Module 1.
Strategic Considerations and the Nature of Policy and Policy Instruments
Questions in module 1

- What is development?
- How does agriculture contribute to development?
- What is policy? Kinds of policy issues?
- Why an agricultural policy?
- What are agricultural policy instruments?
- What does sustainability mean for agricultural policy?
What Does Development Mean?
Development can mean many things but economic growth is always important because it means more employment and higher incomes. But it is equally important to ensure growth is as widely shared as possible, reducing poverty and regional inequalities. Sometimes “development” is confined to enclaves in a country or to a small group of beneficiaries. Case of Angola with its oil?
Development is not only about higher incomes

- Development is *people gaining more control over their own lives.*
- Development centers on the human being and the family.
- Development creates civic values and livable communities.
- Countries and cities increasing compete worldwide in terms of quality of life.
Roads to better citizens’ control over their lives

- *Income* helps people gain more control over their lives, *education* helps a lot, and so does better *health care*.

- But wise *policies* also are important for opening up more *opportunities* for people and for facilitating their *choices*. 
QUALITY IS A KEY TO THE FUTURE

- Quality of products
- Quality of services
- Quality of environment
- Quality of life
- Costa Rica and Bangalore, India, attract high tech industry and tourism because of their score on quality measures
Today, a road to advancement of poor countries is through emphasis on acquiring knowledge and quality.

A key to quality is learning to obtain and manage information.

India is putting internet sites in villages whose only power source is solar cells.
Agriculture’s Contributions to Economic Development
Agriculture has been the most fundamental economic activity for millennia. It has permitted the flowering of human civilizations. Nevertheless, in the era of economic development thinking (the last 50 years), economic theorists have not always been clear on agriculture’s role.
Early thinking on the role of agriculture in development (1950s - 1970s)

- Industrialization was seen as the key.
- Industry was subsidized but not agriculture.
- Agriculture’s role: provide resources for industrialization.
- This meant releasing labor force to move to cities, providing savings to be channeled to urban areas, and earning foreign exchange.
A corollary to this thinking was that agriculture should be taxed to extract its savings. The taxation could be *direct*, to increase fiscal savings for investment in industry or, more often, *indirect* via influencing relative prices between sectors.
Reducing agricultural prices relative to other prices in the economy made food relatively cheaper, thereby permitting lower wages for industry.

It was thought agricultural supply was inelastic, i.e., that it would not be affected by real (relative) price declines. But today we know the contrary. Many econometric studies have calculated a significant price elasticity of agricultural supply.
Reducing real agricultural prices:

- Reduces incentives for production and thus reduces the sector’s capacity to earn foreign exchange as well as produce food.
- Reduces rural incomes relative to urban incomes in terms of purchasing power.
- Reduces rural savings.
- Most of all, it increases rural poverty. Alleviating rural poverty is now seen as one of the highest priorities for economic development.
For these reasons it is now recognized that often real agricultural prices should be raised or at least sustained, and not reduced.

The consequences of higher food prices for low-income urban consumers can be offset through targeted food subsidies.
Food subsidies for the poor can be self-targeting

Examples of milk in the Dominican Republic, rice in South Korea, tortillas in Mexico – where lower visual quality meant only low-income families would purchase the products, and hence they could be priced lower.
Agriculture and Economic Growth: Modern Thinking
Agriculture does not have to be the lagging, backward sector of an economy.
In addition, allowing agriculture to lag:

Creates essentially irreversible flows of labor from countryside to city, causing social problems and incurring high costs for additional infrastructure to support the new urban population.
It also is recognized that economic development depends on agricultural growth. In many cases of economic adjustment, agriculture has led the rest of the economy toward recovery, with the highest sectoral growth rate for several years. In Brazil and Chile it was the fastest-growing sector for about ten years from the late 1980s onward.
In fact, “The growth of total factor productivity in the OECD countries in agriculture has been greater than in manufacturing during the past quarter century or more. The difference has not been small” (D. G. Johnson 1997).
“Typically high growth rates are achieved when agriculture grows rapidly” (J. Mellor, Harvard, 2000).

Agriculture lifts the rest of the economy through high multiplier effects of agricultural incomes on incomes in the rest of the economy. Block and Timmer found in Kenya that agricultural multipliers are 3 times higher than for other sectors.
Agricultural multipliers are high because:

- Rural households tend to spend a higher proportion of additional income than urban households (who save more because their incomes are higher on average).

- Of consumption expenditures, in rural areas a higher proportion goes to domestic goods instead of imports, thus giving stimulus to domestic production.
In Chile in most of the late 1980s and 1990s agriculture was the leading sector in creating skilled employment: scientific, technical, professional, and administrative jobs.
Modern agriculture requires many skills, in engineering, research, marketing, administration and other fields.

Agriculture does not have to be a backward sector. It can be a leading sector and galvanize growth in other sectors including agro-industry, transport, international marketing, and agricultural input sectors.
A major challenge for small farmers in developing countries is how to increase productivity (hence income) per acre, because they have so little land: intensification of production is needed.
Productivity increases have two components: Increasing physical yields and changing product composition toward higher value outputs.

Change is a constant part of modern agriculture, adapting to new market requirements, learning new technologies of production and post-harvest management.

Producers must learn how to learn.
Agriculture and Poverty Reduction
Research shows agricultural growth is the most effective way to:

• Reduce rural poverty
  and
• Reduce urban poverty
Agriculture contributes more than industry to reducing both rural and urban poverty.

