (1979) in order to describe inefficiencies and waste of resources as a result of government interventions.

Therefore, instead of using economic theory as the sole basis for explaining the agricultural policies of the developed countries and, thereby, overlooking all characteristic features of the political system, political actors should be included in the explanations of the agricultural policies. This means that the political black box should be opened, which also imply that the altruistic assumptions about the political actors should be revised because it becomes openly illogical to model actors in the economic system as self-interested whereas the same actors striving for the same benefits in the political system are modelled as altruists.

Not least when it comes to the CAP, criticism of the welfare economic theory used as the sole explanation of the policy has been strong. The reason is not that the instruments and objectives in the CAP are in any way different from what is found in most other developed countries. The reason is rather that the CAP is scrutinised with great interest by many actors outside of the European Union because the European Union has become a major player in the international markets for agricultural goods.

The US Department of Agriculture (e.g. 2001) has often analysed the impact of the CAP on production and trade. Among other things, they conclude that the CAP has considerable impact on the world markets and that the world market prices have decreased and become more unstable as a result and forced a considerable contraction elsewhere. They also point to the welfare losses for European Member States as well as for traditional exporters of agricultural products outside of the European Union.

Many scholars have proposed that the CAP should be more focused. Among others Koester (1991) proposed that agricultural policies in the industrialised states must improve first and foremost the incomes of farmers. The explanation is that in the long run price support policies cannot improve the remuneration of the agricultural labour force. At the same time, the price support policy has a number of negative consequences in other areas. Therefore, the CAP has to be changed according to Koester. After an examination of agricultural objectives, instruments and their impact, Robinson (1989) concluded that agricultural support is often capitalised in the prices of agricultural property and, therefore, the benefits to coming generations of farmers are limited. Piccinini and Loseby (2001) proposed a dual set of instruments for the CAP: one set to be used in their role as producers and one set as producers of services, as “guardians of the environment”.

In short, the CAP has been heavily criticised for many years. The objectives of the CAP often contradict each other. The policy instruments often fail to reach their objectives, and sometimes, the developments of the CAP have even moved in the opposite direction of the

objectives. The aim of this article is exactly to answer why this is the case based upon a theoretical model.

### **3. Rational choice and government failures**

Alongside the criticism of the welfare economic approach, the rational choice theory has been established as an independent theory about the political decision-making process. In this connection the welfare economic theory is regarded as a useable theory about the economic system while the rational choice theory is regarded as a fruitful theory about the political system.

The basic idea in rational choice analysis is to draw out implications of rational self-interest – which is the basis for analysis in the economic system - for political interactions (Besley, 2004). According to Buchanan (1979) individuals must be modelled as seeking to further their own narrow self-interest, narrowly defined, in terms of measured net wealth position, as predicted or expected.

The rational choice theory is also a theory in rapid development. According to Buchanan (1979) the first phase of the theory was from the end of the 1950s and until the mid-1970s. In this period the so-called demand-models dominated. These models were highly influenced by the micro economic supply and demand models. The public sector was more or less regarded as a passive supplier of political decisions adapted to the demand of the median voter (that is the voter with preferences which mean that there are an equal number on each side) of the political spectrum. Therefore, the demand models of the rational choice theory should comprise the foundation for analysing the political process.

In the last 15-20 years rational choice theory has been characterised by analyses of the so-called transformation mechanism that deals with the possible breakdown in the transmission of individual preferences in the political process, for example because the transmission is twisted around by politicians, bureaucrats and interest organizations. One could add that last but not least, the rational choice theory has been applied on an increasing number of policy areas; including European policy areas within the last 5-10 years (see Rosamond, 2000: 118-123; and Pollack 2003). Also when analysing the Common Agricultural Policy of the European Union the rational choice theory (here used interchangeable with the term public choice) has proved itself increasingly useful (Nello 1984, 1997; Nedergaard 1988, 1993, 1995; Piccinini and Loseby, 2001; Moyer and Josling 2002). This article builds, of course, on the results obtained in this research in order to construct a theoretical model.

