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THE ECONOMIC AND SOCIAL JUSTIFICATIONS FOR PUBLIC SPENDING TO AGRICULTURE: THEORETICAL INSIGHTS AND EMPIRICAL OBSERVATIONS

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Abstract. This paper explores the theoretical justifications for public expenditures to support the agriculture sector and farming population. The market failure and welfare rationale for government intervention is contrasted with government failures. In addition to the normative analysis, the paper presents empirical evidence on the level of public agricultural expenditure based on cross-country data with main focus on the European Union countries. The results of own cross-country statistical analysis suggest that per capita costs of EU support to agriculture are only weakly related to the general economic development of the individual countries but this support is relatively more important for the economies of less developed EU members. A look at the findings of the reviewed country studies exploring the link between public expenditure allocated to agriculture and the sector performance reveals that this way to support farming and rural economy may be effective, exerting a positive effect on growth in crop and livestock production, private-sector investments in agriculture and rural and general poverty reduction, but its impact depends on the type of expenditure.

Key words: public expenditure, agriculture, theories, market and government failures

INTRODUCTION

Agriculture has always been an exceptional case for government intervention. In poorer countries it is often taxed, among others because large agricultural sectors provide extensive and available tax bases. Additionally, larger groups face higher costs of collective action in their efforts to minimize their tax base. Given that many of these countries

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are dictatorships, the taxes also reflect the exploitation of the powerless by the powerful. On the contrary, in the richer countries, most of which are democracies, agriculture has been extensively protected or subsidized by the governments.

The purpose of this study is to present theoretical and empirical perspectives on public funding to support agricultural sector. The paper attempts to focus greater attention to this, always important issue, that seems to be even more urgent today, given that the recent crisis has put pressure on public finance in many countries and there is a risk that the governments might be induced to cut down support to agricultural sector and farm population, besides the fact that agricultural spending is one of the most important tools in promoting agricultural development and enhancing rural viability.

MATERIAL AND METHODS

The main method applied in this study is theoretical analysis and discussion drawing on the findings of empirical investigations. The paper analyzes various pros and cons of public spending on agriculture and its impact on agriculture performance and rural welfare.

The data on public agricultural spending used in this paper are taken from the EU Budget Office, Ministry of Finance of Poland and from the literature on the subject. Additionally, data on per capita GDP (in current euro) obtained from the Eurostat were utilized to identify the relationship between the EU spending on agriculture and the levels of economic development across the EU countries. Pearson's linear correlation coefficients were used to describe the degree of this association in the EU and in the two subsamples of the countries: UE-15 ("old" members) and EU-12 ("new" members).

RESULTS AND DISCUSSION

Factors influencing public spending to the agricultural sector

Representatives of different schools of economic thought have advanced several explanations of the reasons for public resources allocation to the agricultural sector. The basic rationale for it derives directly from the fundamental reasoning underlying government intervention in the economy. The most well-established justifications, based on the neoclassical economic theory, refer to the two phenomena: economic inefficiencies created by market failures, which can be corrected through public-sector involvement (via subsidization, provision of public goods and regulation); undesirably low material welfare among the poorest parts of the population, which can be also rectified through public policy (Table 1).

Economic theorists (new welfare economists) see State involvement in the economy through budgetary expenditure as an issue relating to the theory of perfect competition from which the term market failure is defined. Market failure is explained by Bator [1958, p. 351] as "the failure of a more or less idealized system of price-market institutions to sustain 'desirable' activities or to estop 'undesirable' activities. The desirability of an

Table 1. The rationale behind and related examples of agricultural public spending

Rationale	Examples of public spending
Correction of market failures	Financing the provision of goods that are not efficiently and sufficiently produced by the market, e.g. public investment in infrastructure, agricultural R&D and irrigation
Control of externalities	Public funding of environmental projects, afforestation/ /reforestation projects and agroecological research
Addressing information asymmetries, eliminating information gap	Subsidizing agricultural insurance and agricultural credit; investing in public agricultural information system and in data (e.g. weather data collected by meteorological sites); financing agricultural extension
Reducing imperfect competition	Financing the activities that regulate against monopolistic behaviour; public investments in price and other market information systems, as well as in rural transport infrastructure
Provision of public and merit goods	Spending on protection of water quality and availability, indigenous species, habitats and ecosystems whose survival would have been threatened (e.g. on the EU Natura 2000), investment in animal health and welfare
Influencing resource allocation and efficiency	Expenditure on geodetic control and mapping, farm direct payments (e.g. CAP Single Payment Scheme), farm product subsidies, farm labour subsidies
The social, redistributive function of governments	Provision of direct transfers to lowest-income households (e.g. food stamps, aid for elderly); subsidization of agricultural producers' costs (inputs subsidies), provision of credit schemes, CAP support to semi-subsistence farmers

Source: own compilation based on the literature survey [Helming et al. 2010, Mogues et al. 2012].

activity, in turn, is evaluated relative to the solution values of some explicit or implied maximum-welfare problem". Activities under consideration refer to both consumption and production.

