

THE RURAL ECONOMY AND THE BRITISH COUNTRYSIDE
(Ed. P. Allanson and M.C. Whitby, Earthscan, 1997)

CHAPTER 1:

“THE ROLE OF MARKETS IN THE RURAL ECONOMY”

David R. Harvey.

1. Introduction

Adam Smith's "Invisible Hand" and subsequent theories stemming from this proposition suggest that, under certain rather specific and possibly unrealistic conditions, the freely competitive market place can achieve an economically efficient allocation of resources - the so-called "social optimum". This theoretical case for the market economy is often linked with socio-political and philosophical theories supporting libertarianism and the freedom of the individual. When and how might the market fail the rural economy?

This chapter takes as its central focus the role markets and market mechanisms play in sustainable policies for the rural economy. In examining this role, the principal illustrations are drawn from agricultural and environmental policies. The chapter begins with an abbreviated sketch of the market mechanism's effects on the development of the rural economy, section 2, illustrating the primary importance of property rights. Section 3 takes this story further by concentrating on the conflicts which arise over the use of the countryside - the key feature distinguishing rural from urban areas. This examination lays the groundwork for a consideration of the nature and role of government within the market paradigm (section 4). The final section of the chapter draws out the major implications for the future development of rural economies and sustainable use of rural environments.

2 The Market Mechanism and the Rural Economy

Economic development tends to become centred on urban areas, attracting people and wealth (capital) and leading to further development - encouraged by early economies of scale in provision of services (both public and private) in the form of schools, shops, entertainment, banks, post offices, etc. Denser populations make the initial provision of these cheaper, and they are thus encouraged. Typically, these urban centres are at natural transportation nodes, in the lowlands, close to rivers or the coast, and often on Grade 1 farm land. 'Modern' growth and economic development thus appears naturally centred on urban rather than rural areas¹.

The development process also involves a reduction in the time and effort devoted to food and shelter. This leads to a relative, though not necessarily absolute decline in agriculture, and thus to the economic activity which surrounds agriculture, often located in rural areas. However, development also leads to an increasing demand for food off the farm so that the

¹ This modern pattern of geographic development did not manifest itself seriously until the major industrial substitution of fossil fuel, especially coal, for wood and associated transition from animal to mechanical power. By 1750, Britain was "already distinguished by the variety and prosperity of its industries....but much industrial organisation, including that of some of the most important industries in the country, took a rural form, as it had done for centuries since the sharp distinction between town and country of the high Middle Ages had broken down" (Court, 1967, p 43). Court also notes (Ch. 3) the congruence of substantial changes in industrial organisation (leading to the concentration of previous cottage industries into large scale factories), new technologies associated with the industrial revolution and the rapid decline in forests.

development process leads to the commercialisation of farming and a growth in its interactions with the wider economy through both the input supply industries ('upstream') and the food processing, distribution and retailing sectors ('PDR' or 'downstream').

Furthermore, as incomes grow, a smaller share of total income is spent on raw food products and more on other things. The inevitable result of economic growth is that fewer people can earn a full-time living from agriculture. People are encouraged to leave farming for other occupations, typically located in urban areas. However, expansion of population and industrial growth creates a strong demand for food (and much motive power) from the farm sector, which has to compete with the urban and industrial sectors for both labour and capital. This competition helps maintain returns to both labour and capital on the farm (and thus in rural areas) relative to those in the rest of the economy.

When national economic development is coupled with both technological change and an open international trading policy, as has been the case in the UK, the domestic farm sector becomes subject to global competition. The industry declines, well exemplified by the great agricultural depression of the last part of the 19th. century, mirrored in the decline of rural areas and their economies. By 1911, 80% of the British lived in towns. The farm labour force (especially for women) had been declining since the 1850s, and the early contribution of the rural industrial and commercial sectors had given way to the concentration of both population, commerce and industry in predominantly urban areas². This tendency has been re-inforced by technological development which has historically substituted capital (plant, machinery and purchased inputs) for labour and land - more agricultural inputs come from the urban, commercial and industrial areas of the country, and thus more spending on food returns to the urban areas rather than staying in the countryside.

Rural areas have thus been subject to a net out-migration as the development process occurs, and have become more sparsely populated. Those rural dwellers with prospects (and command of higher salaries and wages because of their skills) leave the countryside and migrate to the towns. Consequent increases in costs of providing services for the remaining population (schools close, village shops close etc.) lead to the emergence of the rural "transport poor" problem, exacerbated by market incentives tending to attract the more able and better-skilled away from the countryside.

Subsequent wealth accumulation in the cities, however, leads (at least in Britain) to capital flows back to the countryside as country estates become stores and signs of wealth, and also playgrounds and gardens for the better-off. But this capital inflow is concentrated in blocks

² See, for example, Mingay, 1987, Chapter 1.

mostly controlled by single individuals and locked up in land and property, rather than in development ventures. Hence the market mechanism leads to middle class, prosperous, mobile and 'countryside conscious' incomers to the countryside, taking over and protecting their "positional goods"³ (houses, estates and rural quality of life) whose values are absolutely dependent on limited numbers of people having access to them.

