

Next Generation of Agriculture and Agri-Food Policy

Economic Backgrounder: OECD findings on policy performance and design



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The Next Generation of Agriculture and Agri-Food Policy – A Federal, Provincial, and Territorial Initiative

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Publications Section
Agriculture and Agri-Food Canada
Sir John Carling Building
930 Carling Avenue
Ottawa, Ontario K1A 0C5

Telephone: (613) 759-6610 or (toll-free) 1-800-635-7943 (Canada and U.S.)
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OECD findings on policy performance and design

A careful mix of programs and policies can support a vibrant agriculture and agri-food sector and its contribution to economic growth, a healthy environment and a safe food supply. Understanding objectives and how programs and policies influence the marketplace are key to determining the right combination. Those are some of the lessons learned from several years of research at the Organisation for Economic Co-operation and Development (OECD). The research supports the principles for effective policy and program design adopted by OECD Ministers of Agriculture in 1998.

Table 1: OECD Principles for Effective Policy and Program Design

Transparent	Clear objectives, costs, benefits, beneficiaries
Targeted	To specific outcomes, and decoupled as far as possible
Tailored	To provide transfers just sufficient to achieve identifiable outcomes
Flexible	To reflect diverse situations, responsive to changing priorities and applicable when needed
Equitable	Taking into account support between sectors, farmers and regions

Source: OECD

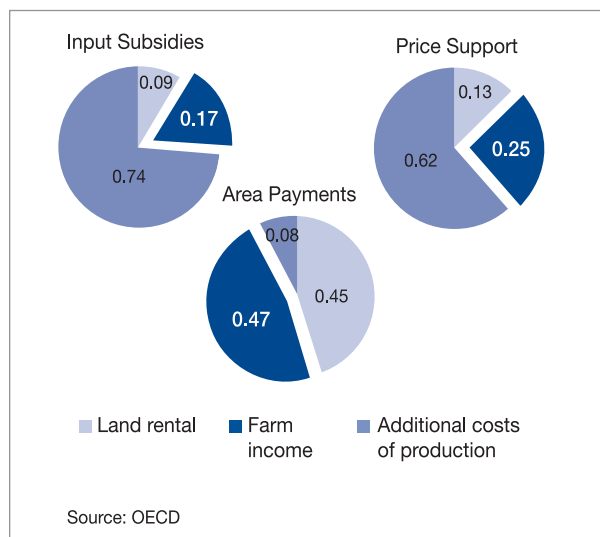
Improving policy performance by making better choices

To improve policy performance, OECD members are seeking ways to reduce policy interference with farm production decisions to let the market play a greater role. A viable agricultural sector relies on markets that respond to changes in supply and demand. Open markets send price signals to producers and consumers which they use to make decisions about what and how much to produce or consume. Markets create economic opportunities and choices that contribute to well-being.

OECD findings show that, over the last two decades, the majority of government agricultural policies and programs in OECD countries have been highly ineffective in translating support into additional income for farm households.

Payments which are less linked to production or “decoupled” have a less distorting effect on markets and are more effective at transferring income to producers. All programs are coupled to some degree, but there is a great variation across program types. Programs which are decoupled are the most effective at increasing farm income.

As examples, OECD studies show that farmers receive \$0.47 for every \$1.00 of program support delivered as area payments (decoupled) but only \$0.17 if delivered as input subsidies. Price support nets only \$0.25 for every dollar.