#### **4. The theoretical model of the common agricultural policy**

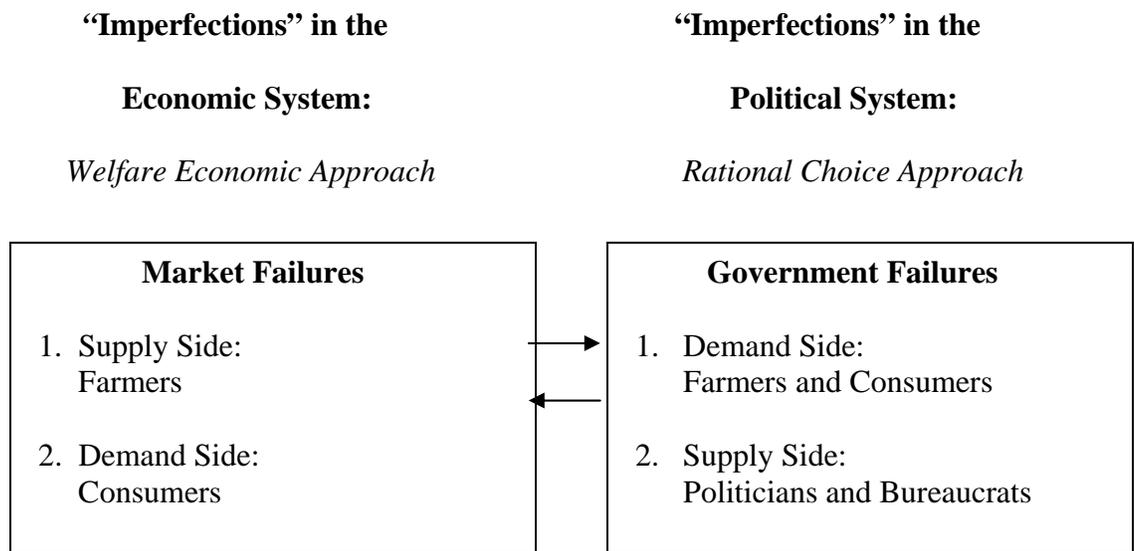
In this article, it is argued that an analysis of the CAP will benefit from combining traditional welfare economic theory with rational choice theory taking into account the insights of historical institutionalism, neofunctionalism, and agricultural economics theory. In the proposed theoretical model, at the micro economic level, the unit of analysis is the individual decision-makers in the market, i.e. producers and consumers. If the micro economic model of supply and demand model is transferred to the political system, the relevant decision-units are the political decision-makers (politicians and bureaucrats) and political partners (producers and consumers) with an interest in the political decisions in this particular area. This is the methodological individualist foundation of the theoretical

model. Politicians and bureaucrats supply political decisions while producers and consumers demand political decisions. As in neo-classical micro economic theory all parties are expected to maximise their utility function no matter whether the analysis is dealing with producers (revenue and expansion), consumers (purchasing power and purchasing possibilities), politicians (re-election and government power) or bureaucrats (power base and career possibilities).

At the micro level, market failures means that economic actors become rent-seekers in the political system and create government failures which influence the micro economic level with the resulting increase in market failures. Besides, the equilibrium between suppliers and demanders of political decisions is dependent both on how powerful the demand is and on how the demand is spread between politicians, bureaucrats, producers and consumers. In all circumstances, it is assumed that there are a number of economic interests in the political system that try to build coalitions because different political decisions lead to different benefits and costs for the various groups in society.

In figure below the arguments put forward above are collected together in a model for analysing the Common Agricultural Policy of the European Union.

**Figure 1. Model for analysing the common agricultural policy of the European Union.**



Source: Compiled by the author.

Following the methodological individualism of the rational choice theory, the starting point of the theoretical model is the individual farmer producing agricultural products for the consumer. The economic problems he is facing brings him in contact with political decision-makers. To use the terminology of Albert Hirschman (1970), denied easy exit, the farmers exercise strong political voice. Of course, agricultural policy decisions taken by politicians and bureaucrats also have impact on the macro level of society, i.e. on the economic and political systems of the European Union as a whole.

The arrows between the boxes in figure indicate structural causal relations between the two boxes in the theoretical model. In other words, it is assumed that market failures in the agricultural markets through the strong political voices of farmers trigger political interventions, the character of which is decided by the equilibrium between the politicians' and bureaucrats' supply of political decisions on the one hand and the farmers' (the producers') and consumers' demands on the other hand. At the same time, this equilibrium is biased or asymmetric because it is dominated by the farmers demand for political interventions (strong demand = strong political voices) in the form of price support, income support, import restrictions, export restitutions etc., while the consumers as a whole only have few claims (weak demand = weak political voices) or a low level of interest in agricultural policy decisions because government interventions caused by strong interest organizations often make the market failures even worse. At the same time, government failures have an impact on market failures which they often tend to increase.