The appeal of the country retreat depends on it being qualitatively different from the town. Since the market power resides among the wealthy, they can control not only their own (non) development of the countryside, but also enforce these values on the rest of the rural vicinity. The countryside becomes the playground of the rich and the workhouse of the disadvantaged and resource-poor, who cannot find the opportunity to leave and better themselves, and whose public and private services and amenities are continually reduced. In caricature, rural areas become the land of the feudal (and capitalist) lord and the peasant⁴.

However, market forces do not stop here. As the economic development process proceeds, growth tends to happen in services at the expense of manufacturing. This is accurately reflected in the proportion of incomes spent on services rather than manufactured products. So manufacturing tends to decline and service activity (media, entertainment, food processing, etc.) grow in importance⁵.

Continuing technological change, often associated with public spending to improve transport and communication links, brings the countryside closer to the town. The "comparative advantage" of rural areas begins to change as transport and communication costs fall. Industries and activities are no longer tied to urban areas to be competitive; they can move, though why should they? Part of the answer lies in the "diseconomies" of towns and conurbations, and consequent desires to move to the countryside, not only to live, but also where possible to work. The attractions of minimum commuting and a greater quality of life leads to reverse migration as people move out of towns and back into the countryside, a trend which has been evident in the population surveys of the UK for some considerable time.

³ Hirsch (1977) explains positional goods as those which attract value not because of their absolute scarcity but because of their 'distributional' scarcity - in that their wide availability and use detracts from their appeal, either through congestion and decline in quality, or through their erosion as indicators of wealth and success.

⁴ Of course, it is never really like this. There always have been and probably always will be other things going on in rural areas than farming and field sports, and other people living and working there than those in farming and those living in the manor house. Apart from anything else, these people need services and some goods which will be provided most effectively (that is delivered at competitive prices) from the immediate locality.

⁵ Thus, although the decline in manufacturing is frequently decried as indicating economic regression, it is more realistically seen as a natural reflection of consumer demand and economic progress. Furthermore, this observation leads to a real (and seldom answered) question as to why manufacturing should be seen as the only genuine producer of wealth.

Furthermore, economic development appears to be associated with a growing emphasis on “footloose” industries (those which do not ‘mind’ where they are, since they do not depend on raw materials and resources and don’t involve major transport problems for either their inputs or their products) and even to specifically rurally-related industries (crafts, tourism, up-market products with green or craftsman image). The greater variety of industry and commerce admits more variety in products (potentially opening niches for smaller companies); all of which experience relative growth potential in a growing modern economy. The countryside now revives as the development process proceeds, but markets are paying more attention to rural areas as a bank of environmental capital, elsewhere termed the “reservoir of natural resources and values”, as playgrounds, gardens and living/working spaces rather than directly as the means of providing a living.

The land of the feudal lord and the peasant has now become a potential battleground between the farmers (representing, also, quarryers and commercial foresters) trying to make a living and the ‘incomers’ trying to have a life in the countryside - between those trying to live off and those trying to live in the countryside. How do markets resolve this battle?

The short answer is through property rights. There has always been a potential conflict between those who want to live on and those who want to make a living from the same resource (land and the natural environment). In the ‘old’ days, this was simply solved through the (typically rich) landowner claiming property rights over large areas of land and dictating the use of it towards his/her own ends - highland clearances, access to Kinder Scout, ‘model’ and landscaped estates and so forth. Once property rights are established⁶, the owners of the property determine how the property will be used, either for consumption or production or a judicious though personal mix of the two. Furthermore, they are typically powerful enough to sustain these rights in the face of considerable opposition. Nevertheless, the question of whether this pattern is considered socially just or justified raises the further query about the socially sustainability of these rights, and hence raises the possibility of political changes to these rights (section 4)

⁶ Typically involving a radical re-assignment of property rights, and resulting in enclosure of village and traditional common land, thus sweeping away the previous socio-economic structures and populations (Dahlman, 1980)