Figure 1: Flow of each \$1 of support by policy type

The reasons for the variation are that program payments tied to production (e.g. input subsidies) and those that provide price support (e.g. administered prices, tariffs and export subsidies) provide an incentive to producers to increase production in order to benefit. When farmers increase production their costs go up. Increased costs stem from two main sources:

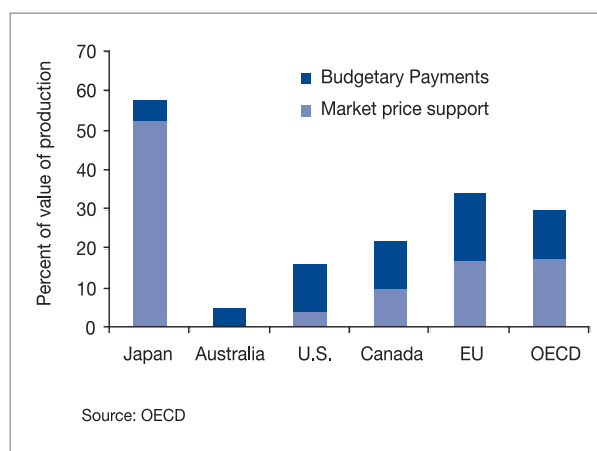
- 1) to produce more, farmers purchase more inputs – fertilizers, feed, seed – which increases their costs, and
- 2) the increase in the demand for inputs puts pressure on supplies available which, in turn, causes prices to rise.

Together, the increases in inputs used and the prices paid transfers the benefit of government support out of farmers' hands, passing it onto suppliers.

Finally, program payments push up farmland values making it expensive to expand in size and for new farmers to enter. Further, since rented land in Canada is somewhere around 50% of all crop land, much of the benefit flows to non-farming landowners.

Canadian policy and program design

In recent years, almost 50% of the support to producers¹ in Canada is through highly coupled market price support. This is slightly more than in the U.S. (35%) and less than the EU (55%), that have both begun to shift more of their support to forms of direct payments. Australia has almost no market price support, relying almost entirely on budgetary payments and other less distorting forms of assistance.

Figure 2: Support to producers 2003-05

Moving to more decoupled programs, setting clear objectives, targeting specific outcomes and tailoring policies and programs to needs can improve policy and program effectiveness, contributing to economic growth by balancing support to the sector.

¹ As a share of the total value of production – a measure known as the producer support estimate (PSE).

Transfer efficiency

Broadly speaking, a key consideration for policy makers is ensuring that policy benefits reach the intended recipients. In this background, *transfer efficiency* is a measure of how effective an agricultural policy is in raising the income of farm households.

In general, additional economic costs are associated with all forms of government intervention in commodity markets. Over a decade of work at the OECD has established that targeted decoupled income payments are a more efficient choice of policy instrument than input subsidies or market price support schemes, or any other form of support tied to inputs or outputs.

Who benefits and who loses from agricultural policy intervention is not always easy to determine. The extent to which agricultural policies have an impact on the value chain depends on the nature of price interactions at each level (i.e. how much more buyers are prepared to pay if the price goes up and how readily they can substitute products) and the degree of market competition.

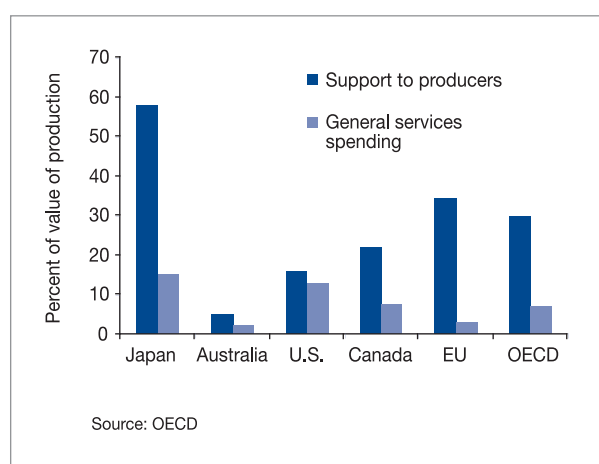
Although “leakage” of benefits to unintended recipients might be viewed as beneficial to the sector, in fact, any value-added activities generated from increased production are likely unsustainable in the absence of ongoing government support. Moreover, leakage creates additional economic losses to the taxpayer. These unintended losses relate not only to the cost of raising additional tax revenues, but also to the cost of disbursing additional funds. The extent of these losses depends on both the choice of policy instrument and the level of market intervention.

