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"SETTING THE AGRICULTURAL POLICY AGENDA"

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VII. SUMMARY OF DIAGNOSTIC PROCEDURES

It is useful to have a fairly simple procedure for diagnosing the performance of a country's agricultural sector and the role that various food and agricultural policies play in that performance. The diversity of situations among developing countries makes it difficult to have an automatic checklist of things to look at in order to be able to spot specific policy problems. Nonetheless, as we have shown in these guidelines, there is a certain logic or order as to how to go about a diagnosis.

Economic and Agricultural Growth

A good starting point is to examine historical rates of economic and agricultural growth, both in total and per capita terms. As part of this examination, it is usually helpful to distinguish between food and commercial crops, and in some countries between the livestock and crop sectors.

An examination of a country's agricultural performance should also include an inventory of the quantity and quality of physical and human resources and how they relate to agricultural production. Such an inventory can include:

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- . The amount of land available for production of different crops and livestock, and the productivity of that land base in terms of climate, soil type, etc.
- . Prospects for expanding cultivated area and increasing intensity of production through irrigation development, better land management, etc.
- . Education and skill levels of farmers and those who provide marketing, research, and extension services.
- . Adequacy of basic infrastructure serving agriculture, particularly transportation and power.
- . Availability of viable new technologies for increasing crop yields and livestock productivity.
- . Adequacy of institutions serving agriculture such as research, extension, and credit.

If both the total economy and the agricultural sector have been growing at satisfactory rates, there are unlikely to be major agricultural policy problems; although, there could still be some policy issues that if dealt with in a satisfactory way could result in even better performance. However, unsatisfactory economic performance is often a good clue that a country is facing some serious problems, and bad agricultural and food policies may be among them.

Macroeconomic Policies

Before turning to agriculture and food policies themselves, it is important to examine several macroeconomic issues. Trade and exchange rate policies are usually the ones that should be reviewed first. If a country's exchange rate is significantly overvalued, the agricultural sector is

being "taxed" heavily and exchange rate policies could be retarding agricultural performance. Trade policies are also important. If a country employs a variety of import constraints to protect domestic industries, these too can be adversely affecting agriculture. One negative effect of trade policies is to raise input prices for agriculture. Another is to slow down both the overall rate of economic growth and growth in domestic demand for food and fiber. An agricultural sector really gets boxed in if it faces slow growth in domestic demand, on one hand, and trade and exchange rate policies that prevent it from being competitive in export markets, on the other.

An additional aspect of macroeconomic policies that may be important is the extent to which the agriculture sector is being taxed as a source of government revenue. Direct taxation can take the form of export taxes for commodities or taxes on agricultural inputs whether imported or produced domestically. It is important to know how large these taxes are. As we saw earlier, heavy taxation does not inhibit agricultural growth if other public investments increase agricultural productivity fast enough to produce net gains in producer returns. However, where productivity growth is not very rapid, heavy taxation of the agriculture sector will have a negative effect on that sector's growth.

Having looked at economic and agricultural performance and a set of key macroeconomic policies, one has to decide whether these economic policies are of overriding importance. Agricultural officers will want to consult with those concerned with general economic policies at this point. In some countries, detailed economic studies may be available to indicate the extent to which the agriculture sector is

adversely affected by economic policies. In other cases, subjective judgments will have to be made based on fragmentary evidence. For example, if a country's currency appears to be overvalued by 10-20 percent, that may not be a serious impediment to agricultural development. But if it appears that the currency is overvalued by 50-100 percent or more, that typically is very bad news for agriculture.

In any event, a judgment must be reached as to whether economic policies are so onerous as to make changes in agricultural policies ineffective, or whether changes in agricultural policies can substantially overcome the bad effects of economic policies. If the situation appears to be of the latter type, then it is probably worth following through with an evaluation of food and agricultural policies.

Commodity-Input Price Relationships

One of the most important sets of agricultural policies to look at are those that directly affect commodity-input price relationships. At any point in time, these relationships determine profitability of agricultural production; i.e., the economic incentives for producers. A simple way to look at these incentives is to compare output-input price relationships (e.g., commodity-fertilizer price ratios) in terms of national currencies with international price ratios. This approach avoids exchange rate adjustments which can be complicated to derive. Of course, this approach works only for internationally traded commodities and inputs, but not for commodities that are not traded or inputs such as land, labor, and water.

If commodity-input price relationships are unfavorable relative to international prices, one has to search for the reasons why:

- . Trade exchange rate and tax policies may distort the price situation.
- . Food policies may work to severely depress prices received by farmers.
- . Inefficiencies in commodity and input marketing due to government interventions that inhibit competition may be major factors, particularly when these markets are dominated by inefficiently operating parastatals.
- . The lack of transportation and other marketing infrastructure may be an important cause of unfavorable commodity-input price ratios.

