1. Introduction

This project is concerned with the role that agricultural policies can play in raising incomes in developing countries, recognising that higher incomes are a pre-requisite for sustained poverty reduction and improved food security. A subsidiary question is whether the pursuit of higher incomes implies a role for agricultural policy which differs systemically from that prescribed for high-income OECD countries, or varies according to a country's stage of economic development.

According to the World Bank, there are approximately 1.3 billion people living on less than USD 1.25 per day (Chen and Ravallion, 2008). At the same time, FAO estimates that nearly a billion people are undernourished, most of whom are chronically hungry because they are poor. Raising incomes is central to the near term target of the first Millennium Development Goal (MDG1), which calls for the eradication of extreme poverty and hunger, with specific targets which include halving between 1990 and 2015 the proportion of people living on less than a dollar a day. The world as a whole may achieve this target, thanks primarily to rapid income growth in East Asia (and China in particular). But in many parts of the world, notably in Africa and South Asia, progress on MDG1 has been weak or non-existent. Moreover, the FAO estimates that high food prices in 2007-08 plunged millions into hunger.[1]

The pursuit of higher incomes is one objective of government policy. There are other dimensions to poverty and food insecurity, and governments have related concerns such as raising farm productivity, ensuring sustainable resource use, improving health and education, and promoting gender equality. The nature of these objectives may differ fundamentally from those in OECD countries. Food security, poverty and hunger are often on a different scale compared with OECD countries, while environmental issues, such as climate change and desertification, may have enormous implications for rural livelihoods.

Developing countries also vary widely in terms of natural resource endowments, the types of agriculture systems that are in place, farm sizes and land tenure laws, basic levels of human development in areas such as health and education, and the development of government and administrative infrastructure. A specific concern is that markets are less developed than in higher-income countries. For example, transaction costs may be higher in output markets, meaning that farmers are less engaged with markets; some markets (e.g. for credit and insurance) may be missing altogether, and market failures (e.g. arising from insecure property rights, incomplete information, or market power) may be more endemic.

Faced with diverse objectives and constraints, governments seek to choose the most appropriate instruments. Within the realm of agricultural and rural policy, their options include:

- Interventions in markets for outputs and inputs: price and trade policies; marketing policies; input subsidies (e.g. for seeds, fertiliser and working capital credit).
- The provision of public goods, such as rural infrastructure.
- Income transfers.
- Changes to institutions (setting up or eliminating marketing boards, land reforms, financial sector reforms, property rights and legal framework).

In the case of developed countries, OECD has established a basic principle for choosing among these instruments, stemming from the notion that policy objectives can be divided into two categories: those concerned with correcting market failures (an efficiency issue) and those concerned with the distribution of income (an equity issue). The principle is that policy should first seek to address market failures, ideally by tackling them at source, and then address distributional concerns with targeted policies. This approach contrasts with one of using blunt market-distorting instruments, such as price supports and input subsidies, to address multiple objectives (OECD, 2002).

With respect to the income objective, this policy recommendation implies safeguarding incomes in the short term via targeted social policies, and strengthening them in the long term by addressing market failures and weaknesses in the "enabling environment". In poorer countries, however, it has been argued that market failures are more widespread and it is often difficult to tackle them directly. For example, farmers may have low incomes partly because they have no access to credit. Input subsidies have been suggested as a practical solution to the otherwise difficult problem of developing input markets and providing financial services to small farmers. Similarly, price stabilisation has been proposed as a relatively simple way of

mitigating the impacts of price shocks on poor households, as opposed to market-based forms of risk management or the provision of income safety nets.

In considering the role for agricultural policies in strengthening incomes, it is helpful to make a distinction between policies that are effective in the short to medium term, a period which encompasses the timeframe of MDG1, and those that are likely to produce fundamentally stronger incomes in the long term. In the short to medium term, economic structures are fixed, while in the long term they can evolve. Three quarters of the world's dollar a day poor live in rural areas (corresponding to 880 million people), and most depend on agriculture for their livelihoods (World Bank, 2007), so there is an immediate need to strengthen agricultural and rural incomes. In the longer term, it is important to consider the evolution of the agricultural sector and the rural economy, and in particular the prospects for smallholders, who form the backbone of developing country agriculture.

