



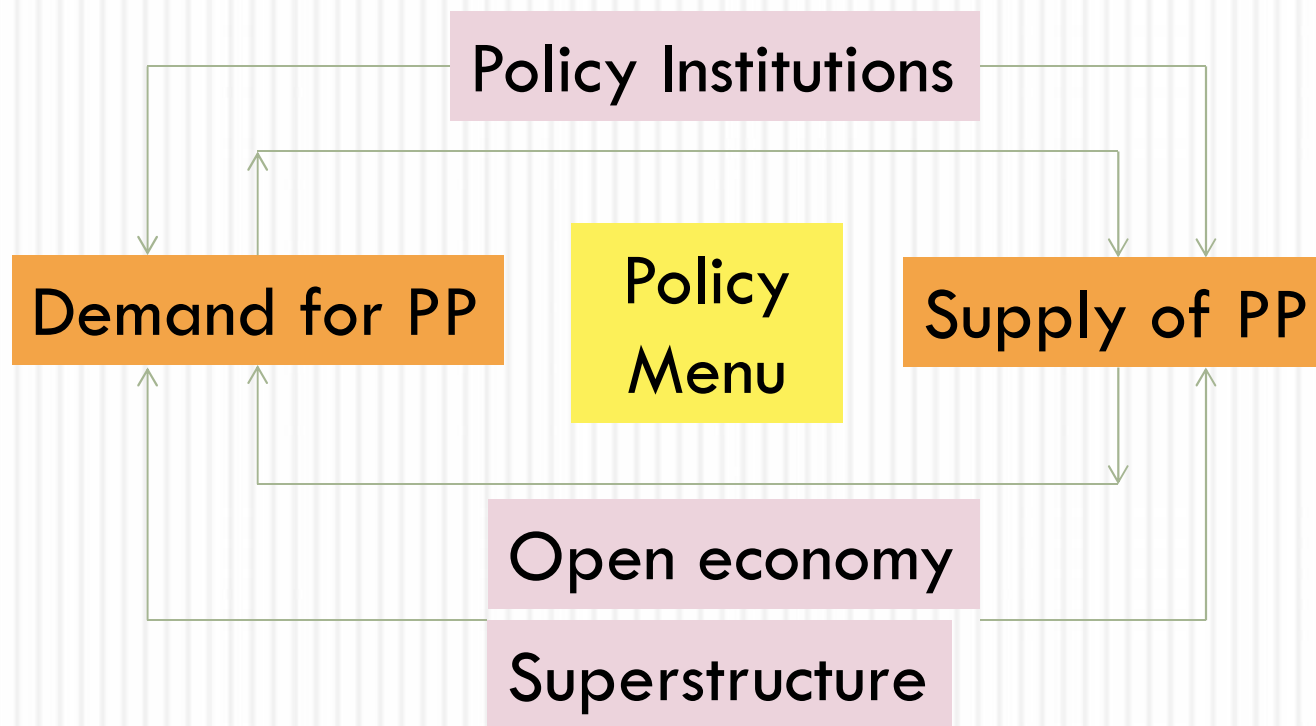
# **POLITICAL ECONOMY OF AGRICULTURAL PUBLIC POLICY**

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Course : EE 390 Economics of Agricultural and Rural Development

# Agricultural Policy

- Market for agricultural product
- Market for 'public policies'



# Agricultural Policy

- Rationales of government intervention in a market
  - ▣ Efficiency
    - Subsidization of public goods
    - Limiting of externalities
    - Regulations that limit market power
  - ▣ Stabilization
  - ▣ Redistribution

# Price Intervention Policy

- Agriculture is a dynamic sector that responds positively to price incentives
- Government Intervention
  - ▣ Direct intervention
    - Agricultural sector policies
  - ▣ Indirect intervention
    - Industrial protection policies
    - Macroeconomic policies

# Price Intervention Policy

- Direct Intervention

- Many of the direct measures have been equivalent to a tax on agriculture

- 1) Depressing the prices received by agricultural producers**

- procurement measures (government marketing boards are often the only legal buyers of agricultural outputs)
- quotas on exports of food crops and other agricultural commodities
- direct taxation of such exports.

