

The OECD and agricultural policy: a critical analysis

The present crisis calls for a reconsideration of a number of precepts underlying economic policy. The aim of this analysis is to discuss the recommendations made by the OECD with regard to farm policy. Targeting and decoupling appear to be concepts that stem from a will to make public intervention more effective and more legitimate. But direct payments should nevertheless not be reduced to a merely temporary measure aimed at accompanying uncompetitive producers towards the exit, especially in a context where the hypothesis that all markets function optimally is being abandoned. Despite the fact that the correction of market failures is put forward as the main justification for public intervention, one can regret that market power (i.e. the existence of dominant positions) and market incompleteness (non-insurability of systemic risks) are largely absent from the OECD's description of the issues facing agricultural policy. The World Bank is currently reviewing the fundamental role of agriculture in development strategies but the renewal of OECD precepts in the developed world is yet to come.

The Organisation for Economic Cooperation and Development (OECD) was set up in 1960, springing from the Organisation for European Economic Co-operation created for the implementation of the Marshall Plan in 1948. Together the 30 member countries of the OECD¹ represent 76% of world GDP. The OECD is a forum, a locus for the exchange of views and cooperation enabling governments to benefit from the experience of other members. The secretariat of the OECD acts as an interface with the academic world and works to build a common body of expertise on shared economic issues.

This normative function works by constructing representations and language on subjects judged to be of interest. In doing so, it calls upon the academic world, which is praiseworthy as it enables the norms elaborated to be based on solid foundations. However, it is not a complete safeguard against cer-

tain aberrations because self-referencing effects can generally be observed in such processes.

For the last two years the globalised world economy has been going through a major crisis that is simultaneously financial, economic, food-related, environmental and social, as well as being ideological and cultural. For some, Alan Greenspan's testimony before the US Congress in October 2008 admitting his incorrect assessment of the supposed self-regulatory virtues of markets mark a sea change in the history of economic thought. A thorough-going review of the dominant precepts of economic policy seems to be under way at the present time.

What we propose here is a critical reading of the OECD farm policy recommendations that applied prior to their current questioning. To do this, we base our analysis on a short booklet² that until very

recently was distributed by the OECD to new representatives of Member States. We begin by describing and discussing the concepts of targeting and decoupling (1). We then broaden the focus to look at market failures over and above externalities alone (2), before going on to consider the food security issues, which the booklet deals with only very succinctly (3). And lastly, we discuss the recommendations made by the OECD on land policy, which lead it to express debatable assessments of the effectiveness of direct support measures (4).

1. The current OECD membership: Germany, Australia, Austria, Belgium, Canada, Korea, Denmark, Spain, United States, Finland, France, Greece, Hungary, Iceland, Ireland, Italy, Japan, Luxembourg, Mexico, Norway, New Zealand, Netherlands, Poland, Portugal, Slovakia, Czech Republic, United Kingdom, Sweden, Switzerland and Turkey.

2. OECD, 2008, *Agricultural Policy Design and Implementation. A Synthesis*, 46 p.

1 - Decoupling and targeting: agricultural policy's twin mainsprings

The analytical system put forward by the OECD for the design and implementation of agricultural policies calls upon a classic three-pronged evaluation of public policy: clarification of initial goals, mobilisation of the right economic instruments and definition of indicators to monitor outcomes. As a supplement to this normative approach, a major role is assigned to a political economy dimension in which policy reform is considered to be the result of a compromise between actors with differing interests. Hence the use of financial compensation mechanisms to offset the cost of reform for certain social groups is put forward as a way of removing "obstacles to change".

The objectives of the agricultural policies described in the booklet fall into three categories: the level and variability of farmers' income; qualitative and quantitative food security at the best price for the consumer; protection of the environment and landscape and the viability of rural areas. The first of these goals – "farm income" – and the third – "environmental and regional externalities" – are, unlike the second, extensively developed and used as a basis for the two key concepts for which the OECD argues: decoupling and targeting.

