

Providing an enabling environment

The basic role for agricultural policies consists of providing the core investments and services that farmers need to develop their operations into viable farm businesses. Focusing on the sector's enabling environment benefits both agriculture and the wider rural economy, facilitating the construction of diversified rural economies. Such policies are likely to be more effective in the long term than subsidies or market interventions, which have the opposite tendency.

The agricultural sector has a central role to play in generating the income growth poor countries need to banish poverty and ensure food security. Yet for the best part of 30 years, agriculture was effectively discriminated against by developing country policy-makers and neglected by donors. One reason was low rates of perceived success, compared with investments in areas such as health and education. Another was the combination of falling real agricultural prices and, in successfully developing economies, a declining share of agriculture in GDP and employment. These changes were often misinterpreted as "declines", when in fact they were signs of development success, with productivity growth bringing prices down and permitting labour and other resources to be allocated to other sectors. In recent years, thinking has come full circle, and the importance of investing in agriculture is now widely recognised. But, in re-emphasising the importance of agriculture, it is essential that policy-makers and donors do not go to the

other extreme of prioritising agriculture exclusively, at the expense of balanced rural and economy-wide development.

Approximately two-thirds of the world's poor live in rural areas, where agriculture is the dominant sector. Most of the farming is done by smallholders, so raising their incomes is clearly a priority. Moreover, in the current context of higher agricultural prices, there are better opportunities for those smallholders to develop commercially viable operations than there have been for many years. Yet realisation of those opportunities by some will result in others moving out of agriculture into new, ultimately more remunerative, activities. Indeed, it is important to recognise that – as all

OECD countries have experienced – the majority of future generations will have better opportunities outside agriculture than within it. As agriculture transforms, it is also important to acknowledge that there is no single efficient farm structure. Smallholders are the current reality, but thriving rural economies will be underpinned by a mix of small, medium and large farms.

■ Broad-based investment in rural areas is essential

The lion's share of investment in agriculture comes from farmers themselves. There is a strong case for increasing the share of public spending in support of the sector, and redressing urban bias in the allocation of resources. There are high returns to investments in agricultural research, technology transfer, and farm extension and advisory services. These investments help farmers directly; indirectly, they benefit consumers by increasing overall food supply, thereby containing upward pressure on food prices and dampening the price volatility associated with tight markets.

Rising levels of foreign investment, prompted by higher food prices, can help offset a dearth of domestic resources. However, there are legitimate

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Photo: J. Boethling

concerns about the nature of some of these investments and who will benefit. Hence, it is important that governments provide appropriate framework conditions for investment in agriculture, and that there are commitments to responsible business conduct on the part of both investors and recipients. Similarly, development aid can be a catalyst, with investments in infrastructure and core public services “crowding in” private investment.

In the case of low-income countries, it has been suggested that because of weak institutions and market failures, some market interventions may be warranted. For example, price stabilisation has been proposed as a way of providing a more predictable investment climate and containing the impact of large international price swings. Similarly, input subsidies for seed and fertiliser have been suggested as a way of redressing failings such as the under-development of infrastructure, missing markets for credit and inputs, and a lack of knowledge of the benefits of improved technologies. These arguments need to be balanced against multiple drawbacks. For example, price stabilisation thwarts the development of private risk management and can export instability onto world markets. Similarly, the provision of input subsidies can impede the development of functioning private markets. Moreover, such measures often become a target for special interests, imposing a severe drain on national budgets at the expense of essential public investments. If they are to be used, they should be time-bound with a clear exit strategy, and they should not crowd out essential investments which tackle the market and institutional failures they are designed to offset.

■ Innovation and effective pricing of natural resources needed

There is more scope for raising agricultural productivity than there is

for mobilising more land and water resources. While it is likely to become increasingly difficult to push yield frontiers at a constant percentage rate of growth (i.e. exponentially), there is great scope for developing countries to close the gap between actual and potential yields. The key to realising these gains is innovation in the wider sense, combining adapted technologies with improved farm management practices. There is evidence of high rates of return to research and development accompanied with extension, albeit with long time lags. Investments in infrastructure can help limit producer losses, which account for around one-third of all production in low income countries.

There is much less scope for increasing cultivated land area than there is for improving yields. Moreover, a large share of the world’s agricultural production is based on the unsustainable exploitation of water resources. There is a need for policies to manage both land and water resources sustainably, for example by strengthening land tenure systems and introducing water charges or tradable water rights.

Climate change is expected to have a range of (mostly negative) effects on agricultural production. A range of investments – for example in research, irrigation and rural roads – can help improve resilience, but production will ultimately need to be located in areas where it is inherently sustainable. In many countries and regions, current production patterns may not be compatible with sustainable resource use, implying trade-offs between sustainability and immediate food security outcomes. Often, there is no effective pricing of natural resources, with the result that production is too intensive or occurs in areas where ultimately it should not. Pricing of resources could improve the sustainability of production but raise farmers’ costs and, in some circumstances, put upward pressure on food prices. Likewise, agriculture is