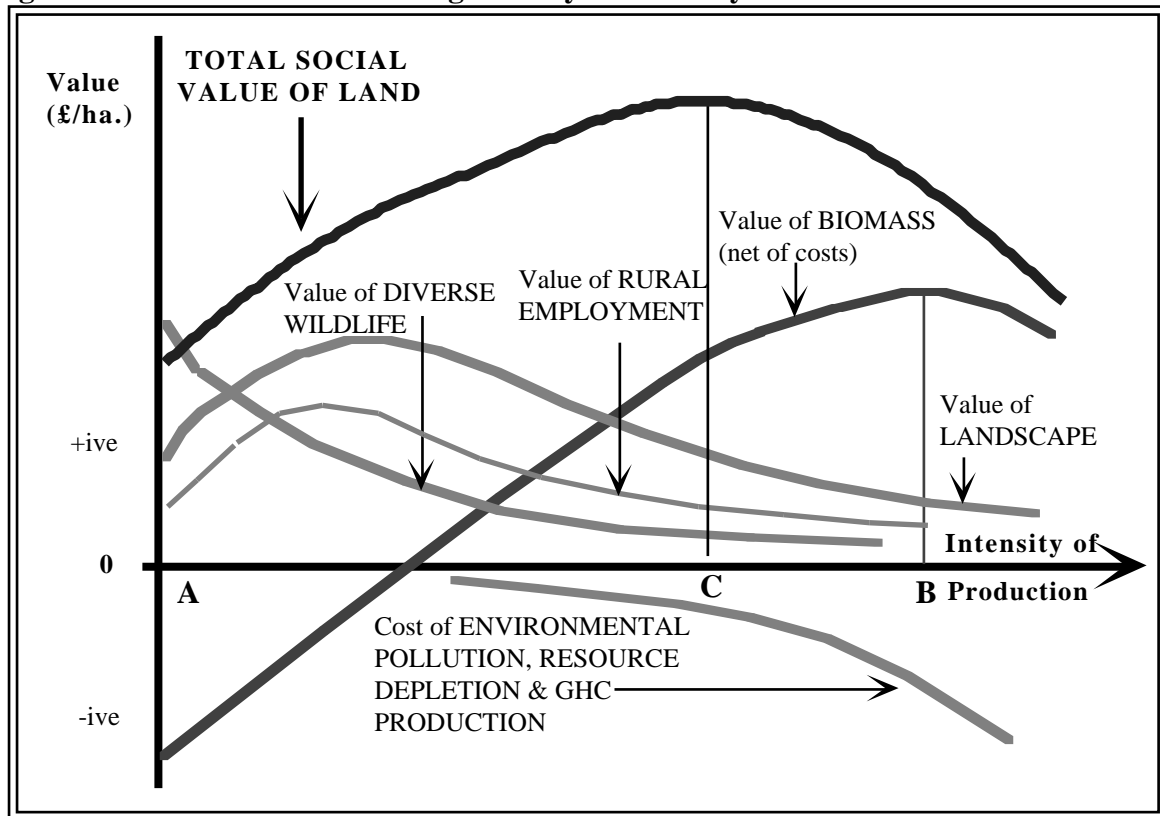
3 Property Rights over the Use of the Countryside

3.1 The analytical framework

The focus is clearly on property rights over the natural environment and land use - since these features most clearly identify the distinction between the rural economy from its urban neighbour. This focus highlights the role of agricultural policy, as both a major influence on land use and as the principal vehicle through which governments have sought (to date) to influence the specific dimensions of the rural economy.⁷

Traill (1988) presents an economic picture of the trade-offs and possible conflicts between various elements of the rural environment by concentrating on the issue of the intensity of land use - Figure 1.

Figure 1. Value of Land Using Activity as Intensity of Production Increases.



Source: modified after Traill, 1988.

In this figure, intensity is measured as quantity of inputs per hectare. The net value of marketable goods from the land base (food, wood, fibre etc.) reaches a peak at point B - the typical private profit maximising level of intensity. The other curves represent hypothetical relationships between intensity and other more or less intangible aspects of the rural

⁷ There are, of course, other government policies which affect rural economies, but these do so through their particular application in rural areas rather than being specifically designed for rural economies. See Hill (1989) for a discussion of these policies and their influence relative to the agricultural policy portfolio.

environment, which have been christened CARE (Conservation, Amenity, and (recreation) Rural Environment) goods (McInerney, 1986). In addition to these CARE goods, a further curve reflects a possible relationship between intensity of land use and rural employment, as one measure of socio-economic concern, here assuming that greater intensity tends to be associated with a shift in employment associated with land use (at least in terms of producing biomass) away from rural areas and towards the industrial and urban areas, or even offshore. In principle, separate curves could be added to represent contributions to reducing greenhouse gases and net costs of depleting non-renewable resources, here included in the general pollution curve.

This representation of the rural environment emphasises three critical components of analysis of land use and countryside management. First, it is necessary to understand the socio-economics of land use decisions and management practice. From an economist's perspective, this understanding emphasises responses to market and policy conditions given peoples' motivations and circumstances. Second, the physical consequences of particular land use decisions and practices for the rural environment need to be identified. The combination of these two elements provide the definition of the several curves in Figure 1 in physical terms and the likely position on the horizontal axis chosen by land users. The third element concerns identification of the social valuations of the several goods and services provided through the interaction of land use and the rural environment.

Given that these three components can be identified, then it is possible to conceive a socially optimal intensity of production at point C, defined as the maximum of the vertical sum of each of the component valuations. Typically this would imply a reduction in intensity from present levels, at least in the majority of circumstances in which the social valuations of the intangible aspects of rural land use are not reflected to the land users, who thus have no incentive other than altruism to respect such values in their private decisions. Thus, although there is a reluctance to 'price' intangible aspects of the rural environment on the part of non-economists, this representation emphasises that all public and private land use decisions imply such a societal valuation. In turn, this representation casts the debate and controversy over the rural environment as arguments about the behaviour of land users, the physical relationships between land use and the environment and the social values of the various outputs and consequences (goods and services in economic terms) from the rural environmental system.

Apart from environmental designations such as ESAs, SSSIs, NSAs, National Parks, AONBs and Stewardship schemes, and with the exception of specific pollution controls and regulations, the social value of wildlife and environmental assets is seldom reflected back to farmers and landusers in the form of incentives or penalties for particular land use practices.

Thus the major relationship determining land use is the biomass net profit function (curve). Furthermore, notwithstanding the 1992 reforms, the Common Agricultural Policy still supports market prices and producer returns to biomass production, which artificially inflates the biomass net profit curve, tending to shift the actual intensity of use of land substantially to the right of point C (that is, has shifted point B to the right of where it would be in absence of support and intervention). Strictly speaking, increasing the biomass net profit through farm price support simply shifts the curve upwards. However, the feedback consequences of this increased profitability can also be expected to encourage its shift to the right as well, through encouraging investment in production increasing technologies.

