



## MULTIFUNCTIONALITY AND AGRICULTURE POLICY IN OECD COUNTRIES

**Agriculture provides goods or services that are additional to its primary products of food, feed and industrial raw materials. What does this mean for agricultural policy? The issue is complex, requiring serious attention on the part of policy makers.**

### *What is “the multifunctional character of agriculture”?*

OECD work, initiated following the 1998 Agriculture Ministerial meeting, treats multifunctionality as a characteristic of the sector and explores the policy implications. The primary outputs of agriculture are food, feed and products for an increasing range of ‘industrial’ uses (from pharmaceuticals to bio-fuels). But agriculture also has a range of additional outputs or effects, which can be either positive or negative depending on the physical, economic and policy setting. Among the positive effects associated with the multifunctional character of agriculture are landscape, biodiversity, cultural or heritage values, rural development and food security; these are also referred to as non-commodity outputs. The negative effects can include pollution, soil and water degradation, and landscape destruction. The multiple outputs of agriculture (or indeed, of any other sector with multifunctional characteristics) may be intended or unintended, complementary or conflicting, reinforcing or offsetting.

There are profound differences of perception concerning the correct policy strategy to adopt in order to achieve the desired mix of commodity and non-commodity outputs. Some stakeholders contend that the positive effects of agriculture are strongly linked to agricultural production itself. They believe that the benefits of multifunctionality can be threatened by farm policy reform and trade liberalisation. Others argue that the links between commodity production and non-commodity outputs are weak or non-existent, and that only policies targeted to specific positive effects can be effective. Still others adopt a middle ground between these positions.

### *Are current policies appropriate?*

Government action may be required if specific, non-commodity outputs of agriculture are threatened by structural adjustment, technological developments or reductions in support arising from policy reform. Precisely which type of policy intervention is likely to be optimal requires careful investigation. Current levels of support and protection of agriculture are relatively high and a large share of that support is delivered through broad mechanisms based on production or factors of production.

Conversely, a very small share is delivered through mechanisms that target specific non-commodity outputs. Little work has been undertaken to assess whether some non-commodity outputs would be under-supplied in the absence of current policy support. It cannot therefore be concluded that the current level and composition of support is necessary because of multifunctionality. In fact, there has been a stark lack of precision in much of the debate on multifunctionality, at both domestic and international levels, and in particular on the link between policy objectives, related policy instruments and desired effects. Much more specificity is called for if the complex, diverse and sometimes divergent interests are to be addressed effectively.

OECD work can help lend the needed clarity. A key insight concerns the degree to which a non-commodity-output may be jointly produced with a commodity output. If the relationship between a unit of agricultural production and units of non-commodity output is fixed over the entire range of production levels and systems, then production-linked measures should be considered. If the link is strong, there can be a case for agriculture-specific interventions. If the degree of jointness is weak, or non-existent, the non-commodity output can be supplied independently of commodity production and there is no rationale for policy measures specific to agriculture.

While a systematic empirical analysis of relationships between commodity and non-commodity outputs has not been undertaken, OECD work to date does allow a number of important observations:

- the link with agricultural production is weak in the case of non-commodity outputs such as cultural or heritage features and agricultural employment in most OECD regions;
- provision of non-commodity outputs rarely, if ever, depends on the intensity of production;
- even where non-commodity-outputs depend on the continuance of a certain level of production, provision does not require production beyond that level;
- many of the positive effects of agriculture are site, locality or region specific.

These conditions, when they are observed, point towards measures which target directly the desired non-commodity output, as well as the specific site, locality or region of interest and argue against very broad, sector-wide, production and price based support policies.

Possible exceptions relate to very strong and/or widespread jointness or to situations in which the difference in transactions costs (design, implementation and monitoring costs) between targeted and broad-based measures is large enough to outweigh the efficiency gains of the former.

#### ***What does multifunctionality imply for future policies?***

OECD work on multifunctionality recognises the multifunctional role of agriculture and confirms the need for governments to apply an appropriate analytical framework. Its purpose is to determine if there is a need for policy intervention and how it might best be designed. Such a framework has been developed and agreed by all OECD Member countries — its three essential steps are described in the Box. It remains now to be implemented by governments as part of the ongoing policy making process. Only in this way will it be possible to move beyond arguments that support long-established positions towards policy actions that effectively ensure an adequate supply of both commodity and non-commodity outputs, without causing negative domestic effects or distorting global markets.

#### **Analysing Multifunctionality**

1. What is the nature and extent of the link between non-commodity outputs and agricultural production (*i.e.* to what degree are the outputs joint)?
2. Is there a shortfall in the supply of some non-commodity output that is jointly produced with an agricultural commodity, *i.e.* is there “market failure”? Will market failure occur in the wake of reform?
3. Is governmental provision of the desired non-commodity-outputs necessary? Is market or other non-governmental provision possible?

OECD (2001), *Multifunctionality, Towards an analytical framework*.

Good policy design involves precise definition and quantification of objectives and careful monitoring of outcomes relative to costs. This involves significant data requirements. A pragmatic approach to obtaining this information is best and would make use of data that are available at reasonable cost. Market approaches can help ensure that the supply of site-specific non-commodity outputs is commensurate with societal demand and willingness to pay. A progressive, gradual approach to reform would allow outcomes to be monitored and remedial action to be taken where unintended effects are observed. At the same time, the costs of maintaining inappropriate policies should not be overlooked.

Policy design should be specific to each country, region or locality; it should also be comprehensive, encompassing positive and negative effects, whether intended or unintended, both domestically or internationally. Transactions costs associated with implementing targeted measures may, in some cases, be higher than for generally available measures. On the other hand, the more “distant” a policy instrument is from the desired non-commodity output, the greater will be the need for, and costs of, monitoring outcomes. It could be that transactions costs for some targeted measures are so large as to offset their higher efficiency and effectiveness, but this requires empirical investigation. In any event, all possible avenues should be explored to minimise total costs and to maximise total benefits of government actions. Further analysis of the transaction costs of alternative policy measures is underway at OECD.

Many policy interventions will have some spill-over effects on production and trade. Well-targeted policy measures and approaches can ensure that these impacts are reduced to a minimum. OECD Agriculture Ministers meeting in 1998 acknowledged this when they identified the intrinsic complementarities between the efficient pursuit of domestic policy objectives (some of which are associated with multifunctionality) and the avoidance of production and trade distortions.

1. See *Multifunctionality: the policy implications* [AGR/CA/APM(2002)10/FINAL].