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The Political Economy of Instrument Choice in Agricultural and Food Policies: Theory and Evidence from OECD Countries

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Abstract

We study the political economy of instrument choice in OECDs agricultural and food policies. After a review of the historical evolution of Western Europe agricultural price and trade policy instruments since 1880, we develop a simple political economy model of instrument choice. The key predictions of the model suggest a rational explanation of instrument choice patterns, based on the trade-off between the different costs component of the policy, imperfect information about future market conditions, and internal and external political constraints. A formal empirical analysis on OECD countries gives broad support to the main predictions of the theoretical model.

Keywords

Political Economy; Instrument Choice; OECD Agricultural Policy

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1. Introduction

An extensive literature on the political economy of agricultural policies has developed over the past 20 years. Papers in this literature have attempted to provide an explanation for the stylized facts on agricultural protection, such as the widely observed increase in agricultural protection when an economy grows. Theoretical studies attempting to explain these and other facts have stressed the implications of organization costs on the political decision-making process (Gardner, 1987; Olson, 1990), structural factors affecting the distributional effects of agricultural protection (Anderson and Hayami, 1986; Anderson and Tyers, 1988; Honma and Hayami, 1986; Swinnen, 1994), the relative income position of agriculture (Bullock, 1992; de Gorter and Tsur, 1991; Swinnen and de Gorter, 1993), the transfer efficiency of agricultural policy (Gardner, 1983; Bullock, 1992; Bullock et al., 1999) and, more recently, political institutions like differences in electoral rules and the degree of democracy (Beghin and Kerallah, 1994; Swinnen et al., 2001; Olper 2001, 2007; Olper and Raimondi, 2004).

These political economy studies of agricultural policy have focused primarily on explaining the level of policy intervention and less attention is paid to the explanation of the instruments used for intervention (de Gorter ans Swinnen, 2002). This bias in focus is an important shortcoming of the literature. From a welfare perspective the key question should be why governments have introduced so many market distortions through agricultural policies. The distortionary effects of government interventions are equally dependent on the choice of the instrument as on the level of the intervention, a consideration recognized by same World Trade Organization (WTO) through the classification of policy instruments in the green, blue and amber box.[1] Therefore the choice of instrument should be at least of equal concern as the intervention level.

[1] Considering a hypothetical range of policies from more to less distortionary, the total distortions will decrease for a given level of intervention. An important low recognised by

An important cause of this bias in focus on the level of intervention is the availability of good empirical data on levels of intervention, resulting in some stylized facts, such as the correlation between agricultural protection and economic growth (Bale and Lutz, 1981). Such stylized facts, which have stimulated the political economy literature on explaining protection levels mentioned above, were not readily available for instrument choice.

Therefore, a first objective of this paper is to present some stylized facts on the choice of instruments in OECDs agricultural price and trade policies. The empirical observations indicate that also in instrument choice, there appears to be an important conflict between policy prescriptions by economists and observations on actual instruments used. This is consistent with, for example Rodrik (1986), who argues that the observed use of policy instruments for trade and price interventions is almost the inverse of their ranking in terms of economic optimality.

A second objective is to analyze the existing literature on the political economy of instrument choice. This literature can be grouped into four categories. First, the imperfect information (or "Virginia school") approach explains how inefficient policy instruments will be chosen because of differences in information between various interest groups and voters (e.g. Tullock, 1983; Coate and Morris, 1995). Second, the obfuscation argument is refuted by the efficient redistribution (or "Chicago school") approach. This approach, and other models emphasizing political competition, argue that competition among political parties and pressure groups favours the choice of instruments which minimize the costs of redistribution (Stigler, 1971; Becker, 1983; Wittman, 1989). Third, the "Berkeley school" analyzes redistributive policy instruments as part of a larger political economy framework. In this approach, redistributive policy instruments are chosen because of their role as compensation instruments for uneven distributional effects of other policies (Rausser, 1992; Rausser and de Gorter et al. 1991; Rausser and Foster, 1992; Swinnen et al 2000). Fourth, the transaction costs approach

public economic is that, in the extreme case when the government selects a non-distortionary "lump sum" transfer, the amount of distortions is independent from the level of transfers.

argues that standard models ignore costs involved in the implementation, administration and enforcement of the policies, causing substantial biases in conclusions regarding the relative efficiency of policy instruments (e.g. Munk 1994; Dixit, 1996).

This paper has four objectives. First, we summarize empirical observations on government instrument choice in West European agricultural policy-making, and present some "stylized facts" to be explained. Second, we review the literature on instrument choice deriving a conceptual political economy model, which combines critical features of the various approaches, and derive hypothesis to be explained. Third, we use this model to explain the stylized facts on long run policy choices in West European agriculture. Finally, we test the predictions of this model with quantitative cross-country data on instrument choice in OECD agriculture.

The theoretical model is a two-stage political economy model in which governments choose policy instruments to maximize a political objective function, but are constrained in their choice by (1) the need to secure sufficient political support in order to stay in power (2) external institutions (international agreements, IMF conditions, etc.) and (3) imperfect information on future market conditions. As in Rodrik (1986), Cassing and Hillman (1985) and Campos (1989), we assume that in the first stage, governments choose a political economic optimal policy level, and in the second stage they choose the policy instrument. With sufficient competition between political agents this model implies that governments will select a policy which minimizes the sum of the total transfer costs (TTCs), taking into account the uncertainty about future market conditions and the influence of external institutions. We show how this model can provide an explanation for the widely observed phenomena of path-dependency in policy instrument choice and the persistence of 'inefficient' policy instruments. The model's predictions are largely consistent with observed long run instrument choice patterns in Western European agriculture. The paper end by deriving a more general implication suggesting that by ignoring the existing situation and the importance of transaction costs, much of the literature on policy instrument choice is addressing the wrong question. The key issue is not so much the relative efficiency of two theoretical policies,