The model above is a theoretical model for analysing the CAP. The model has a dynamic of its own. At the same time, the causal relations in the model can be put under pressure

from factors outside the European Union as has increasingly happened in the last 15 years within the GATT and WTO or more directly by the United States. However, it is predicted that such external pressures on the CAP will trigger internal reactions in the European Union in accordance with the theoretical model. This means that an external pressure will lead to changes and adjustments in the Common Agricultural Policy that are “filtered” through the mechanisms shown in the model.

The rest of the article elaborates on the theoretical model of the Common Agricultural Policy in the figure above. In section 5 the market failures and their impact on the farmers on the supply side of the economic system is analysed whereas section 6 analyses the market failures on the demand side of the economic system of agriculture. Section 7 analyses the government failures of the political system and their impact for farmers and consumers on the demand side of the economic system. In section 8 the government failures of the political system and their impact on politicians and bureaucrats on the supply side of the political system are analysed. Finally, section 9 contains the conclusion.

### **5. Market failures and the supply side: Farmers**

A broad definition of market failures – at least as far as agriculture is concerned - includes stabilisation, allocation and income problems. The reason why the market mechanisms lead to these problems is certain characteristics of the supply of agricultural goods - and to a lesser extent of the demand of agricultural goods (cf. Hallett, 1981).

The supply of agricultural goods has two main characteristics. Firstly, the farms are geographically spread and great in number. This implies a specific system for collection

and treatment of the agricultural produce, for example, in form of dairies and slaughterhouses. Furthermore, the production factors in agriculture are characterised by immobility and lack flexibility in response to price changes.

Secondly, the supply of agricultural goods is marked by the fact that the goods (to a larger extent than in industry) are produced on a risk market. This reflects the lack of information on future prices, exchange rates and other farmers' production (Runge and Myers, 1985). One reason for this is the biological nature of agricultural products. This taken alone leads to annually unforeseeable fluctuations in the supply of agricultural products and it leads to the concentration of the supply of products to certain seasons. Besides, the biological nature of agricultural products limits the durability of the products and makes storage and processing necessary.

A result of the fact that agricultural products are produced on an inflexible risk market is that the supply is chronically unstable. This means that the supply and demand in the agricultural sector fluctuate more than supplies and demands in other sectors of the economy. This instability is often used in order to socially construct a political legitimization of the institutionalised public support for agriculture. In agricultural economics the fundamental instability of agricultural production is often illustrated by the so-called hog cycle.

According to agricultural economics, the great number of farms also means that the individual producer only has a very limited proportion of the total production and therefore has no influence on the price of the products. In other words, the individual producer is

faced with a horizontal demand curve and is a price-taker. At the same time, it is often claimed that in comparison with industry, where the market is often characterised by oligopolistic competition, the individual farmer is in a situation with perfect competition. In other words, according to this view, which is cultivated by farmers and their representatives, agriculture is like a perfect competition island in a sea of oligopolistic competition.

The competitive situation in agriculture might be a probable explanation of parts of the structural income problems in the sector. At the same time, the structural income problem is used as another factor to construct a legitimisation of the institutionalised public support for agriculture. On the other hand, the specific agricultural characteristics mentioned so far cannot explain the "overconsumption" of productive means that seems to take place when the level of incomes is considered. Rational behaviour means that the consumption of productive factors is decided by the point where the marginal product of increased factor consumption equals the marginal costs of increased factor consumption. Therefore, the factor consumption should fall in case of falling product prices no matter whether they are produced in a market with perfect or imperfect competition (Meiners and Yandle, 2003).

However, the "overconsumption" of productive factors in a situation with perfect competition can be explained using the introduction of new technology as an example (Hagedorn, 1983). In the long run, the farmer cannot expect to improve his income position by introducing a new technology. On the other hand, he is forced to constantly introduce new technology in order to keep his relative income position. Perfect competition in agricultural markets means that the advantage of production rationalisation is widely

externalised. At this point, agricultural firms are fundamentally different from industrial firms.

Olson (1985) has also analysed the differences between agriculture and industry starting from the fact that agricultural firms need land. Production based on land makes coordination and management more difficult in agricultural firms. Therefore, diseconomies of scale are reached at a much earlier point of time in agriculture than in industry. In the last century, very large farms existed in the United States, but these farms could not compete with the smaller and seemingly more efficient homesteaders. In other words, it seems that the optimal size of an agricultural firm is much smaller than that of an industrial firm. As a result, the number of farms is large enough to create a market with full competition.