Thus, the twin focus of sustainable policies from this perspective becomes: a) get the price of biomass “right” (without distorting and supporting it as under the CAP, which shifts the biomass curve upwards and to the right); b) “properly” reflect the public or social values of the CARE goods (including pollution) back to the landowners and users. Only then can we expect market forces to encourage land users to operate at the socially optimal level of intensity at point C⁸.

Three important characteristics of land use are worthy of emphasis in concluding this brief outline of the framework. First, both social valuations and the underlying technical relationships will vary between different regions and locations depending on their circumstances and conditions - no one hectare is identical with the next, if for no other reason than its exact location and spatial relationship with adjacent land. This makes the spatial representation of this framework a critical feature of the analysis and also means that appropriate policy prescriptions are likely to be highly regionally and locationally specific - as already reflected in ESA and NSA policy design and implementation.

Second, land-users responses to both the physical production possibilities and to market incentives and policy signals/constraints are likely to vary depending on individual and social circumstances, and on their motives. Responses to similar market and policy conditions in similar regions are likely to be heterogeneous simply because people do different things for different reasons. Even the economist’s assumption that individual behaviour is ‘economically rational’ - driven by profit/income on the production side and rational choice leading to increased satisfaction on the consumption side - admits of different responses depending on whether land use is seen predominantly as a production or consumption activity. In practice, people are more complex than is conceived of in the economic model,

⁸ Notice, however, that even this prescription relies on an assumption that the majority of land users are at least constrained by, if not actually driven by, the need to make normal profits and thus earn an acceptable living from their land, rather than treating their land-use activities as consumption or life-style practice.

and their responses will be more diverse than is envisaged in a rigorous mathematical application of this framework, though not than is catered for in the market place.

Third, different policy options, technological possibilities and market conditions will encourage different production techniques which will shift and alter these curves, while changing incomes, prices and preferences (possibly associated with better or more information) among the general population will change social valuations associated with the goods and services. Thus, the picture is but a snap-shot, and is subject to substantial and not always very predictable change over time. The dynamics of land-use relationships are deliberately ignored in Figure 1, but cannot be forgotten in the use of the framework for the identification of appropriate policies. In practice, the picture which emerges is dramatically heterogeneous and variegated: there is no simple picture or analysis which can be relied upon to provide a ‘sustainably’ satisfactory answer to the question of whether or not any social system is sufficient.

3.2 *The major Implications*

This framework has seven important implications for the design of agricultural and environmental policies.

First, sustainability in this framework is dependent on social valuations of environmental assets. Any private or public decision to encourage, regulate or compensate for production practices in favour of the environment implies some notional valuation of the environment, at a minimum that the environmental gain is worth at least the foregone production plus any additional effort required to produce the environmental gain. Such decisions involve choices about the allocation of resources (including effort), and these choices imply relative valuations of the outcomes, regardless of whether or not the market mechanism is used. Not only is valuation of environmental assets possible, it is inevitably implicit in any decision as to whether to preserve or conserve such assets.

Second, the importance of social valuations means that public decisions require mechanisms to establish and legitimise these values. Even presupposing that agreement is reached on appropriate physical measures of environmental assets and their quality (Parris, 1994), if these mechanisms are less than transparent (as is typically the case), the political process is likely to be subject to ‘interest group capture’ and political failure. Both information on revealed social preferences and understanding of environmental issues are thus critical for the development of sensible and sustainable agricultural, trade and environmental policies. That is, in terms of Figure 1, the *process* of defining the social values of the wildlife, landscape, pollution and employment aspects of rural land use is critical to the definition of the optimal level of intensity (point C).

Third, however, dependence on social valuations is *not* equivalent to arguing that the only way to approach the socially optimal land use pattern ('C') is to use the market mechanism. It may be more socially efficient on occasions to make use of direct regulations on land use practices, or a judicious combination of both approaches. This will depend on a number of factors, the most important being: the certainty about the relationships between intensity and environment; the costs of policing the regulation alternative; the transactions and information costs of the market-based and regulation alternatives; the assignment and enforcement of property rights; ultimately, the capacity of both market and the political systems for 'failure' (see below).

Fourth, *both* the physical/technical relationships between intensity and environmental assets *and* their social valuations are likely to vary substantially between localities and regions (as already noted). Hence appropriate price or regulation signals for the development of 'sustainable' agriculture and land use will vary substantially between localities and regions, notwithstanding the global nature of some environmental concerns. In turn, this variation may well militate against both common European payment/penalty systems and against conventional market mechanisms (price signals) because of the increased transaction and information costs, as opposed to regulations or combinations of regulations and price signals. Subsidiarity, in this case, involves a presumption in favour of local decision and action within national and international frameworks of property rights and compensation mechanisms. Furthermore, wide differences in family and business circumstances, and in motivations and constraints between farms and land users mean that responses to policy and market signals will vary considerably between users even within the same region or locality. Diversity and heterogeneity thus mitigate against central planning, though they may also contribute to environmental sustainability.

Fifth, following this point, attempts to define "level playing fields" in terms of common definitions of environmentally friendly practices (either within countries or, *a fortiori*, between them) is also in violation of the very concept of sustainability as advanced here. The "level playing field" concept does *not* mean that trading nations (or regions) should have identical environmental conditions or identical social valuations (and hence opportunity costs) of environmental assets, any more than it means that they should have identical costs of land, labour or capital. In fact, it is regional and national differences in these resource endowments, capabilities and social valuations which provide the very basis for economic gains from trade.

