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The Implementation Costs of Agricultural Policies

Executive Summary

There are many different kinds of costs associated with the implementation of any policy. Administrative costs, for the purposes of this study referred to as policy-related transaction costs (PRTCs), are one cost element that has been receiving attention. Concerns about PRTCs have been raised in the specific context of multifunctionality and more generally with respect to agricultural policy reform, in particular the move from market price support measures towards more decoupled and targeted policies. This study considers two main issues. The first is a public administration issue, which relates to the need to identify and track PRTCs with a view to controlling costs and making better use of public funds. The second is an economic issue, which relates to the role of PRTCs in determining the most efficient option for achieving a given policy objective.

PRTCs occur at all stages of policy implementation, from policy design and enactment to final evaluation, through interactions between and within government agencies, private organisations and programme participants. Implementation *per se* includes the delivery of payments and monitoring of eligibility and compliance, as well as the associated checks and controls.

PRTCs are necessarily incurred in the pursuit of policy objectives and are not "wasteful" *per se*, but everything else being equal, notably expected and unexpected outcomes, it will be beneficial to try to reduce them, both in order to make better use of public funds, and to minimise one of the components of the overall economic costs of a given programme. In order to reduce PRTCs while maintaining programme benefits, it is important to identify the factors that determine them. These factors relate to the characteristics of the policy, including the precision and clarity of its objectives and the nature of compliance. For a given policy, the administrative structure and the regulatory environment in place, structural factors such as the number, size and diversity of farms, and access to information and co-ordination will also be important.

PRTCs can be reduced by sharing experiences across agencies, regions or countries, exploiting already existing administrative networks, integration of government and private information systems, reducing the number of agencies, and use of information technologies. Properly measuring and monitoring PRTCs will make it easier to control them. PRTCs for a given policy can decrease over time as experience grows and initial costs are amortised.

While the importance of PRTCs in policy choice is recognised, they are rarely, if ever, taken into account in practice. The failure to take them into account is particularly noticeable in cases where big shifts in policy focus have occurred, *e.g.* from market price support to direct payments. Ideally preparations for the introduction of a new policy initiative, for example in the context of policy reform, should include a full fledged cost-benefit analysis, of which PRTCs would be a component. Transfers generated by the policy should also be considered, as how much society is prepared to pay to obtain desired

outcomes is an important component of policy choice. This study found rather few attempts to estimate PRTCs. Moreover, when estimates are made, they are mostly *ex post*, with varying degrees of reliability. In order to obtain more consistent and reliable estimates for use in policy comparison, systematic and accurate procedures are needed to measure PRTCs and evaluate policies.

A full comparison of costs and benefits of different policy options needs to relate the economic value of what the policy achieves to its resource costs, including PRTCs and side-effects, as well as the transfers it may generate, both intended and unintended. This is not attempted here. In the absence of real life examples, a schematic comparative analysis is presented to illustrate the trade-offs. Stylised comparisons are carried out, for a range of hypothetical policy options, assumed to all have the same results in terms of the objective pursued. This assumption is made to simplify and to allow the analysis to focus only on the comparison of resource costs (including deadweight losses due to coupled policies, possible additional costs of de-linkage due to decoupling in the context of market failures, and PRTCs) and transfers among different policy options. Plausible assumptions regarding certain parameters and the value of unit PRTCs are made, drawing on the literature and the case studies (for example, median values from the literature reviewed in Chapter 1 are used for PRTCs). The comparisons are purely illustrative and do not represent any specific, real-life situation. This illustrative analysis indicates that, all other things being equal, the choice of policy instrument will depend on the trade-off between the targeting ratio (*i.e.* the share of the total transfer that is actually needed to achieve the objective) and the PRTCs. All the hypothetical examples developed for this study show that the reduction in unintended transfers as a result of targeting is one of the crucial parameters in policy choice.

Although the PRTCs of targeted payments can be higher as a percentage of transfers than those of untargeted measures, total PRTCs are not necessarily higher and in many cases, the total costs of achieving a desired policy outcome could be lower for well-targeted and well-coordinated measures. The hypothetical examples developed in this study indicate that targeted policies, whether decoupled or not, are the least-cost options under a wide range of assumptions about key parameter values, especially when the targeting ratio is low. In the case of income policies, the inclusion of income transfer efficiency in the comparison reinforces the benefits of decoupling and targeting as leakages are generally smaller (as the transfers are smaller). In the case of policies that aim to correct market failures, when jointness exists, trade-offs between gains from decoupling and the possible additional costs of de-linkage, (i.*e* the extra cost of producing a non-commodity output separately from commodity production – to be added to transfers to producers needed to produce it jointly) also need to be considered. This also means that the trade-off includes the transfers to producers needed for joint production of the public good on one side, and the total cost of separate production of the public good on the other side. However, the full diversity and complexity of situations in OECD countries is probably not covered, and uncertainties remain on the actual value of parameters. One could envisage cases, where implementing a targeted policy measure would not reduce the total cost of pursuing a policy objective and where the targeted option does not have the lowest cost because of high PRTCs and/or a high targeting ratio. This would presumably be the case when a policy explicitly seeks to apply a common rate of support to almost all the population, or to almost all land, and where there is no or little (negative) unintended impact, domestically or internationally. There are also cases where the total cost of pursuing a policy objective

is not lower with decoupled measures than with coupled measures due to high PRTCs and/or high additional costs of de-linkage. Finally, some governments might consider it appropriate to give different weights to welfare components and transfer components to reflect equity, feasibility and other social concerns, thus affecting policy choice.

Many issues still need to be further explored in terms of policy comparison, including the time dimension in policy implementation, the impact of institutional settings, and the other components of costs and benefits of policies. For the sake of simplification, the approach presented here compares policies that are assumed to generate the same desired outcome. In reality, the quality of the result may differ for different policy instruments and there may be other unexpected impacts, both positive and negative, that vary with the alternative policy instruments. Generally speaking, the information and data that would be needed to make these more complex comparisons are not available.

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