The many and geographically spread agricultural firms are individually owned and normally run by the owner and his family alone or by means of one employee. Hence, the variable costs are often small compared with industry. In the short run, variable costs are only things like fodder, fertiliser and repair costs. While wages represent the largest cost in many industrial firms, farmers can almost never cut costs by dismissing workers.

At the same time, the costs of moving resources from agriculture to non-agricultural sectors have to be paid by the farmer himself. So, while the advantage of structural changes in agriculture is externalised, the costs are internalised (Hagedorn, 1983). In this perspective, the highly supportive agricultural policies in almost all industrialised countries could be seen as a compensation for the fact that farmers do not benefit from the structural changes they work so hard to accomplish. If this interpretation is diffused to the wider public and is

broadly accepted, a consequence is that it will probably be harder to oppose agricultural support by consumers and tax payers. At the same time, the fact that it is very costly for farmers to make an exit from their business is probably a necessary incentive if farmers have to exercise a strong political voice, however, as it will be argued in section 7, it is not a sufficient incentive.

## **6. Market failures and the demand side: consumers**

Generally, the demand for agricultural goods is characterised by low income elasticity. According to research done by agricultural economists, the food products in the European Union taken as a whole have an income elasticity coefficient of about 0.2. This means that the consumption of food products increases by 20 per cent every time income increases by 100 per cent. Already Adam Smith (1776) noted that one of the differences between agricultural goods and industrial goods is that the consumption of agricultural goods is limited by the size of our stomach while the consumption of industrial goods seems to be without limits at all.

At the same time, the demand for agricultural products is characterised by small increases in consumption resulting from decreasing prices even though the changes in demand as a result of price changes differ considerably from product to product. In other words, the demand for agricultural products is characterised by both low income elasticities and low price elasticities.

In the political system, the fact that agricultural goods are both necessary goods for survival and, at the same time, are “overmatured” products on the market with low income and price

elasticities can be exploited by farmers in their argumentation with the public - somewhat similar to the tradition of subsidising or protecting other “overmatured” products at the end of the product life cycle like ships, coal, and textiles. Again, however, beside being “overmatured” products, other factors must play a role, since agricultural goods are significantly much more protected than other “overmatured” products.

### **7. Government failures and the demand side: Farmers and consumers**

Market failures in the agricultural markets imply a fundamental insecurity in production, and the specific agricultural economic conditions give permanent income problems for a great number of farmers. This situation creates a consensus among farmers that it is legitimate to use the political system as an alternative way to pursue their own economic interests. Stated in the terms of the rational choice theory, farmers see that their economic profit-seeking in the market is unsuccessful. Instead, it looks as if political rent-seeking through organization in an interest group provides better economic pay-off (Krueger, 1990).

In order to be rational, when an economic actor decides to join or participate in an interest group, he has to judge whether the potential benefits exceed the foreseeable costs. Costs are incurred by the administration and co-ordination that is necessary in order to acquire political influence through an interest organization. If an economic actor belongs to a group with structural features which imply few organizational costs, this group must be expected to be easy to organise. For farmers this is a decisive factor for the strength of their group organization. Their preferences are similar, the size of the group is large and the sector has some specific economic characteristics which more or less invite potential participants to

be part of the group (Nello, 1984).

Similar to other large interest groups, farmers run the risk of some members' free-riding when they organise themselves in order to acquire political influence with the aim of enhancing common interests. Political influence has many features in common with public goods since it is impossible to exclude non-organised farmers from benefiting from the efforts made by the organised farmers. For example, all farmers in the European Union will benefit from a rise in the common minimum prices or increasing protectionism that are partly results of the political activity of the agricultural organizations.

Olson (1965) was the first to point out the necessity of selective incentives if individuals are to participate in a collectively beneficial activity that looks like a public good. The selective incentives of trade-union membership in many European countries are so-called exclusive agreements (= all workers at a workplace have to be organised in a certain trade union), that the unemployment benefit system organised by the trade unions, etc. However, the selective incentives of the agricultural interest organizations are probably much more efficient. These incentives are, for example, that the publicly-financed consultative services of the farmers are administrated by the agricultural interest organizations and that those applications for different kinds of public support and milk quotas are first treated by the agricultural interest organizations. At the same time, the subscription fee paid by farmers is normally symbolic because the administrations and secretariats are often financed by funds, etc., that were originally created by public means. Hence, as a result, the affiliation percentage in the agricultural sector is considerable above that of wage-earners.