Sixth, "getting prices right" is critical for the development of sustainable systems of resource allocation. If farm product prices are over-valued, then this framework implies that the system *cannot be sustainable* (either environmentally or socio-economically). The only

viable definition of ‘appropriate’ value of marketable goods from the land-using sector is the ‘free-trade’ world price. Any other price level requires a direct social valuation of agricultural output which is different from private market valuations, and, as such, requires *both* that the domestic *product* be identifiably different from its inter-regional or international competitors *and* that the social valuation of this difference is demonstrably *not* manifest in private market valuations of the differentiated products. Differences in the environmental conditions of their production can and should be identified at the point of sale, on which information consumers should be relied upon to take action as they see fit.

A final implication of this analysis is that support of farm (or rural) incomes over and above those provided by a proper reflection of all social valuations of outputs and environmental asset maintenance is unjustified, other than from purely distributional and equity arguments, typically and sensibly handled through social security and general taxation policies. However, having said this it is important to realise (at least on the superficial evidence of previous policies and political concerns) that distribution issues include an important component of both geographical and sectoral distribution of economic activity. Thus there appears to be a powerful set of constituencies in favour of a more equitable distribution of economic activity between favoured and less favoured areas than would necessarily be achieved through the unhindered operation of market forces, and there has also been in the past a clear presumption in favour of a larger agricultural sector than would be the consequence of an unhindered market-place.

It may be that the latter presumption is simply a reflection of the socio-political concern over security of food supplies. Since this is now presumed to be of merely historical interest, it is the geographical distribution which is now of major concern as far as farm policy is concerned. In this case, conventional economic analysis strongly suggests that policy concerns ought to be about the provision of an adequate infrastructure of communication and transport links, and of a pattern of communal and social services, sufficient to support sustainable local rural economies. In addition, concern ought to be about the economies and dis-economies of different sizes and concentrations of market-based commercial activity.

However, it is plausible that there is a concern over an “optimal” structure of agriculture - in terms of farm sizes and types in particular regions, both as this contributes to a socially acceptable and desirable landscape as well as the (arguable) contribution to the pattern of rural employment, activity and social structure. Encouragement of such an ill-defined (and possibly undefinable) optimal structure (loosely characterised as the preservation of the “traditional family farm”) may also be an effective force in favour of more or less traditional forms of farm support, even if barely justified on rational or logical grounds.

4 The Nature and Role of government in the Market Place

As mentioned at the beginning of this chapter, the economic theory of welfare optimisation stems from Adam Smith, and although variously extended and developed, still provides the foundation for economic policy analysis (Just *et. al.*, 1985). In essence, the theory holds that a system of perfectly competitive markets (in which there is freedom of entry and exit in all markets, all actors are price-takers and for whom private costs and benefits are identical with social costs and benefits) is capable of generating a socially optimal allocation of resources to the production of goods and services for the population, such that no one person can be made better off without making at least on other person worse off (the Pareto welfare criterion). While the elementary versions of this theory assume perfect information, more sophisticated developments allow that information can never be perfect and that information-gathering, decision making and associated risk-taking themselves are resource-using activities, and subject to optimisation within the economic welfare calculus.

In this simple model of the world, there are four major functions for government.⁹

i. ***The Policeman***: to establish and maintain the legal and judicial framework within which the market will operate, both at the national and the international level, including the important role of establishing and policing property rights. The free market involves a massive number of transactions, each of which can be viewed as a contract between buyer and seller. The efficient working of this system requires that both sides of the market have confidence in the security and probity of these transactions. The costs of ensuring this are typically assumed away in elementary analyses, but are not insignificant, especially in atomistic markets (with a great many individual buyers and/or sellers) characterised by long-term decisions and associated difficulties of uncertainty and risk, such as the agricultural or housing sectors. Solid and well-policed laws of contract are necessary (but not always sufficient) conditions for the efficient operation of the free market. In short, at the door of every auction room there stands a policeman, and the long arm of the law is necessarily attached to Adam Smith's invisible hand.

ii. ***The Doctor/Engineer*** to correct "market failures" including at least the organisation of the provision of public goods (defence, government itself, etc.) and the correction of the free enterprise system for externalities, imperfect competition and monopoly, all of which prevent the free market from attaining the social optimum. The key problems with public goods are: a) that these goods are non-rival in consumption, meaning that one person's use or consumption of the good (or service) does not deny another person use of that same (unit of) good; b) that prevention of people (such as non payers) from consuming or using of the good is either impossible or impossibly expensive - the so-called non-exclusion characteristic. In

⁹ See, e.g. Grant, 1975, though not labelled as here.

other words, once a public good is supplied to one, it is supplied freely to all, a market condition in which private entrepreneurs cannot survive. Hence the pure free market would not be expected to provide any of these goods.¹⁰ Externalities (pollution is the traditional example, pretty landscapes, pleasant housing estates or the converse, dilapidated estates are others) exhibit a similar problem in that rational market transactions cannot account properly for their production or consumption. They arise as more or less unintended by-products of either consumption (C) or production (P), and once produced are difficult or impossible to price, often since they have public good characteristics, as in the above examples. However, since they are directly associated with normal market transactions, textbook solutions of adjusting the price of the marketable good through taxes or subsidies can theoretically correct the market signals for these goods.