According to Krueger [1990, p. 11] "market failure has always been defined as being present when conditions for Pareto-optimality are not satisfied in ways in which an omniscient, selfless, social guardian government could costlessly correct". What is quite clear from experience in many countries is that governments are not selfless, omniscient, social guardians and their corrections of market failures are costly.

So, though market failures approach to public spending has become quite popular in theoretical and political discussions, disillusionment with governments caused that this approach has been confronted by the problem of the limitations of government or government failures pointed out, among others, by the public choice theory economists.

Using the definition parallel with that for market failures, the government failures are the sum of government actions and failures to act which result in a less-than-optimal situation. However, as underlines Krueger, this definition suggests that all uncorrected market failures as well as government interventions leading to greater deviations from efficient use of resources than a market outcome would be regarded as government failures. Using the narrower definition of the government failures, they occur when

the government intervention to improve the market failures actually makes the situation worse than what would have occurred under laissez-faire, or when the costs of the government intervention exceed the benefits [Krueger 1990]. The weakness of this definition is lack of distinction between government failures to provide essential public goods and government actions leading to greater private departures from the first-best situation than would otherwise occur.

There are various reasons for occurring government failures. Firstly, many public policies affect the creation and allocation of rents. Their existence generates the problem of rent seeking [Krueger 1974] by potential recipients of public funding. Apart from the fact that rent seeking activities (either legal or illegal) can cause distortions of the political process, they are usually competitive and resources are devoted to competing for rents. Competition in rent seeking may result in either partial or complete rent dissipation into rent-seekers' costs [Posner 1975]. The devotion of resources for capturing rents does not generate new wealth merely causing income redistribution, so from the society's perspective those resources are wasteful. The second reason of government failure is rational ignorance [Becker 1983, Tullock 1988] about policy issues among the voting public (when per person effects are small) which would result in possible control of political outcomes by special-interest groups (the farming lobby for example). The next reason is the free-ridership on public expenditures when an individual may be able to obtain the benefits without contributing to the costs incurred for the group of beneficiaries [Buchanan 1968, Zawojska 2011].

Even in the absence of market failures, government spending in the economy may be considered to be necessary in order to achieve a fair distribution of real income. Redistribution of income or wealth by government may be differently explained. Power resources theory [Korpi 1983, Esping-Andersen 1990, Hicks 1999] links income distribution with class-based political power. It recognizes income redistribution and origin of welfare states as the results of conflicts between class-related interest groups (e.g. employees versus employers; working and middle classes versus owners of capital) and collective actions. The general empirical observation is that welfare states are more egalitarian and advanced in countries with stronger left parties and labour unions.

From the structuralist economics perspective [Prebisch 1950, Furtado 1964, Taylor 1991] income redistribution is influenced by structural features of the economy (i.e. broad demographic and economic variables).

Income redistribution or poverty relief is also recognized to be a public good because it benefits large number of people including those who may not have contributed to the support of the poor. In consequence, poverty relief through redistribution programs is viewed by many economists [Friedman 1962, p. 28] as a legitimate government activity.

However, political economy models (e.g. median voter models) suggest patterns of public spending that are likely to favour the preferences of households in the middle of the income distribution. In other words, the redistribution goes in line with Aaron Director's law which states that "Public expenditures are made for the primary benefit of the middle classes, and financed with taxes which are borne in considerable part by the poor and the rich" [Stigler 1970, p. 1].

From the point of view of economic theory of democracy, government distributive benefits can increase voter turnout among their beneficiaries. Empirical evidence from

the United States, for example, shows that recipients of agricultural subsidies exhibited higher voting rates than non-recipients [Wolfinger and Rosenstone 1980]. In line with the economic theory of the rational voter, the decision to vote is basically determined by expected net benefit, i.e. voting behaviour is influenced by economic calculation [Downs 1957]. It suggests that politicians, through offering benefits in exchange for voter choice ("vote buying" or "turnout buying"), can influence the actions of the electorate and shape the electorate's composition.

Agriculture-specific government programs are often justified on the ground of the concept of the traditional, family-based farming being a part of a viable rural way of life, culture and heritage that should be preserved by government because almost everyone benefits from the survival of the culture [McKenzie 1981, p. 369]. Family farms have also a longstanding history and tradition of providing youth with valuable work experience [Preserving… 2012].