Additionally, the costs of acquiring political influence have been minimised among farmers

because of the existence of a privileged group of farmers with considerable individual resources in time and money. This elite group dominates the national agricultural interest organizations and, to an even greater extent, the farmers' Community-level organization, the Comité des Organisations Professionnelles Agricoles de la CEE (COPA). Some would argue that the design of the CAP – even after the latest reform (cf. OECD, 2004) – is a reflection of this fact, i.e. that the CAP benefit the biggest farmers the most.

Another explanation of the agricultural sector's organizational strength relates as mentioned earlier in the article to the economic conditions to which farmers are subject. The constant pressure on incomes makes it easy for agricultural organizations to create a basic consensus and socially construct a well-defined goal to improve the incomes through protectionism, public price support or direct financial support.

One interpretation of this phenomenon is that the farmers find it legitimate and attractive to invest in political lobbyism in order to compensate for the situation that the agricultural sector does not benefit from the introduction of new technology because the benefit from the introduction of new technology in agriculture is externalised (i.e. this externality is a benefit which is not subject to market transactions between the farmer and the consumer). Lobbyism aims to ensure that the costs of introducing new technology are externalised as well. On the other hand, bad economic conditions are far from being an adequate explanation for the costly agricultural policies all over the industrialised world. In the retail sector, for example, incomes are often on average as low as those in the farming sector. However, the retail sector has proved itself very unsuccessful in getting support through the public budgets. The reason for this difference is partly that the organizational costs in the

farming sector are lower, and partly and more fundamentally, that there are no selective incentives in the retail sector which are necessary in order to participate in a collectively beneficial activity like being organized in a strong interest organization.

The farmers of the Member States can be divided along the following lines: 1) small farmers versus large farmers, 2) vegetable producers versus animal producers, 3) producers of 'Northern' products (milk, grain, beef) versus producers of 'Southern' products (olive oil, wine, fruits), and 4) the farmers from the "old" Member States versus farmers from the "new" Member States. Nevertheless, the preferences at both EU and national levels are similar enough to safeguard a strong common appearance. The reason is that, as a general rule, conflicts are avoided by using the principle of the 'highest common denominator'. In other words, it seems possible for the group of farmers of the European Union to upgrade their common interests in their lobbyism vis-à-vis the European decision-makers.

While farmers can be regarded as demanders of agricultural support and interventions, the demand of the consumers and taxpayers is expected to pull in the opposite direction. In other words, farmers are expected to be supporters of agricultural protectionism and subsidies, while consumers and taxpayers are expected to be opponents of agricultural protectionism and subsidies.

In this light, the actual level of protectionism can be regarded – according to the proposed theoretical model - as a function of the investment made in political influence on behalf of the farmers and consumers/taxpayers respectively. The result is assumed to be an equilibrium situation between opponents and supporters of agricultural expenditures and

protectionism against the background of calculations of the marginal benefits, respectively the marginal costs, of the investments made in political influence.

The equilibrium situation in the agricultural political market is asymmetric because the farmers are able to press the slope of their lobby-curve downwards due to the selective incentives (see also Ballisacan and Roumasset, 1987). That is, for example, not the case for firms in the retail sector. As a result the farmers are 'over-motivated' to use money and time to further their collective interests which is reflected in agricultural protectionism and subsidies to the agricultural sector. The potential opponents of the farmers are consumers and taxpayers, but they are seldom organised at all. Besides, the marginal benefit of opposing the farmers resulting from lower taxes and consumer prices is very limited among a great number of consumers and taxpayers.

Therefore, the political decision-makers assume that consumers and taxpayers stay relatively calm and indifferent when import tariffs are introduced, food prices are kept well above the world market level, and farmers are subsidized. Farmers, on the other hand, often see the benefit of investing time and resources in protest meetings, demonstrations, attacking trains with imported agricultural products, blocking the roads with tractors, burning tyres, etc., if the import limitations, direct income support and export funds are conceived as unsatisfactory (see also Olson, 1982). A factor that might pull in the opposite direction is, perhaps, the increasing environmental awareness which puts independent but, until now only comparatively weak pressure upon the decision-makers in the agricultural policy arena. However, at the same time, in recent years, the suppliers as well as demanders of agricultural support have managed to redefine parts of the agricultural subsidies as

compensation for achieving various environmental policy goals. Also the enlargement of the European Union from May 1, 2004, have put pressure on the CAP, but exactly because of the asymmetry on the European agricultural policy market, one should not expect a radical change of CAP due to the enlargement.