The decoupling of support involves separating the act of production from the support provided to farmers. In order to grasp this idea correctly, it is necessary to look back over two decades of the European Common Agricultural Policy (CAP) reform. Prior to the 1992 reform, the main form of intervention was the provision of income support to farmers through action upon prices based on mechanisms involving storage, customs duties and export subsidies. This meant that EU prices were higher than those prevailing in international trade, but were more stable for consumers, who were ultimately funding the support provided to producers. However, in the absence of coordination of international trade between the major regional markets and given the desire of certain EU sectors to develop exports of products receiving support, protests were made against price support by the EU's trading partners, due to its depressing effect on

international markets. Moreover, due to a lack of sufficient supply control, the budgetary cost of this type of support ceased to be tenable once the EU became a net exporter for most temperate zone products.

With the reforms of 1992 and 2003, the CAP adopted direct support regimes increasingly decoupled from production. This meant that support payments were made directly to the farmer in amounts independent of product value or volume; support thus became more transparent and was now funded by the taxpayer rather than the consumer.

From the 1980s on, the increasing importance of environmental and regional considerations was reflected in a recognition of the functions fulfilled by agriculture in addition to the production of foodstuffs and fibres. The shaping of the landscape, contributions to regional activity and the upkeep of certain biotopes are all "positive externalities" or "joint-product" to certain types of agricultural production that are usually gathered together under the umbrella notion of agricultural "multifunctionality". Like other public goods such non-market services frequently lead to extra costs for farmers who are not paid to produce these. So there is a high risk of the provision of these public goods being below their expected social optimum in the absence of specific public intervention.

Nevertheless, not all the externalities of agricultural production are positive and it is also possible to observe negative externalities such as nonpoint source pollution. Externalities, whether positive or negative, are seen as market failures and their correction is one of the main justifications of public intervention. The idea of targeting is thus aimed at promoting the construction of programmes and instruments to correct clearly defined problems with a view to efficiency. However, as the OECD booklet indicates, it is sometimes impossible to implement effective policies targeted on the provision of a public good, especially in those cases where it is difficult (or indeed ineffective) to separate out the production of the market good from the public good. This is true when the administrative costs arising from a targeted measure become excessively high compared with the estimated value of the service provided.

With regard to the notions of decoupling and targeting, the OECD's normative approach as described in this booklet stems from a determination to make public intervention more rational and more effective, this being an imperative objective for any policy, whether it is in the agricultural sector or not. However, where the decoupling of support from income is concerned, the reasoning put forward suffers from a debatable initial premise: the assumption that agricultural markets function efficiently enough to ensure that the prices for products correspond to the long-run marginal production cost, that is to say the total cost of production incurred by the least competitive producer in order to meet actual demand. On this view, direct income support provides a means to assist the structural adjustment of a sector, giving breathing space for the withdrawal of the least competitive producers. But such support will need to be decoupled from production to ensure that it does not prevent the market from arriving at the right price level and to avoid rent-seeking behaviour by buyers of the products through a cut in prices caused by the stimulation of supply generated by coupled aid. This means that in light of this analysis, which calls on the general equilibrium assumptions in the absence of market failures, and notably those that result in the existence of market power, decoupled support can be no more than provisional, lasting just long enough to compensate superfluous producers and to allow prices to move back up to their level of equilibrium. This is in a nutshell the philosophy underlying the decoupling of support according to the OECD.

It is certainly true that the idea that support intended for farmers may be "captured" by other economic agents actually reflects an undeniable reality: payments made to a producer are frequently reflected in a lower selling price and in the end benefit not so much the farmer as the rest of the supply chain. On the other hand, if we admit that markets sometimes fail to generate efficient price signals, due to errors of anticipation, speculative episodes or simply the expression of bargaining power, the issue of the competitiveness and logic of decoupling changes completely. On this view, prices may remain below total costs for a large majority of producers whose production is nevertheless required to

meet global food demand that has been steadily rising for the last four decades. Given this, it is no longer possible to see direct support as a way of helping uncompetitive producers to leave the sector: it is a safety net to help retain producers who are useful to meet the demand but whose long-term survival cannot be assured due to the instability of markets left to their own devices. And it also guarantees international prices for agricultural commodities that are lower than the long-run marginal costs of production thanks to taxpayers in countries sufficiently rich to fund such support.

