

Regulation vs. market-based environmental solutions

In the previous column, as a part of our broader analysis of farm program considerations, we identified four ways to deal with negative farm externalities related to the environment and discussed the first two: voluntary activities by farmers and government programs that provide financial assistance to farmers for implementing practices that reduce or eliminate negative externalities. We left the last two: government regulations and market-based programs to achieve environmental goals for this week's discussion.

When we talk to farmers about government regulations without identifying any particular issue, they are generally against them and see regulations as a hindrance to their activities and a burden. In that way they reflect a wider societal trend that sees government as the problem.

But, when the discussion gets down to specific problems these producers are facing, they often say, "The government should do something about that!" We remember when corn farmers went to their state legislatures in the corn belt to ask them to require the use of ethanol as a fuel oxygenate. Even today, politicians and researchers can get a lot of grain farmers mad at them if they talk about dialing back or phasing out the Renewable Fuel Standard which sets the amount of biofuels that must be used in the nation's motor fuel supply.

Like the rest of us, our view of regulations depends on which side of the fence we stand. We are thankful when the government issues a recall notice on an airbag that might cause our death if it were to suddenly inflate, and frustrated when a regulation takes a product we like off the market or makes us jump through extra hoops to get a prescription for certain medications.

Talk to those who earn their livelihood by fishing in the Gulf of Mexico and you will get a different perspective about the Environmental Protection Agency's proposed Waters of the US rule than you will if you talk to a farmer in the Mississippi River Basin. Almost everyone agrees that we need to reduce the chemical load that makes its way to the Gulf of Mexico, the question is how to achieve the goal.

The advantage of regulations is that they are the same for all producers in the marketplace, though farmers with various soil types and land formations will be impacted differently. In addition, regulations also have a basin-wide impact, so that problems of pollution are cleaned up more quickly and more certainly than they would with a voluntary program. One only has to look at the rapid improvement of the waters around Cleveland, Ohio after regulations were put into place following a fire on the Cuyahoga River in 1969.

When regulations are proposed, the industries impacted by them use cost studies to argue against easing or eliminating the regulation. The supporters of the regulation also have their cost estimates. If the regulation is implemented, the costs are usually only a fraction of industry estimates. In some cases, they find that the strategies they use to implement the rules end up making them money. Surprisingly, the costs are often even lower than the proponents projected.

But we live in an era where regulations are coming under greater scrutiny and sustained opposition. As a result, we have seen more change coming from the marketplace. We see companies implementing policies that were unachievable by the regulatory route. A case in point is the decision by a number of companies to label their products for GMO ingredients when Congress was unwilling to enact such a requirement.

This happened because consumers spoke with their dollars. They used their monetary might by switching to organic and "natural" products—there is no agreed upon definition of

what “natural” on a food label means, but it sells. Consumers also shifted a portion of their purchases to food retailers that set standards for the products they sell.

The result was a loss of market share by the mainline companies and when you are a major brand, the loss of market share has a significant impact on profits and stock price. Consumers had spoken and the mainline companies decided that they did not want to see further erosion of their customer base. Today we see market-based solutions to issues that previously would have been settled by government regulations.

To date, we have not seen significant movement in the area of environmental issues. But, it could happen. Strategies for reducing agricultural-based, non-point-source water pollution could shift over the next decade from relying on government regulations to market-based solutions. Where today the market provides eggs from chickens that were fed organic or all vegetable feeds, labels in the future may indicate that the grain was grown by farmers who met certain standards for reducing the leaching of farm chemicals into the waters of the US.

The strategy for accomplishing a goal like that will probably involve a carrot and a stick. The carrot comes from customers who shift their purchase patterns to achieve a desired goal. With differential pricing, there will be farmers who will be quick to provide the products consumers want. The stick is the threat of impending regulation and the loss of market share.

While market-based solutions do not have the force of regulations and cannot make shifts as quickly, they do provide an irresistible force because major companies cannot afford to lose even a small slice of consumers. Once enough companies make the change, the resistance to writing regulations to bring along the rest will become minimal.

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Dr. Harwood D. Schaffer: Adjunct Research Assistant Professor, Sociology Department, University of Tennessee and Director, Agricultural Policy Analysis Center. Dr. Daryll E. Ray: Emeritus Professor, Institute of Agriculture, University of Tennessee and Retired Director, Agricultural Policy Analysis Center.

Email: hdschaffer@utk.edu and dray@utk.edu; <http://www.agpolicy.org>.

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