### **8. Government failures and the supply side: Politicians and bureaucrats**

The farmers strong interest organizations (relative to other sectors) and the consumers' and tax payers' relatively weak interest organizations are necessary conditions for political decisions being pro-agricultural in a status quo perspective. Besides, political decision-makers (politicians and bureaucrats) are required to be willing to fulfil the wishes of farmers to a smaller or larger extent.

In this context, it is a widespread notion that politicians and bureaucrats in a democratic society make decisions reflecting the wishes, attitudes and preferences of the people, in particular, the political goals that are common among a majority within the electorate and that these decisions are assumed to make up the foundation of the political decisions of society.

According to the rational choice theory, however, the existence of such correspondence between the democratic, collective decisions and policy objectives based on individual preferences is a much too optimistic, although long lasting, democratic theory. Because the gain from limiting agricultural expenditures or agricultural protectionism is spread collectively among all taxpayers and consumers, extraordinary incentives are needed to mobilise taxpayers and consumers in the political process. In the same way, costs of the expansion of expenditures or of protectionism have to be paid by all taxpayers and

consumers. Again, extraordinary incentives are needed to mobilise taxpayers and consumers. Their loosely organised groups, however, are confronted with a smaller, but much more homogeneous group of farmers who enjoy the benefits of an expansion of the agricultural expenditures or protectionism and who are hurt by a cut in agricultural expenditures or free trade. The gains and losses of this group are concentrated and private in character.

Generally, it is predicted that the resistance against consumer-financed support is less intensive than against taxpayer-financed support because higher prices as a result of protectionism are more difficult to blame on agricultural lobbyism than higher taxes. As a result, farmers are normally in favour of price support measures. On the other hand, taxpayer-financed support is more acceptable if the measures have an “objective” character based on discretionary and bureaucratic criteria. Besides, the fact that taxpayer financed support through the CAP originates from the EU agricultural fund which is again financed by Member States’ contribution to the EU budget means that the connection between taxes paid in Member States and the CAP expenditures is not very clear for many tax payers. Hence, one should not expect a much stronger pressure against subsidies paid by consumers than subsidies paid by taxpayers in the European Union.

At the same time, because of the marginal impact of rising and decreasing agricultural protectionism or budgetary expenditures, electorates in general have no incentives to have a specific interest in CAP. The individual farmer, however, has an income which is more or less a function of political decisions. His motive for influencing the policy is therefore very strong. Agricultural organizations will gather information about what political

representatives do as far as agriculture is concerned, whereas the general public does not bother to keep themselves informed on these matters. Hence, it is no wonder that politicians are tempted to pay specific attention to the interests of agriculture.

Normally, politicians decide on a political issue according to how voters will react. Voters, on the other hand, have to consider the costs in time and money when they form their preferences and transmit them to the politicians. If the voter is a little rational, a minimum of benefits for him is necessary if he wants to pay the costs of collecting information and transmitting preferences to the political decision-makers (Nello 1984). As mentioned above, just getting information about the impact and size of public support for agriculture is difficult and costly because very often either the support is "hidden" in the prices or it is "hidden" in bureaucratic measures.

In the theory of rational choice - where "the political market" is used as a metaphor - it is assumed in the theoretical model that politicians "supply" political decisions in order to be re-elected. According to Winters (1987) re-election depends on the following factors: the number of voters affected by the political decisions, how voters are affected by political decisions, the political influence of the affected voters, whether or not the politicians regard it as acceptable that certain groups of voters get benefits, the possibility that the affected group of voters will punish the politicians for a bad political result and whether or not a bad political result for an affected group will have an impact on public opinion or not.

Hence, one should expect a falling willingness of politicians to supply the farmers with agricultural subsidies and protectionism as the number of farmers decline. Especially in

relation to agricultural policy decisions, however, it is often the case that the support of agricultural organizations is more important than indicated by the actual number of votes of the agricultural sector. The reason is that supporting agriculture gives politicians a base for attracting non-agricultural votes from rural areas. Also, in general, the agricultural organizations have a high political profile because an important part of the farmers' incomes stems from political rent-seeking. This means that the basic condition for the survival of farmers and farmers' organizations is to be found in the creation of public awareness. Politicians with a friendly attitude towards agricultural interests will benefit from this. Additionally, in most developed countries, rural areas are over-represented through the electoral system, i.e. there is an institutional bias towards agricultural interests within the political system.