# Price Intervention Policy

- Direct Intervention

- 2) Benefiting agricultural producers**

- Subsidization of the costs of farm credit and important agricultural inputs, such as fertilizer.
    - Protection for domestic producers of import competing food products through quantitative restrictions or tariffs to increase their food self-sufficiency, have protected on imported commodities.
    - Stabilization of the domestic producer prices in relation to prices on world markets

# Price Intervention Policy

- Direct Intervention

- 3) Cost control of food for urban consumers**

- fixing retail food prices
    - imposing ceilings on producer prices
    - “dual pricing systems” to keep producer prices high and consumer prices low

# Price Intervention Policy



## □ Indirect Intervention

- industrial protection and macroeconomic policies
- affect the prices of agricultural tradables relative to nontradables (through their impact on the real exchange rate) or to other tradables (as a result of industrial protection)
- affect production incentives by making agriculture more or less attractive than other sectors of the economy

# Price Intervention Policy

## □ Indirect Intervention

- E.g. policies that affect the appreciation of real exchange rate
- reduce the real purchasing power of income received from the sales of export and import-competing commodities
- appreciation of the real exchange rate can raise the relative cost of nontradable inputs
- stronger, easily outweighing the positive influence of direct interventions

# Price Intervention Policy

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## □ Indirect Intervention

### ▣ Protection for domestic industry

- raising the domestic price of importable agricultural inputs above world prices
- reducing the purchasing power of farm households as consumers of manufactured goods, and causing further appreciation of the real exchange rate.

# Price Intervention Policy

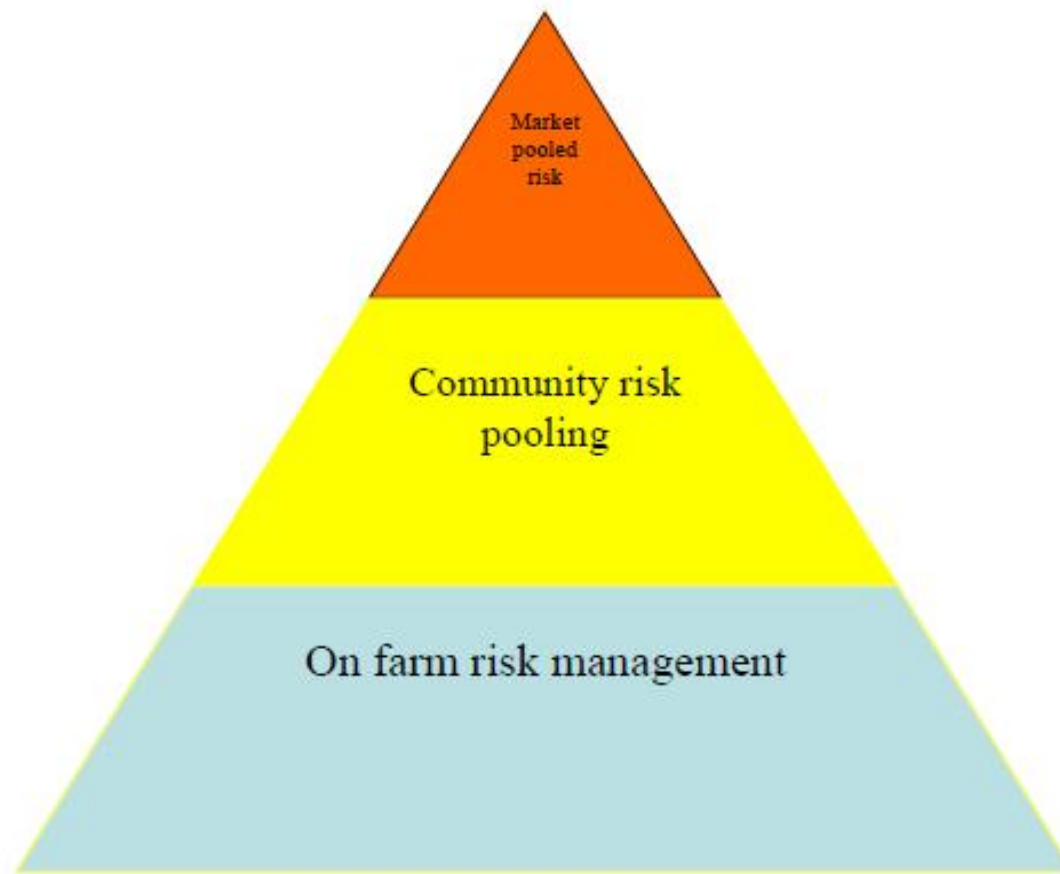
- On average, direct intervention taxed exportables and protected importables, which are predominantly food products
- Indirect interventions, however, lowered both producer and consumer prices.
- Justifications on taxing agriculture
  - ▣ reduction in agricultural investment
  - ▣ increase outmigration
  - ▣ reduce the implementation of new techniques