Additionally, public policy makers argue that financial support to family farms with relatively weak bargaining positions is necessary to protect them from more economically powerful agriculture companies and foreign competitors.

Public spending related to agriculture could be determined by the roles the sector plays at different stages of economic development (Fig. 1).

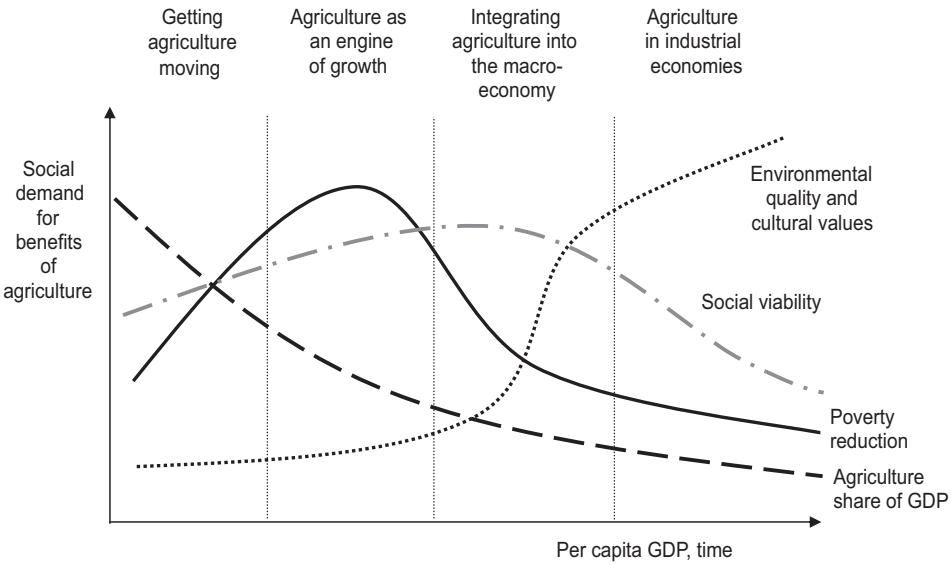

Fig. 1. Major roles of agriculture at different levels of economic development

Source: own compilation based on Dévé [2004].

The society's willingness to pay for non-market benefits generated by agriculture rises with economic development; it is the highest in rich urbanized countries with small proportions of the population engaged in agriculture, and is the lowest in the largely rural, poorest countries.

Empirical evidence on public agricultural expenditures

Budget allocations and expenditures on agriculture have received little attention in the literature on the political economy of public expenditures. One of such studies, for instance, is the research by Mogues et al. [2012] who investigate the trends in volume and intensity of total and agricultural government spending for a global sample of 70 developing and transition countries (including 14 from Eastern Europe and Central Asia – EECA[1]) over the period from 1980 to 2007. Since the composition of government expenditure has reflected government spending priorities, considerably different patterns among regions were existed. On average, the level of per capita agricultural expenditure increased from 20 USD in 1980 to 29 USD in 2000 to 44 USD in 2007. EECA topped the levels of public investment in agriculture, infrastructure and social protection. In those countries per capita agricultural spending doubled between 2000 and 2007 and was almost 100 USD in 2007, which was more than two times the sample average. Agriculture spending intensity (percentage of agricultural expenditure in agricultural GDP) also doubled the sample average, at 15 per cent, however developed countries usually have an intensity of over 20 per cent.

In Poland, current (2012, 2013) national public support to agriculture (excluding social security for farmers) accounts for almost 2 per cent of the state budget expenditure or 50–56 USD per capita. In 2012, agriculture spending intensity (percentage of national public expenditure on agriculture in Gross Value Added in agriculture) was at 11 per cent[2].

In the EU member states, including Poland, agriculture is the only sector almost entirely financed from the common budget, meaning that EU spending generally substitutes national expenditure. The EU spends about 30 per cent of its budget on agriculture (market related expenditure and direct aids). In 2011, the highest per capita outlays on agriculture from the EU budget occurred in Greece (212 EUR), Ireland and Spain, while the lowest ones were in Malta (11 EUR), Romania and Bulgaria. As a fraction of GDP, they were the largest in Greece (1.16%), Hungary and Lithuania, and the smallest in Malta (0.08%), Luxembourg and the Netherlands (Table 2).