iii. ***The Pharmacist/Mechanic:*** to encourage and foster economic efficiency, both in static terms - the need for which can be seen as resulting from the public good characteristics of information; and in dynamic terms to assist in adjustment to changing circumstances, which might be associated with externalities of progress and growth and with the public good aspects of technological change. This function can also be seen as operating at both the macro and micro level in the economy.

iv. ***The Judge:*** to redistribute income and wealth in the interests of equity, since welfare optimisation theory takes the initial resource endowment distribution between people as given, while (eg. Rawls, 1971) there is every reason to suppose that societies regard equitable (not necessarily equal) distributions of endowments (wealth, income, good and service provision and entitlement, and spatial patterns of economic activity) as desirable.

v. In addition to these four well-recognised functions of government in a market economy, a fifth function should also be added: ***The Priest:*** - as the guardian of public morals and ethics, requiring additional roles to those envisaged by the clinical calculus of neoclassical economics for the policeman and the judge.

At the risk of gross simplification, but in the interests of systematic analysis, table 1 identifies the principal functions fulfilled by the countryside, and the potential reasons for government intervention associated with each function.

¹⁰ A moments reflection will provide real life examples which contradict this proposition, public service television in the US for instance, which relies on voluntary subscriptions from those with a social conscience, or the Trinity House lighthouse system. In fact, more sophisticated analysis, attributable to Lindahl and Samuelson (see, e.g. van den Doel, 1979) shows the possibility of negotiations between people cooperating to ensure provision of such goods, while the simple theory does not deny the possibility that one or two rich people might choose to 'buy' such goods for themselves and thus also provide them for others. Nevertheless, traditional economic theory driven by self-interested rationality finds it difficult to explain private (non government) provision of public goods to the extent observed.

TABLE 1 COUNTRYSIDE FUNCTIONS AND POTENTIAL FOR MARKET FAILURE:

Function	Rival?	Excludable?	Public Good?	Externalities:
factory floor			x	P/P; C/P
private garden			x	C/C
real estate			x	none
playground			x	C/C
museum/art gallery	?	?	?	C/C
nature reserve	?		?	P/C
wilderness retreat		?	?	none
landscape	x	x		C/P; C/C
option reservoir	x	x		C/P; C/C
existence value	x	x		C/P; C/C

The Countryside is a multiple activity, joint product complex. The question is: if markets worked perfectly, with public goods properly supplied, does the fact that many goods and services of the countryside are both jointly produced and consumed cause any insurmountable problems for the market mechanism's potential achievement of social optimality? For example, the consumers' regard for the methods of production as well as the quantities and qualities of product; the interactions between agricultural production practices and the provision of wildlife and landscape; the potential consumer regard for other peoples' enjoyment/benefit of the natural environment (both now and in the future); the potential rival consumption of a non-excludable (or non-excluded) good - crowding of wilderness areas or natural habitats; all constitute *prima facie* examples of externalities which potentially destroy the social optimality of the market. As the obverse of the same argument, it is an economic necessity that those people supplying the various elements of the countryside package receive sufficient income to persuade them to continue supplying the package. 'Unadulterated' market prices may not provide sufficient income.

Even in the event that all goods and services could be provided through the appropriately governed (regulated) market place (accounting perfectly for all externalities and jointness through appropriately modified prices using the subsidy/tax adjustments), it may be that it would be less expensive (more efficient) to provide at least some of the countryside attributes through the public sector given the resources necessary to establish, implement and police appropriate policies. In other words, inclusion of the costs of information, decision making, policing and implementation may result in sufficient economies of scale in organisation to make the conventional competitive market inefficient. In this case, public provision/organisation of part of the countryside portfolio of goods/services might be justified on efficiency grounds, requiring at least extensive public regulation if not public operation. This short discussion parallels the arguments about the efficiency of the Coasian tax/subsidy solution to externalities versus regulation (see, eg. Pearce and Turner, 1990).

Even given all these arguments, there remains the fact that the market system results in a distribution of goods and services amongst consumers on the basis of ability to pay. Although in abstract any objections to this could be overcome through appropriate redistribution of income and wealth, the difficulties of designing (as opposed to defining) the necessary resource-neutral transfers means that distributional objectives have a legitimate place in determining the question of who should pay for the countryside. As a final point, the above arguments have been outlined in terms of the Pareto criterion for maximising social welfare¹¹. Other criteria may well provide strong arguments in favour of public provision of some countryside goods.

There is some evidence that the Lindahl/Samuelson negotiation solution to part of the “public good problem” (non-rival consumption) can be achieved in practice (eg. van den Doel, 1979). This solution involves one person (or group) acting as the contractor for the provision of the good for many, negotiating with the contractor on the amount to be paid for a given quantity of the good. This can be shown to result in a Pareto optimal production/consumption of the non-rival good so long as consumers are willing to reveal their preferences and so long as there is no problem with free-riders - ie the good is more or less excludable. RSPB bird sanctuaries are an example of this solution in practice, where members grant the society the right to negotiate with landowners on their behalf. This idea could be more widespread as argued in Hodge's suggestion for CARTs (Conservation, Amenity and Recreation Trusts - Hodge, 1988).