Therefore, one can only hope this reductionist view of direct support simply seen as a policy for assisting the restructuring of agricultural production will be reconsidered. On the contrary, consideration should be given to the reasons for the low relative remuneration of agricultural factors of production, foremost among which is the labour of the farmers themselves. Moreover, although the externalities of production and their internalisation are an important topic, it is nevertheless regrettable that the other market failures occurring in the farming and agrifood sectors do not receive more attention. Nothing is said about them in this booklet, despite the fact that they provide the grounds for public intervention in neoclassical theory.

2 - Market power and incomplete contingency markets are also market failures of huge importance to the agricultural sector

When they operate satisfactorily, markets provide a good mechanism for the coordination of economic activities. However, in reference to one of the criticisms of proponents of the “Washington Consensus” made by economists such as Dani Rodrik: markets that operate perfectly, without friction or distortion, are more an exception than the norm³. The reality tends in fact to be a «second-best» world in which it is illusory to adhere to what is a theoretical construct, seeking to ensure the emergence of pure, perfectly competitive markets which exist only in the abstract. While public intervention is justified in neoclassical theory in order to correct market failures, where such correction is not possible or too

costly, the “second-best” theory dictates that action be taken against their effects by limiting their expression or compensating for them with measures that may themselves be distortionary.

One of the attributes of a perfect competitive market is that buyers and sellers are sufficiently numerous and uncoordinated to ensure that they do not enjoy excessive bargaining power. Agrifood value chains are characterised by very high levels of concentration in the processing and distribution sectors. This means that those downstream in the chain have greater bargaining power than those upstream. In the case of certain types of production such as milk, for which the perishable nature of the product leads to a spatial dimension that limits competition, producers are even described as being economically dependent. Such failures lead to problems affecting price transmission along the supply chain or the creation of economic rents. To some degree, certain market support instruments such as milk quotas made it possible (before their gradual phasing out) to correct the consequences of such failure in a second best approach. Now that direct payments have replaced market price support the effects of this market failure are apparent to all, but the provisions needed to correct this structural problem have received little consideration⁴.

The absence of complete contingency markets constitutes a second failure that is all too often ignored. In theory, risk and insurance markets have the capacity to provide actors with solutions for cover against the whole range of hazards. In practice however, like price risk, not all such hazards are insurable due to their systemic nature in particular. It is certainly possible to use public intervention to support the insurance sector and enable it to offer policies against risks for which the possibilities of pooling are limited, but such solutions, especially for market risk, are usually not very efficient regarding their cost to public funds (subsidisation of insurance premiums and public reinsurance). Given the cost of agricultural price volatility, not only for farmers but also for the economy as a whole (inflation, rent seeking, food security), the issues surrounding the instability of agricultural markets cannot be seen solely in terms of the availability of risk management instruments.

Recognition of the systemic characteristics of price risk must allow the public authorities to take on their role as insurers of last resort in order to help instruments emerge that can limit the realisation of insurable hazards rather than simply endeavouring, usually in vain, to reduce exposure to the risk.

Unfortunately, one can regret the fact that the instability of agricultural markets is not an issue for the dominant paradigm which assumes, following general equilibrium theory, that stability is simply the corollary of a competitive market.

3 - Is it really possible to ignore the food-related aspect of farm policies?

The explosion in prices and the food crisis of 2007-08 have put the issue of food security back on the political agenda, after a period in which this aspect of farm policy tended to be relegated to the category of arguments considered groundless in economics and protectionist in intent. The OECD booklet testifies to this stance because although food security is effectively on the list of agricultural policy objectives, it is said that “*the objective of producing adequate amounts of food at reasonable prices to feed the growing urban population in the industrialising society is of less relevance now in OECD countries*” (p. 12). Moreover, no details are given in what follows of how this objective might translate into action.

While it is undeniable that food security means securing sources of supply more than it does autonomy of food supply, it is doubtful, to quote Louis Pascal Mahé, that “*the authorities in charge of the common destiny should pay no attention to the security of the community’s supply of fundamental commodities or the resilience of its food supply system in the*

3. Rodrik D, 2008, *Nations et mondialisation. Les stratégies nationales de développement dans un monde globalisé*, La Découverte, 188 p.