Alongside the politicians, the bureaucrats are important suppliers of agricultural decisions. In the rational choice theory it is assumed – even though politicians formally take the political decisions under counselling by the administration – that bureaucrats are also independent actors who are maximising utility by preserving or expanding their power base, their career possibilities etc. In the agricultural area, bureaucrats probably have quite a considerable amount of influence in the agricultural policy area because this area is characterised by a lot of technicalities and many specific rules. A result of the technical character of agricultural policy is that politicians avoid dealing directly with the many regulatory and distributive questions in agricultural policy. When political decisions are transformed into quasi-political and bureaucratic-technical questions, agricultural policy takes on a seemingly objective character. Not least the Common Agricultural Policy has given national bureaucrats an institutionalised influence in making regulations through a

network of regulatory and administrative committees. At the same time, it gives the bureaucrats making the inputs to the political process an extremely large amount of influence (Winters 1987). All else being equal, one must therefore expect that bureaucrats in the agricultural decision-making process prefer agricultural reform which uses bureaucratic instruments instead of a liberalisation or a market orientation of the agricultural policy which would reduce the need for bureaucratic interventions and bureaucrats in general.

Normally, in the rational choice theory, it is often assumed that bureaucrats involved in the agricultural decision making process gain no immediate benefits from the political decisions taken. As mentioned above, the major implicit goals of agro-bureaucrats are to increase their power bases, responsibilities, staff, and career possibilities. These goals are best achieved the more complex and technical the agricultural policy is, and the more important agriculture is as an economic sector, the more agriculture is governed politically rather than by market forces. Therefore, in general, agro-bureaucrats are expected to oppose change in agricultural policy if it involves strong market orientation, less support for agriculture and a smaller agricultural sector. Bureaucrats must even be expected to be more in favour of continuing and building up agricultural protectionism than agro-politicians because they gain fewer benefits from taking general national or European economic and political considerations into account. Bureaucrats can normally only be expected to move away from the agricultural protectionist line if the present agricultural policy directly weakens their relationships with other parts of the administration. For example, the Commission's Directorate-General for Agriculture has for years been pressing for a moderate reform of the CAP because continuation of the former line was creating an

increasing number of conflicts with the surroundings within the Commission and with external actors outside of the Commission. In particular, the agricultural policy has been damaging the international relations of the European Union and its reputation in general.

In the agricultural policy area, the general asymmetry which – according to the rational choice theory - is always present in collective political decisions, is sharpened by the “suppliers” who have independent reasons for reinforcing a complicated, protectionist “super asymmetric” agricultural policy. However, a stronger reflection of individual preferences could be achieved by limiting the general asymmetry of political decisions and by limiting asymmetry that is specific to agriculture. Generally, in the rational choice theory it is recommended to set up institutions in order to put restraints on the utility maximising actors whether they are interest groups or Member States. These institutions should be designed in order to bring about a larger degree of correlation between the particular interests and the common interests. In the CAP, one way of doing so could be to strengthen the horizontal political element in the now very “segmented”, technical and highly complex agricultural decision-making process. This can be done by letting other politicians, rather than agro-politicians alone, participate in the agricultural decision-making process. Increasingly, this is also what is happening, especially in the form of the European Council meetings which have in recent years sometimes played the role of counterweight to the agricultural policy-making process, not least in cases of major reform initiatives with regard to the agricultural policy and the EU budget.

The European Parliament is also a horizontal political element in the European decision-making process. In the constitution adopted in June 2004 (but not yet ratified) the

Parliament is supposed to participate fully (before the Parliament was only “consulted”) in the decision-making procedure concerning CAP as far as legislation and budgets are concerned. The problem is, however, that the Parliament is long away from playing the role of an active counter-weight at the European level to the specific sector interests. Until now the Parliament has normally always taking a very positive stance concerning all kinds of European legislation and European political initiatives in order to increase its European power base. At the same time, the parliamentarians have no power to tax citizens and companies and, therefore, are never held responsible for increasing budgetary expenditures because of the CAP. A more radical way to reduce the asymmetric characteristics of the CAP would be to renationalise the CAP or part of the CAP. Then, of course, European integration would loose the potential neofunctionalist spill-overs from the CAP to other policy areas. On the other hand, one could argue that these spill-overs (to the customs union, the internal market, the economic and monetary union, etc.) have already been exploited. At the same time, it is difficult to identify from where the decisive pressure could come from in order to bring about such a renationalisation of the CAP. Another way of making the asymmetric agricultural policy less asymmetric is by setting certain constraints on, for example, the EU budget for agricultural policy. Such ceilings have also been decided at the EU level by the European Council. The problem, however, is that the support for the agricultural sector can take many other forms than what can be seen on the budgets, and that the budgetary discipline decided upon is not always followed in practise.