Decoupled targeted policies can improve transfer efficiency. For these policies to be truly effective, the beneficiaries of support need to be explicitly defined.

Contributing to economic growth by balancing support to the agriculture sector

As globalization creates new opportunities and challenges for agriculture and agri-food around the world, governments are taking a second look at policies and programs that can foster an efficient, sustainable and innovative sector.

Figure 3: Support to producers compared to spending on general services, 2003-05



Support through general services, such as research, training and market development, enhance productivity and competitiveness of the sector in less production-distorting ways. This kind of support may be more effective than other forms of support.

A recent study² shows that public agricultural research in Canada:

- has provided very high returns on investment with benefit-cost ratios typically 20:1 or more for individual commodities,
- represents one of the highest payback for the Canadian public sector, and
- mainly benefits Canadian agricultural producers who typically have received from 85 to 96% of the gains.

OECD framework to respond when markets don't

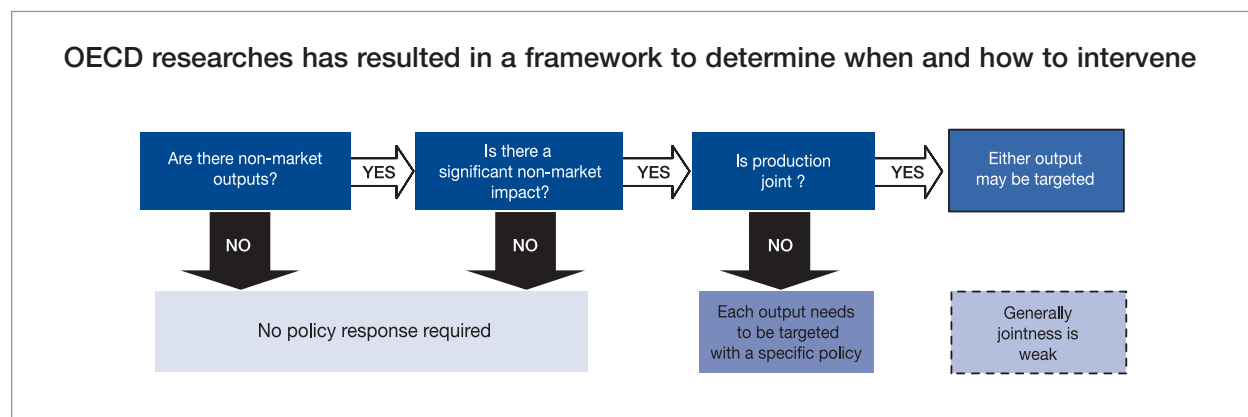
OECD research has also considered what policy choices are possible when no markets exist to give appropriate signals. This can occur when an economic activity such as agricultural production (a market output) creates other “non-market” outputs or side-effects. Governments may decide to intervene with regulations, taxes or other measures to meet specific objectives in

the public interest, such as reducing the risk of water contamination or ensuring that food is safe to eat.

In some cases, policies can work at cross-purposes. For example, policies that increase production can exacerbate environmental risks and work against efforts to achieve long term sustainability.

The OECD's work in this area has resulted in a decision-tree for policy makers that can help when and how to intervene. Targeting specific objectives and beneficiaries can enhance policy performance, while minimizing unintended transfers and negative spill-over effects.

Seldom can one measure effectively target multiple objectives. Effective policy design translates each general objective into practical, well-defined objectives that identify targets explicitly in terms that allow progress towards outcomes to be monitored and evaluated.



² Brinkman, George L. 2004. Strategic Policy Issues for Agricultural Research in Canada. Current Agriculture, Food and Resource Issues 5(1) http://cafri.usask.ca/j_pdfs/brinkman5-1.pdf

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