Such solutions can be regarded as a ‘market adaptation’ to the potentially damaging behaviour of un-restricted and narrow self-interest. In this sense, to anticipate discussion below, they can be viewed as the ‘natural’ extension of market forces into the ‘political’ or collective choice arena. However, there are clearly limits to the countryside attributes which can be provided through such negotiated solutions. Provision of the last three functions of the countryside in table 1 at socially acceptable levels seem likely to require some public or government assistance to voluntary negotiations, contracts or contributions.

Typically, economic policy analysis finds it impossible to reconcile these potential functions of government with the observed characteristics of the policy. Such analysis is limited to providing estimates of the “social welfare cost” of existing policy compared with the benchmark of an “un-regulated” though policed, well-engineered and maintained healthy economy. It is obliged to conclude that the re-distributive effects of the policy must be the

¹¹ The Pareto Principle employs the simplistic criterion that no policy (or market) change can be judged a social improvement unless at least one person is made better off while no-one else is made worse off. More applied analysis of real world choices modifies this criterion to allow those made better off to compensate any losers before deciding if the change constitutes an improvement, though this modification clearly requires inter-personal comparisons of welfare, which are not without considerable difficulty.

reason for its existence. The apparent fact that many policies actually transfer income and resources from the poor to the rich rather than *vice versa* compounds the embarrassment of neo-classical economics in explaining and understanding farm policy. "Clearly agricultural support has been neither in the national interest nor justified by widely held perceptions of social justice" (Wilson, 1977) or " the political system exists to legitimise the protection of vested interests at the expense of unsatisfied or badly expressed and represented interests". (Josling, 1974)

The neoclassical economic model, however, contains within it the seeds of its own destruction. Consider the implications of profit-seeking firms and utility-seeking consumers combined (as theory admits it must be) with a government whose major function is the redistribution of income and wealth. The workings of the competitive market mean that this redistribution, even if entirely resource-neutral, will need to be continuous. Even in the absence of market imperfections and failures, the market model includes a government continually engaged in economic activity, taking and re-distributing income.

The existence of such a government provides entrepreneurs, consumers and taxpayers with the means to influence their economic environment, including government, to their own ends. Add to this model the evident gains to be made from collective action (especially but not only in the labour market) and the pressures in favour of the maintenance of workable competition are now turned in favour of winning control over the government, as well as over the market place.

Consider the effect of high support prices for the products of agriculture¹². More money accrues to the agricultural sector than would otherwise be the case as a result of supported product prices. Increased revenues (with the politically assured prospect of these revenues being sustained in the future) means increased incomes (at first) for those in farming. People who previously did not consider farming returns sufficiently attractive to stay in (or join) the business now re-assess their decisions. More people now seek to earn a living from farming (either directly or through selling farmers more inputs and lending them money). The business of farming is stimulated (this being a point of the support system). But the land base on which this sector is fundamentally based is more or less fixed. The inevitable consequence is that the land is used more intensively, and earns more than without support. Rents and land prices increase, as the opposite side of the coin of increased intensity of production. Put as simply as possible, wheat at £150/tonne pays for more fertilisers, chemicals, and tractors, equipment and drivers to apply them, than does wheat at £90/tonne.

¹² The consequences of post-war price support on UK agriculture are explored (for example) in Harvey (1991).

The result is both increased output and an increased intensity of production, as well as greater capital and labour use than would otherwise be the case¹³.

Farmers' incomes, however, are not necessarily increased by this process. Farmers' demands for more land, labour, capital and other inputs tends to drive these prices up, so net returns (farm incomes) do not increase. The end result of the market system faced with such 'interventionist' policies is that more people earn a full time living from farming (and thus earn less from doing other things). Meanwhile, the artificial security of the "controlled" market place lends support to increased investment in agriculture, encouraging the pace of capital-intensive technological change, and aggravating farm expansion and land intensification (removal of hedgerows, enlargement of fields, development of monocultures).

Farm policy creates vested interests (including bureaucrats) with clear advantage in continuation of the system. Costs (both to taxpayer and consumer) are more widely distributed and cause less individual pain, so weakening political opposition. There is an inbuilt tendency towards the *status quo*.¹⁴ Thus, in terms of the evolutionary perspective developed in Chapter 2, once a particular policy trajectory has been established (as under the original development of the Common Agricultural Policy), an interaction/feedback system is established which heavily conditions the future development of the policy, potentially transforming 'market-improving' policies into those which frustrate and subvert the more socially desirable aspects of the market mechanism leading to policy failure¹⁵.

5. Conclusions and Implications: Reconciliation of Market and State

The future represents a genuine watershed for many rural areas - how to protect the good and encourage development without destroying the very attributes which make these regions attractive for development in the first place. The only sustainable resolution to the battle between those seeking to live *off* and those seeking to live *in* the countryside is one which enables us all to live *with* the countryside.

The central message of this chapter is that markets are *not* independent of Government - markets assume government is there, market theory has to take account of the fact that

¹³ Harvey (1990) estimates that the agricultural value of land in England and Wales has been inflated by about 40% as a consequence of the European Union farm support system. This increase in land values, in turn, accounts for some 55% of the total support, implying that the remaining 45% of support is dissipated in increased returns to other owners of fixed factors (labour and capital) associated with farming, including the suppliers of farm inputs and capital equipment.