For India: “Both the urban and rural poor gained from rural sector growth. By contrast, urban growth had adverse distributional effects within urban areas, which militated against the gains to the urban poor. And urban growth had no discernible effect on rural poverty” (Ravallion and Datt, 1996).
Analyzing 35 countries, Timmer (1997) found “A 1 percent growth in agricultural GDP leads to a 1.61 percent increase in per capita incomes of the bottom quintile of the population…. A similar 1 percent increase in industrial GDP increases the incomes of the poor by 1.16 percent.”
Mellor (2000) concluded “There has been a tendency to conclude that economic growth reduces poverty, when in fact it is the direct and indirect effects of agricultural growth that account for virtually all of the poverty decline.”
Why an Agricultural Policy?
What makes agriculture different from other sectors of the economy?

Why does it need a policy and strategy framework more than, say, textiles, pharmaceuticals, the service sector, etc.?
Some reasons for an agricultural strategy and policy

- Agricultural growth catalyzes overall growth through its multiplier effects.
- Agricultural growth is the best way to reduce rural and urban poverty.
- Rural areas contain most of the labor force. Millions of small farmers are not well linked to input and output markets.
- Agriculture uses vital natural resources (land, water, forests, fisheries) for which markets alone do not work well.
Additional reasons for treating agriculture differently

- Issues about the societal role and legal status of land are linked to agriculture.
- Environmental degradation and pollution from agriculture requires special policies.
- Rural-urban labor migration is practically an irreversible flow of resources and so lack of proper attention to agricultural development can close off later options.
- Economic institutions and rules of the game are less developed in rural areas.
In Rwanda, fertilizer use has been minimal so the government tried delivering it physically to coops. Then it tried giving subsidized loans to networks of agro dealers, but loan repayment was very weak and many dealers went bust. Finally it moved to providing poor farmers with coupons to be used for buying fertilizer, administering the program through producer coops. Not easy, but feasible.
In Estonia, with the collapse of the Soviet Union the collective farms were disbanded. But who should get the land of those farms? In the 1990s the government tried finding the pre-Soviet landowners (from the 1930s and 1940s) or their heirs, but it most cases that proved impossible. So the lands were divided into smaller plots and auctions were set up. If no buyers were found (poor farmers) new auctions for land leases were held.
Also in Estonia, with the collapse of the Soviet Union the many services of collective farms were lost (although those farms were inefficient in production). In an economy coming out of central planning, how to generate businesses for input sales, crop storage, farm advice, output sales, machinery repair, child care, veterinary services, post-harvest handling, and the many other things done by collective farms?
In Eritrea, as in many African countries, traditional land tenure systems prevailed. They focused on equitable treatment of all. So a newly married young couple was guaranteed access to land in the village, and people’s plot boundaries were redrawn and moved to free up land for the young couple. As this happened frequently, farmers had no incentive to invest in improving their land even though they had rights to use it.
In Colombia and Panama, literally scores of small irrigation systems have stopped operating because of lack of system maintenance. In Kazakhstan and Uzbekistan in the post-Soviet era, large irrigation systems stopped working because the drains clogged up, resulting in salinization of the land, which went out of production.

Who should pay for system maintenance? Who should be responsible for ensuring that it is carried out?
Agricultural Policy Objectives and Instruments
Broad Categories of Agricultural Policy

- Pricing or incentives policies, mostly macroeconomic.
- Natural resource management policies, including land tenure and water use rights.
- Access policies, including access to inputs, finance, markets and technology.
- Policies to facilitate private sector development.
Structure of agricultural objectives and policy areas

Rural well being

- Subsidies for poorest families
- Rural purchasing power
  - Ag. income, employment
  - Real farm prices
    - Production, investment, value added products
      - Human, social capital
    - Macro, sectoral policy for incentives
  - Access to markets, inputs
  - Natural resource management

- Infrastructure
Strategy and Policies and Their Means of Implementation

Strategy

Policy for a given area

- Investment projects
- Programs (current account)
- Legislation
- Executive decrees
Kinds of agriculture policy that are declining in use

- Production and marketing by the State.
- Interventions in grain markets.
- Direct delivery of inputs.
- Delivery of credit by non-financial institutions.
- Price and trade controls, including government monopolies on specified kinds of trade.
Types of policies that are increasingly useful

- Institutional development, in both public and private sectors.
- Providing well-defined and secure use rights to land, water and forests.
- Farmer training and organization.
- Improving the functioning of factor markets in rural areas.
- Support for marketing: certifications of food safety and phytosanitary quality, certificates of origin, etc.
Types of fiscal policies that are productive

- Subsidies well targeted on lower-income farmers, such as assistance in purchasing or renting land, subsidies for purchasing extension services and inputs, etc.
- Transitional subsidies, such as support for trial shipments of exports, to new markets or for new products (underwriting risks).
- Greater fiscal support for agricultural research, especially in coordination with farmers.
- Veterinary services for livestock: externalities.
- Infrastructure investments including water and soil management.
Caution is recommended in making the transition from old policies to new

- The private sector often is not prepared to take over government roles in all areas immediately.
- Creation of private monopolies should be avoided.
- Elimination of input subsidies should not occur until output prices are favorable.
- The process of developing viable private credit institutions is slow.
- Private credit institutions typically do not finance medium- and long-term projects.
- Government policies may need adjustment to favor entry of private sector (e.g., interest rates).
Economic sustainability: deliver real economic benefits, promoting productivity change.

Social sustainability: Improve the well-being of lower income and disadvantaged groups, including rural women.

Fiscal sustainability: Identify sources of financing for all programs, institute cost recovery where possible.

Institutional sustainability: Create institutions that are solid and viable in the long run.

Environmental sustainability: reduce depletion and degradation of the natural resource base.