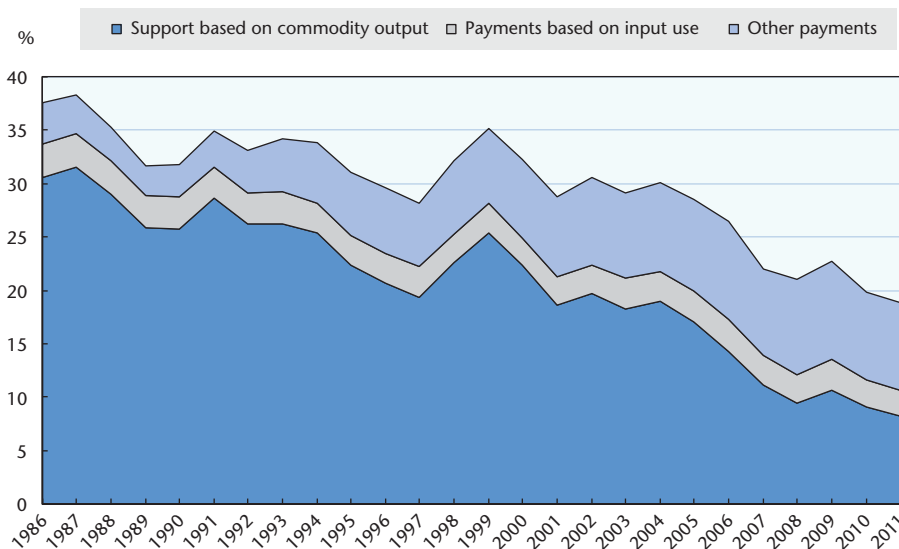
a major contributor to anthropogenic climate change, but taxing farmers’ greenhouse gas emissions could lower their incomes and raise food prices. These trade-offs underscore the primary importance of income growth: only if incomes grow sufficiently can food security and sustainable resources be fully compatible. On the positive side, pricing of environmental services could raise some farmers’ incomes.

■ Trade is pivotal, but complementary policies are necessary

Open markets have a wider role to play in raising production and incomes. Trade enables production to be located in areas where resources are used most efficiently and has an essential role in getting product from surplus to deficit areas. Trade also raises overall incomes through the benefits to exporters (in the form of higher prices than would be received in the absence of trade) and importers (through lower prices than would otherwise be paid), while contributing to faster economic growth and rising per capita incomes. Trade will also be essential in order for supply increases to be achieved sustainably. It enables production to locate in areas where natural resources, notably land and water, are relatively abundant, and where systems are more resilient to the effects of climate change. Looking ahead, the areas of the world with sustainable productive potential are not the ones experiencing rapid population growth.

However, reforming countries may need to put in place parallel measures to maximise the benefits and mitigate the costs. In order for existing and potential exporters to reap the full benefits from reform, there may be a need for complementary supply-side investments. Conversely, the needs of those who stand to lose from the removal of trade protection may require a combination of adjustment assistance and social

OECD composition of Producer Support Estimate, 1986–2012 Percentage share of gross farm receipts



The Producer Support Estimate (PSE) captures transfers to farmers from consumers (in the form of higher prices) and taxpayers (in the form of budgetary payments).

Source: OECD, PSE/CSE database, 2012.

safety nets. For mitigating the adverse impacts of international price volatility, targeted social programmes (including cash transfers) are a preferable option, while agricultural investments and the development of risk management tools can improve farmers' resilience to risk.

■ The right moment for fundamental reforms in OECD countries

The traditional charge against many OECD countries is that high levels of agricultural support and protection have undercut farmers' livelihoods in developing countries. Tariffs on agricultural products remain several times higher than those levied on industrial goods, which restricts market access for developing country farmers with export potential. Higher prices have historically led to the accumulation of surpluses, which have been disposed of with the use of export subsidies. These depress international prices, making conditions more difficult for competitors on international markets and for import-competing producers on domestic markets. Often, policies to support farmers have

also been counter-cyclical, which stabilises domestic markets but exports instability onto world markets.

There have been important reforms over the past 25 years. As a result, annual support to farmers across the OECD areas, in the form of higher prices than those prevailing on world markets or direct payments financed by taxpayers, increased from USD 240 billion in 1986–88 to USD 253 billion in 2010–12. This represents a decline in real terms and as a proportion of farmers' incomes, with the share of farmers' gross receipts coming from consumer and taxpayer support falling from 37 per cent to 19 per cent (see Figure). On average, support is also less production and trade-distorting, with less than 60 per cent of support now linked to output or input use. In recent years, there has been little use of export subsidies.

Reforms in recent years have been facilitated by strong market conditions, which have reduced the gaps between domestic prices and world market prices. Moreover, as price gaps have narrowed, so the counter-cyclical element of domestic support programmes

has declined. At the same time, some OECD countries have instituted supports for biofuel production, which have the reverse tendency of making international food prices higher than they would otherwise be, while (in the case of mandates) adding to price volatility by creating a demand that is less responsive to prices. In addition, a number of tariff peaks and cases of tariff escalation remain. Given structurally higher food prices, now should be a good time to remove all trade-distorting instruments and put in their place more efficient alternatives, including social safety nets and tools to help farmers manage risk, as well as measures to improve long-term productivity. However, recent changes in European and US farm policies suggest that this opportunity is unlikely to be seized.

In the context of high food prices, a range of new concerns has emerged. They include export restrictions, the use of biofuel mandates, and the opportunities and threats presented by increased foreign investment in agriculture. On these issues, as well as in terms of conventional support mechanisms, policies in emerging economies (in particular the BRICS – Brazil, Russia, India, Indonesia, China and South Africa) are increasingly important. Multilateral action is needed to ensure that national policies in OECD and emerging economies do not generate a new range of spill-overs that compromise development opportunities in poor countries.

Further reading

OECD (2012), *Agricultural Policies for Poverty Reduction*

OECD (2013), *Global Food Security: Challenges for the Food and Agriculture System*

→ see also www.oecd.org/agriculture

For a detailed review of the recent OECD publication *Better Policies for Development*, which focuses on policy coherence, see www.rural21.com → Publications