4. See most notably the Competition Authority opinion on the operation of the milk sector, referenced 09-A-48 dated 2 October 2009.

face of international, political and economic shocks”⁵. Given the structural instability of international agricultural commodity markets, which are controlled by a few dozen traders, free trade alone cannot constitute the definitive recommendation for global food security. The steps taken by various countries to stimulate production, and strategies for land allocation are indicative of a loss of confidence in the capacity of international markets to secure supply on the part of countries that traditionally import food. Furthermore, the damage that can be caused by an inflationary episode affecting food prices in economies in which food takes up a major part of household budgets means that developing countries have an imperative need for control over their food supplies and therefore robust food and farm policies.

4 - Capitalisation of support and land policies

A belief in the self-regulation of markets leads the OECD to argue for two controversial positions. In the booklet, policies governing access to land are considered simply as obstacles to the optimal allocation of resources (p. 11; p. 43), despite the fact that a majority of OECD members use this kind of regulation. Based on neoclassical economic theory, the Organisation pays only passing attention to a key topic in the history of economic thought : land rent and control over it, and applies to the land factor the usual precepts whereby competitive markets are obviously the optimal way to allocate resources.

Apart from prescriptions on the need to liberalise land markets, the consequences of which might be a growing source of concern (especially in the countries of Eastern Europe), this bias leads to a major misunderstanding of the evaluation of the effects of direct support

policies in Europe. This is so because leaving aside such policies, and on the basis essentially of theoretical studies, the analysis of the effect of a subsidy that is more or less decoupled from land area reaches the conclusion that it will have an inflationary impact on land prices, both for tenancy and sale, due to the low supply elasticity of this factor. As a consequence, it is generally thought that this type of support primarily benefits the landowner rather than the farmer⁶ (p. 14; p. 18). This assessment is open to challenge insofar as the analysis does not take into account the existence of a variety of land-related policies in most countries of Western Europe, policies the objective of which is precisely to control the capitalisation not only of support but also of a large part of future agricultural profits.

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To conclude, it is apparent that the analysis of agricultural policies proposed by the OECD can be reduced to just two sets of issues relating to social assistance for structural adjustment of the agricultural sector and to the positive and negative impacts of agricultural activities on the environment and the vitality of rural areas. Despite the fact that neoclassical theory and public economics, both part of the dominant paradigm for most international institutions, justify public intervention on grounds of correction of market failures, market power and the incompleteness of contingent markets (non-insurability of systemic risks) fail to come within the

5. L. P. Mahé, 2005, “La question de l'autosuffisance protéique est-elle définitivement obsolète pour l'Union européenne ?”, Revue OCL, vol. 12, n° 3, pp. 196-202.6. In France, 76% of agricultural land was occupied by tenant farmers in 2005. Source: *Enquête Structure 2005*.

purview of the OECD whereas these are in fact the causes of a large proportion of agricultural and food crises. This partial reading of economic theory is prejudicial insofar as it leads to the conclusion that the regulation of markets is counterproductive, or even negative, and should be gradually dismantled in the name of market self-regulation. Will the current crisis result in a questioning, or at the very least an adjustment of the paradigm for agricultural policies in the developed world as currently applied not only in the OECD, but in other forums? This would appear to be essential given the change in direction already undertaken by the World Bank in its *World Development Report* in 2008. It seems indeed that the post-Washington Consensus era has already begun for agricultural policies and development strategies in developing countries.

Frédéric Courleux
Economist
**Centre for Studies and
Strategic Foresight**

frederic.courleux@agriculture.gouv.fr

**Ministère de l'Alimentation, de l'Agriculture
et de la Pêche**

Secrétariat Général

Service de la statistique et de la prospective
Centre d'études et de prospective

12 rue Henri Rol-Tanguy - TSA 70007

93555 MONTREUIL SOUS BOIS Cedex

Tél. : 01 49 55 85 05

Sites Internet : www.agreste.agriculture.gouv.fr

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