# Risk Insurance Policy

- Risks of agri. as business
  - Price volatility
  - yield and resource risk
- unstable incomes
  - Ability to meet family's food and expense
  - Ability to repay loans
  - Asset losses (from catastrophe)

# Risk Insurance Policy

- Farmers' strategies toward risks



# On-farm strategies

## 1. Risk-reduction strategies:

- 1) Diversification → Different crops, trees, livestock or different crop varieties and animal breeds
- 2) Inter-cropping and staggered planting dates
- 3) Fragmentation of the farm to include plots that have different risk exposures in the landscape
- 4) Investing in water harvesting and small scale irrigation
- 5) Diversification into non-farm sources of income (e.g. non-farm business activity or employment, and seasonal migration)

# On-farm strategies



## 2. Risk-coping strategies:

1) carrying food stocks, and extra animals and other assets (e.g. jewelry and trees) that can be easily sold in times of need

2) borrowing credit and engaging in temporary migration for employment

# Risk-pooling within communities

- Traditional risk-pooling → Social capitals
  - ▣ Credit groups
  - ▣ Kinship network
  
- Inadequate to be the safety net for the poor
  
- The aggregate losses associated with these types of events can easily overwhelm community risk sharing arrangements, dry up informal credit, reduce asset prices and agricultural wages, and force many people into poverty

# Market-based insurance

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- Crop insurance

- Based on the difference between actual yield and a pre-specified target yield, not on actual crop damage or input costs lost
- Some programs included deductibles so as to help control for adverse selection and moral hazard problems
- In some countries the insurance has been made compulsory for all farmers growing the insured crops or borrowing from a state bank

# Market-based insurance

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- Crop insurance

- Some research evidence: the total payouts exceeded the premiums collected from farmers
- the premium rates paid by farmers would need to be more than tripled for the insurers to break even without government subsidies
- high costs & risk of moral hazards

# Government failure

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- Government are limited in their ability to maintain long-term contracts with farmers
- Policies are designed on basis of both economic and political reasons
  - Government not exactly maximize social welfares but also balance different interest groups
- Rent-seeking behaviors
  - The activities of influencing the political process to obtain favorable outcomes or to avoid unfavorable one

# Government failure

Policy	Ranking		
	Economic Efficiency	Number of Votes	Political Choice
A	A	C	C
B	B	B	B
C	C	A	A

# Government failure

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- Rent-seeking behaviors
  - Interest groups or firms will take resources from other productive endeavors and spend them on lobbying or other rent-seeking activities
  - Asymmetric information
- Outcomes
  - Inefficiency
  - Conflicts with the objectives of other groups: civil society/environmentalists