Section 2 examines the short- to medium-term impacts of alternative agricultural policies in developing countries using a new model, the Development Policy Evaluation Model (DEVPEM). The aim of the model is to provide illustrative results that show how structural diversity among developing countries, and systemic differences between developed and developing countries, can affect the welfare and distributional outcomes of alternative agricultural policy interventions.

When markets function smoothly, the OECD's Policy Evaluation Model (PEM) has shown that policies which interfere with the functioning of those markets, such as price supports and input subsidies, perform poorly in terms of raising the incomes of farm households (OECD, 2001; OECD, 2003). By contrast, targeted income payments are shown to be both more efficient and more equitable. The question is whether these conclusions hold when markets do not work smoothly. DEVPEM incorporates several specificities of developing countries that may affect the welfare impacts of agricultural policy interventions. One is the joint role of the farm household as both a producer and consumer of food crops. A second is the prevalence of high transaction costs, which may inhibit farmers' participation in markets. A third factor is heterogeneity among households in terms of their income sources, expenditure patterns and endowments of factors (particularly land).

Section 3 describes some important aspects of long-term structural change and the agricultural transformation. The main thesis of this section is that the long term (i.e. inter-generational) future for many agriculture-dependent households will lie outside the farm sector. Accordingly

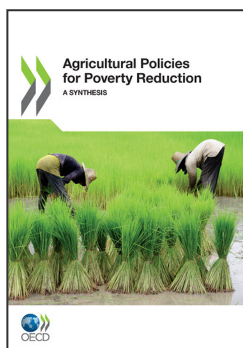
governments need to anticipate this process, adopting long-term policies that both improve the productivity of those who are potentially competitive within the sector, and generate opportunities outside the sector for those who are not, or in the long-term have superior prospects elsewhere.

Section 4 proposes a strategic framework for improving rural incomes in developing countries. A distinction is made between measures that are likely to be effective in the short term and those that are likely to sustain economic development and promote wider employment opportunities in the long term. A key point here is that there may be both complementarities and trade-offs between short- and long-term policies. For example, income support may boost incomes in the short term while sowing the seeds for deeper development by offsetting market failures and enabling farmers to break out of "poverty traps". On the other hand, subsidies to farmers may raise incomes but ultimately impede sectoral development and the adjustment into more remunerative activities. The strategic framework establishes a mapping between alternative development pathways and potentially relevant policy instruments, situating agricultural policies among the broader suite of measures at the government's disposal.

For both short- and long-term objectives, agricultural policies have been proposed on the basis that they provide practical alternatives when best practice options are not possible. Agricultural market interventions are not the theoretically optimal way of providing social protection (where social safety nets are to be preferred); nor, in the absence of market failures, are they the ideal way of fostering growth, since they treat the symptoms of a lack of competitiveness, rather than its underlying causes. Nevertheless, plausible reasons have been suggested why, given weak institutions, high transactions costs and endemic market failures, agriculture-specific interventions might be desirable. Price stabilisation has received renewed interest in the wake of the 2007-08 food price crisis, during which policy makers in many developing countries felt impelled to act quickly, rather than address the underlying issue of risk management. Similarly, input subsidies have been seen as a possible solution to the weak performance of African agriculture, with the World Bank advocating the use of "smart subsidies"' (e.g. for seeds and fertiliser) as a way of "jump-starting" agricultural markets (World Bank, 2007). Sections 5 and 6 discuss the pros and cons of using these particular instruments. Section 7 provides concluding remarks on the potential role for agricultural policy in strengthening incomes in countries at varying stages of economic development.

Note

1. The FAO estimates the global total of chronically hungry people at 925 million in 2010, down from 1.023 billion in 2009, principally due to food prices declining from their 2007-08 peaks.



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