Cross-country correlation between per capita agricultural spending and its intensity (measured by the spending share of the total GDP) in the EU-27 was moderate and positive (with Pearson correlation coefficient value of 0.48). When looking separately at the two subsamples of countries: UE-15 ("old" members) and EU-12 ("new" members excluding Croatia), the correlation coefficients across both subsamples ($r_{UE\text{-}15} = 0.86$; $r_{UE\text{-}12} = 0.77$) were higher than across the full sample of countries.

There was no observable correlation across the whole EU-27 between the level of economic development and the total EU spending on agriculture in the individual countries ($r_{UE\text{-}27} = 0.07$), probably since they are dissimilar in physical and population size.

[1] Azerbaijan, Belarus, Czech Republic, Estonia, Hungary, Israel, Kazakhstan, Kyrgyzstan, Latvia, Lithuania, Moldova, Poland, Romania, Russian Federation.

[2] The data on agriculture expenditures was derived from 2012 and 2013 Budget Acts (the Ministry of Finance website); the data on GVA in agriculture was obtained from the National Accounts Statistics database provided by the Central Statistical Office of Poland.

Table 2. EU agriculture spending by country in 2011

Country	Total (€m)	Per person	% of GDP	Country	Total (€m)	Per person	% of GDP
Austria	739.9	88.0	0.25	Italy	4 649.3	76.5	0.3
Belgium	556.9	50.6	0.15	Latvia	109.2	52.6	0.54
Bulgaria	315.1	42.8	0.84	Lithuania	279.9	91.7	0.95
Croatia	0.0	0.0	0.0	Luxembourg	36.9	72.0	0.12
Cyprus	42.0	50.0	0.24	Malta	4.4	10.6	0.08
Czech Republic	667.9	63.7	0.46	Netherlands	860.2	51.6	0.14
Denmark	964.2	173.4	0.39	Poland	2 398.3	62.2	0.68
Estonia	74.8	55.8	0.49	Portugal	760.9	72.0	0.46
Finland	496.4	92.4	0.26	Romania	795.7	37.2	0.59
France	8 679.9	133.4	0.43	Slovakia	296.9	55.1	0.44
Germany	5 498.1	67.3	0.21	Slovenia	108.7	53.0	0.31
Greece	2 406.9	212.8	1.16	Spain	5 819.5	126.1	0.56
Hungary	1 049.8	105.1	1.11	Sweden	697.8	74.1	0.18
Ireland	873.1	191.1	0.7	United Kingdom	3 315.5	53.1	0.19

Source: European Commission, Directorate General for Budget.

The results for the whole UE show weak positive correlation of per capita GDP with agricultural spending per capita ($r_{UE-27} = 0.21$). In the two sub-samples, however, GDP and agricultural spending, both on per capita basis, were inversely interrelated ($r_{UE-15} = –0.19$; $r_{UE-12} = –0.17$).

A moderate negative correlation was found between per capita GDP and agricultural spending relative to GDP ($r_{UE-27} = –0.55$). The relationship between the economic development level and EU agricultural spending share of GDP was more linear among the sample of new member states ($r_{UE-12} = –0.72$) than among the sample of old member states ($r_{UE-15} = –0.49$).

The mentioned above results suggest that per capita costs of EU support to agriculture are only weakly related to the general economic development of the respected countries but this support is relatively more important for the economies of less developed EU members.

A literature review of the effects of agricultural public spending

An in-depth review of the empirical literature on the subject is beyond the scope of this paper, so only some selected research findings for individual countries are presented in Table 3.

They show that there is empirical association between public spending on agriculture and: agricultural outcomes, private investment in the agricultural sector, farm prices, general agricultural development and rural welfare. The results however suggest that this impact differs depending on the type of expenditure (agricultural research and extension,

Table 3. The impacts of public spending on agriculture – review of empirical research