All in all, it is very difficult to come up with “institutional solutions” in order to fundamentally change the CAP. Hence, in general, according to the proposed theoretical model, fundamental changes of the Common Agricultural Policy are expected only to come

due to hard pressure from actors outside of the European Union. The “iron construction” of the various interests embedded in the CAP can only be “deconstructed” in any significant extent if and when the CAP comes under fire from strong political players outside of the European Union.

## **9. Conclusion**

The aim of this article is to propose a theoretical model of the Common Agricultural Policy of the European Union which should be able to give an understanding of an issue or a process, have an explanatory power and be able to predict events, be consistent and coherent, cover the full scope of the research object and have a capacity for self-reflection and engagement with contending theories.

The proposed theoretical model is an interdisciplinary model drawing on elements from economics and political science. As argued by North (1990:5), such a theory should build on individual choices because this theoretical approach is logically consistent, and because it can, by integrating individual choices with institutional constraints, serve as a major step toward unifying various social science theories. Hence, methodological individualism is a starting point of the proposed theoretical model.

The next point of departure for the proposed theoretical model for the CAP is the existence of a number of market failures when market failures are seen in a broad perspective. The market failures here cover certain characteristics of the supply and demand of agricultural goods as well as some peculiar characteristics as far as the production of agricultural products is concerned. Among other things, a result of the peculiarities of agricultural

economics is permanent income problems, that is, problems with economic profit-seeking which means that farmers have a potential interest to organise themselves in order to become political rent-seekers. In their efforts to organise themselves the farmers are helped by their perennial income problems and homogenous preferences. This is the foundation for their "logic of collective action".

At the same time, normally, the farmers have great success in avoiding 'free-riding', which is always a problem when interests are organised. This is due to the existence of a number of selective incentives. Besides, politicians and bureaucrats are motivated to supply farmers with public support. Still, the expected opponents of agricultural support, i.e. consumers and taxpayers, are too weakly organised and too little interested in making any forceful counterweight to farmers and agricultural politicians.

The general asymmetry between farmers and consumers is sharpened in the CAP because it is possible to push the costs of expansion of agricultural production to other Member States and countries outside the European Union. At the same time, many of the institutionalised counter-weights that exists at the national level, are either very weak or do not exist at the European level. This is why the political system of the European Union could be characterised as a "super asymmetric" political system as far as agricultural policy decisions are concerned.

The proposed theoretical model of the CAP is not "tested" in this article, however, such a test has some rather clear success criteria, for example, the predictions on the basis of the theoretical model are a) that the European Union has large obstacles that are almost

impossible to conquer when it itself want to fundamentally reform the CAP, b) that the level of support to the agricultural sector is very difficult to bring down in a reform process meaning that a reduction of one kind of support will probably lead to a shift to another kind of support and c) that there is a structural tendency to increasing bureaucratisation of the CAP as it changes due to, for example, external pressures and d) that the resistance from the tax payers and consumers vis-à-vis the protectionism and subsidizing of farmers will be relatively small.

Some would argue that the proposed theory is somewhat “autistic” as it is build on a specific set of assumptions, which, if accepted, automatically lead to the next step in the theoretical model. Some might criticize that the proposed theoretical model leaves almost no room for, for example, a reform process based on ideals and principles. Others might criticize that fundamental changes of the CAP can not happen due to rational entrepreneurs within the European Union like the Commission.

At the same time, even though the proposed theoretical model is very much in accordance with the basic assumptions of neo-classical economic theory, and, therefore, should be no stranger to economists and political scientist, there might some truth in the criticism. There is a danger that theories are simply written off because they do not fit with the basic assumptions of the rational choice based theoretical model of the CAP. This might be a hindrance of self-reflection and self-critique. Therefore, the proposed theoretical model of the CAP should be used with an open mind in order to integrate insights from other theoretical schools.

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