¹⁴ MacLaren discusses this tendency, referring to the concept of a "conservative social welfare function" under which the political process tends to do as little as possible as late as possible.

¹⁵ See, for example, Allanson *et al.*. Rausser also explores (from a more conventionally economic base) the notion that socially desirable policies can 'deteriorate' into socially unjustified policies. For an evolutionary perspective on the future development of the CAP, see Harvey, 1995.

governments (at least in democracies) are made of the same people who operate the market place - it would be both naive and inconsistent to assume otherwise. In addition, if it is assumed that markets operate to take advantage of profitable opportunities, it should also be assumed that the same people will act in similar ways when arguing for (or against) government policies. Hence political failure comes from market failure and *vice versa*.

The artificial distinction between the State and the (private) Market is no longer useful or productive. Civil institutions and procedures including a wide variety of quasi-state and quasi-market systems are already evolving to deal with conflicts and competition for limited resources. From this perspective, politics is the system used to moderate and regulate individualistic behaviour to minimise social ill-fare and maximise social welfare, and can be viewed as a “market place” within which social opinions are discussed, collected and balanced to produce a consensus, coalition or compromise in support of social or public decisions and choices. To divorce this “market” from the commercial or private market can only be an analytical fiction, whose convenience is now fundamentally obsolete.

The conclusion is that both “smart markets” (individual action with appropriate recognition and integration of both the limits and effects of individual actions) and “sympathetic states” (collective action which recognises and incorporates the value and power of individual actions) are required for a genuinely sustainable future. The combination might be termed “*smarsets*”¹⁶. The opposite might well be “*mastate*”: more market mistakes, more political failures, more unbridled selfishness or more mis-guided patrony.

¹⁶ The author hereby claims intellectual property rights over this term!

References:

- Allanson, P., Murdoch, J., Lowe, P and Garrod, G. (1994): *The Rural Economy: an Evolutionary Perspective*, CRE Working Paper 1, Centre for Rural Economy, Department of Agricultural Economics and Food Marketing, The University of Newcastle upon Tyne.
- Court, W.H.B. (1967) *A Concise Economic History of Britain*, Cambridge University Press.
- Dahlman, C. (1980) *The Open Fields and Beyond*, Cambridge University Press
- Grant, R.M. (1975) "Economic Problems, economic theory and the role of Government", Ch 1 in *Current Issues in Economic Policy*, ed. Grant, R.M. and Shaw, G.K., Philip Allan, Deddington.
- Harvey, D.R. (1990) "The Economics of the Farmland Market", *Proceedings of AES One Day Conference: The Agricultural Land Market*, ed. P.J. Dawson, Department of Agricultural Economics and Food Marketing, The University, Newcastle upon Tyne.
- Harvey, D.R., (1991) "Agriculture and the Environment: The Way Ahead?", Chapter 15, *Farming and the Countryside: An Economic Analysis of External Costs and Benefits*, ed. N. Hanley, C.A.B. International, p275 - 321.
- Harvey, D.R., (1995) "European Union Cereals Policy: an Evolutionary Interpretation", *Australian Journal of Agricultural Economics*, **35** (3), December, 193 - 217
- Hodge, I.D., (1988) "Property Institutions and Environmental Improvement", *Journal of Agricultural Economics*, **39** (3), 369 - 375.
- Hill, B. and Young, N. (1989) "Evaluating support to rural areas", Whitby, M.C. and Dawson, P.J. (eds): *Land Use for Agriculture, Forstry and Rural Development*, 20th Symposium of the EAAE, Dept. Agric. Econ. & Food Marketing, Newcastle upon Tyne.
- Hirsch, F. (1977) *Social Limits to Growth*, Routledge & Kegan Paul.
- Josling, T.E. (1974); "Agricultural Policies in Developed Countries: A Review", *J. Agric. Econ.*, **25** (3), 229 - 264
- McInerney, J.P., 1986, Agricultural Policy at the Crossroads, Gilg, A.W. (ed.), *Countryside Planning Yearbook, Volume 7*, 44 - 75, Geo Books, London.
- MacLaren, D. (1992) "The Political economy of agricultural policy reform in the EU and Australia", *JAE*, **43** (3), September, pp 424 - 439
- Mingay, G.E. (1987) *The Transformation of Britain, 1830 - 1939*, Paladin, Grafton Books, London
- Parris, K., 1994, Environmental Indicators for Agricultural Policy Analysis, *Paper to AES Conference, Exeter*.
- Pearce, D.W. and Turner, R.K. (1990) *Economics of Natural Resources and the Environment*, Harvester Wheatsheaf, London
- Rausser, G., "Political Economic Markets: PERTS and PESTS in food and agriculture", *Am.J.Ag.Econ.* , **64** (5), Dec. 1982 pp 821 - 833.
- Rawls, J. (1971): *A Theory of Social Justice*, Harvard University Press, Cambridge, Mass.

- Traill, B., 1988, The Rural Environment: What Role for Europe?, Chapter 6, *Land Use and the European Environment*, ed. Whitby, M.C. and Ollerenshaw, J., Bellhaven, London.
- van den Doel, H. (1979); *Democracy and Welfare Economics*, Cambridge University Press.
- Wilson, G.K., 1977, *Special Interests and Policy Making*, Wiley.