Authors	Region/study years	Type of public spending	Findings
Rosegrant et al. [1998]	Indonesia (1969–1990)	Agricultural irrigation, research and extension	Significant effect on crop growth: 85% of the growth for rice and maize, 93% for cassava, 71% for soybean
Esposti [2000]	Italy (1956–1995)	Agricultural R&D and extension investment	The main impact of public R&D and extension investment is on capital use and animal products
Siudek [2008]	Poland (1997–2006)	Agricultural loans (incl. preferential ones) given by the cooperative banks	Significant positive Pearson's correlation (r = 0.29) between ratio of farm loans to the cooperative banks' assets and the level of Polish agriculture development (as measured by the synthetic indicator)
Xu et al. [2009]	China (2007–2020)	Spending on agricultural R&D, subsidies and irrigation	Increased spending on irrigation and R&D contributes to the lower prices of rice, wheat and maize; on subsidies and R&D leads to higher income of farmers; on R&D, irrigation and subsidies has modest impacts on GDP growth, industry and service
Dastagiri [2010]	India (1970–2004)	Livestock-specific expenditures and public gross capital formation (GCF) in agriculture	Significant positive expenditures' effect on the livestock sector, and rural/general poverty reduction. GCF is effective in improving output only in some livestock commodities and has much weaker than spending positive impact on poverty reduction
Baba et al. [2010]	Himachal Pradesh, India (1969–2002)	Investment in agriculture	A positive highly significant effect of public-sector investment in agriculture on private-sector investments in agriculture
Kilian et al. [2012]	Germany, Bavaria (2005)	Single Farm Payments (SFP)	Decoupled SFP are capitalized into land rental prices, and to a larger degree than the coupled direct payments of the time prior to the Fischler reform of the CAP
Karlsson and Nilsson [2013]	Sweden (2007–2008)	Income support – Single Farm Payments (SFP)	The decoupled SFP has no influence on prices of small- and medium-sized farms (both built and non-built land) at local and regional levels
Daniłowska [2013]	Poland (2000–2011)	Agricultural investment loans on preferential terms	Great importance of the preferential loans in farm investment financing (excl. farmland buying). The period mean ratio of investment credit value to investment outlays at 60% with its drop since 2007 (from 73 to 42% in 2011)
Easterly and Rebelo [1993]	About 100 countries (1970–1988)	Agriculture investment	A statistically insignificant effect on economic growth and statistically significant negative impact on private investment
Mosley et al. [2004]	34 transition & developing countries (1980–2000)	Spending to whole agricultural sector	Agricultural expenditure as a share of GDP has a statistically significant positive impact on poverty reduction but lower than spending on education, housing and social services

Source: own compilation based on the literature survey.

rural infrastructure, subsidies, irrigation etc.). Additionally, in some cases public agriculture expenditures exercise negative effects, for example "crowding out" effect on private investments.

CONCLUSIONS

Although agricultural public spending has attracted quite considerable attention in economic research, it seems that recently it has been investigated less frequently than other types of public expenditures, especially when it comes to the developed economies, where agricultural sector accounts for a small fraction of the economy.

In the case of the developed countries, the conventional wisdom that public expenditure should be addressed to agriculture, since it positively affects the sector development and overall economic growth as well as poverty reduction, has been largely replaced by the belief that agriculture should be supported because it offers a range of positive externalities and public goods.

Consequently, the questions which need to be addressed in the future research on agricultural public expenditure include: (1) How much of this spending is for pure public goods or for goods with large positive externalities and how much for private goods?; (2) How much of public spending is for activities that are most likely to benefit the rural poor?; (3) How much of this spending goes to those intended to receive it?; (4) What part of this spending is for current consumption and what part is for on-farm capital investment?

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EKONOMICZNE I SPOŁECZNE UZASADNIENIE WYDATKÓW PUBLICZNYCH NA ROLNICTWO: SPOSTRZEŻENIA TEORETYCZNE I OBSERWACJE EMPIRYCZNE

Streszczenie. W pracy zilustrowano teoretyczne uzasadnienie wydatków publicznych na wsparcie sektora rolnego i ludności rolniczej. Korygowanie nieprawidłowości w funkcjonowaniu rynku oraz konieczność sprawowania przez państwo funkcji opiekuńczych, przytaczane jako argumenty za jego interwencją, skontrastowano, przez analogię do zawodności rynku, z niesprawnością państwa. Oprócz analizy normatywnej przedstawiono fakty empiryczne dotyczące wydatków publicznych na rolnictwo w różnych krajach, ze szczególnym naciskiem na państwa UE. Wyniki przeprowadzonej analizy statystycznej sugerują, że koszty wspierania rolnictwa przez UE w przeliczeniu na mieszkańca są słabo powiązane z ogólnym rozwojem gospodarczym poszczególnych krajów, ale pomoc ta ma stosunkowo większe znaczenie dla mniej rozwiniętych gospodarek UE. Z przeglądu obcych badań empirycznych dotyczących związku wydatków publicznych na rolnictwo z sytuacją ekonomiczno-finansową gospodarstw rolnych oraz ogólnym rozwojem sektora i obszarów wiejskich wynika, że ten sposób interwencji może być skuteczny, wywierając pozytywny wpływ m.in. na wzrost produkcji roślinnej i zwierzęcej, prywatne inwestycje oraz łagodzenie ubóstwa na terenach wiejskich, ale jego efekty są uzależnione od rodzaju wydatków.

Słowa kluczowe: wydatki publiczne, rolnictwo, teorie, zawodności rynku i państwa

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