Improving producer incentives usually requires changes in several policy areas simultaneously. Commodity prices can be allowed to approach world market levels by removing a variety of government interventions and improving marketing efficiency. These adjustments may allow input prices to rise without diminishing production incentives, an important consequence in cases where inputs are heavily subsidized and represent a serious drain on government resources. However, achieving greater efficiency in input marketing will help hold down the increase in input prices as subsidies are removed.

Food Price Policies

Increasing commodity prices may conflict with food policy objectives. In many developing countries, food policies that artificially depress food prices significantly

affect producer incentives as well. Virtually every government in the world, whether in developed or developing countries, has policies to provide food assistance to the poorest segments of society. As discussed earlier, these are legitimate policy objectives. The real issue, however, is how to take care of the poor without adversely affecting producer incentives.

All too frequently, food prices are kept low for all consumers, including those who can afford to pay higher prices. In the process, producer prices are also depressed. A first step in any diagnosis is to determine the extent to which food prices are held down and to describe the mechanisms that are used maintain low prices. At a second stage, one can examine alternative approaches that target food assistance to those who really need it while allowing others to pay higher prices. In any event, changes in food policies will usually have to be considered along with changes in producer prices.

Agricultural Support Services

Finally, one should look at the status of a variety of support services for agriculture in trying to diagnose prospects for increasing agricultural output. These usually involve developmental efforts that work only over a fairly long period of time.

One category of support services includes increasing yields and productivity and involves a range of activities such as research, extension, irrigation development, and soil conservation. As we have seen in this report, countries that achieve rapid growth in productivity can also

realize rapid growth in agricultural output even if prices received by producers are depressed. The positive productivity effect on producer returns offsets the negative effect of low prices. Conversely, if there is little productivity growth, increasing producer prices may have only a modest effect on agricultural output.

The role of credit in financing agricultural production is also important, but is a complicated issue to analyze since it involves both production and income distribution questions.

The first question that needs to be answered is whether the amount of credit available is adequate to support growth in agricultural output. The process of agricultural modernization involves increased use of purchased inputs (fertilizers, chemicals, and machinery) and farm investments in land and water development. Not all of these expenditures can be financed from current savings and farmers, therefore, must borrow. It is important to know if the total amount of credit available is adequate and if it is being distributed appropriately among the crops and inputs that require financing.

Distributional issues take several forms. One arises from credit rationing that is forced by monetary and fiscal policies that have caused low or even negative real interest rates. In these situations, the demand for credit exceeds its supply because the cost of money (real interest rate) is so cheap. Government and financial authorities must decide who gets the available credit, and these decisions can be made on the basis of commodities, size of farm, region of the country, or just plain political favoritism. One should

try to find out what the actual credit situation is in terms of both cost of money and its distribution.

Another distributional issue centers on the cost of extending credit to various types of producers. Servicing small businesses is more expensive than lending money to large borrowers. This puts small farms at a disadvantage. One needs to assess the extent of that disadvantage, and if it is significant, to determine what institutional arrangements can be made to reduce the cost of credit to small producers.

Reducing Economic Distortions

There are both short- and long-term implications of reducing economic distortions facing the food and agriculture sectors. In the short-run, a more rational pricing structure in relation to world market prices for both commodities and inputs can lead to increased production, and to a reordering of consumption that might include less reliance on imported foods.

We have seen that the short-run (within a few years) response in production can be very sizeable in situations where productive capacity is in place -- good soils, adequate irrigation, and improved crop varieties -- and increasing output simply requires using these resources more intensively. There are other situations where correcting food, agricultural commodity, and input prices will not have much of an impact on production in the short-run because the response capability does not exist. However, eliminating or reducing these distortions will generally provide economic signals and stimulate political forces that lead to improved agricultural productivity longer-term.

If increases in producer prices flow from policy reforms, this increases profitability from farming and raises rates of return on investments in research, land and water development, education, extension, and a variety of other private and social investments. As returns to these investments improve, there will be more pressure to increase available funds. Over a period of years, the benefits from these investments will be reaped in terms of further increase in agricultural productivity and output.

A similar line of reasoning can be applied to reducing food subsidies. To the extent that reduced food subsidies increase producer prices, they generate incentives to increase output. Furthermore, reducing subsidies may shift consumption away from imported to domestically produced foods, providing a larger demand base for the agricultural sector.

Summary

We have presented one possible sequence of steps in diagnosing a country's agricultural policy problems. It should be viewed as an illustrative approach that needs to be tailored to fit each country situation. For some nations, little may be known and a policy diagnosis has to start at the beginning. However, in the more typical case a lot is already known about a country and the policy focus may start fairly far along in the sequence of diagnostic steps.