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Multilateral agricultural policy reform

An imperative for the new millennium

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Agricultural protection and subsidies in OECD countries are now at extreme levels. In 1999, total OECD agricultural support is expected to approach the heights reached in the mid-1980s. At that time the weight of trade distortions brought on by agricultural policies gave an impetus to focus on agriculture in the Uruguay Round.

Under the Uruguay Round some reductions to agricultural trade barriers were agreed, subsidised exports were capped and domestic production support payments were limited. Also, countries were encouraged to change methods of providing farm support to reduce their distorting impacts on world markets.

Despite these developments, it has become apparent that the degree of trade liberalisation resulting from the Uruguay Round was only modest (Anderson 1998). This means that the task of substantially advancing international agricultural policy reform lies ahead.

Multilateral negotiations

The coming World Trade Organisation (WTO) negotiations, to be launched in Seattle in November 1999, are an opportunity to make substantial progress in liberalising agricultural policies internationally.

The key test of these negotiations will be the extent to which policy induced distortions to world trade are reduced. This will require addressing the limitations of the Uruguay Round outcome as well as making substantial reductions in distorting forms of agricultural support.

Trends in agricultural support levels

World agricultural trade remains substantially distorted. Governments in many OECD countries continue to provide farmers with support that boosts their returns and insulates them from world markets.

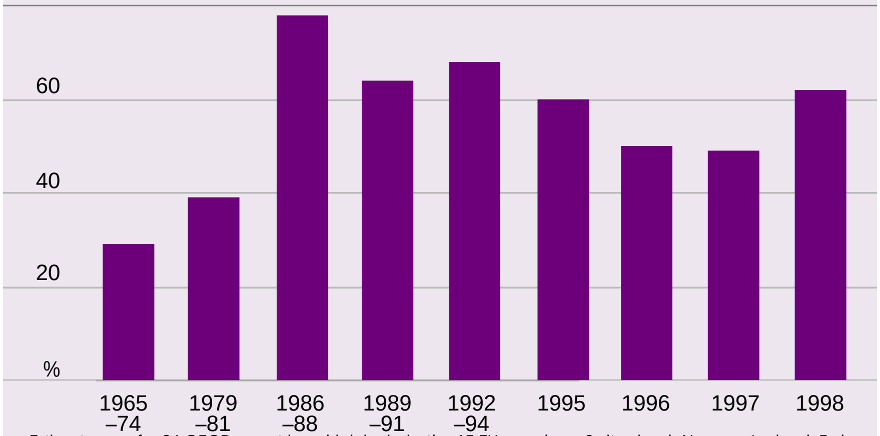
Such policies restrict market access and increase the volume of subsidised production. Internationally, this lowers and destabilises world prices, harming farmers in countries where agriculture is efficient and globally oriented (Tyers and Anderson 1992).

In the protecting countries, agricultural support policies divert resources away from more profitable activities into agriculture. This reduces the value of overall national output. The outcome is lose–lose, both internationally and nationally.

Recent estimates of total agricultural support in OECD countries are shown in their historical context in figure 1. Prominent providers of support include Japan, the European Union and other western European countries, the Republic of Korea and, for some commodities, the United States.

Support levels for western Europe over the past four decades compared with support levels during and prior to the great depression of the 1930s are

1 Nominal rates of assistance for agriculture in OECD countries a



a Estimates are for 24 OECD countries which include the 15 EU members, Switzerland, Norway, Iceland, Turkey, Canada, the United Sates, Japan, Australia and New Zealand. The estimate for 1965-74 was derived from a comparison of data from Tyers and Anderson (1992), with OECD data for later years. As the OECD introduced a new method of calculation, 1998 data were rebased on a value basis to be comparable with previous data.

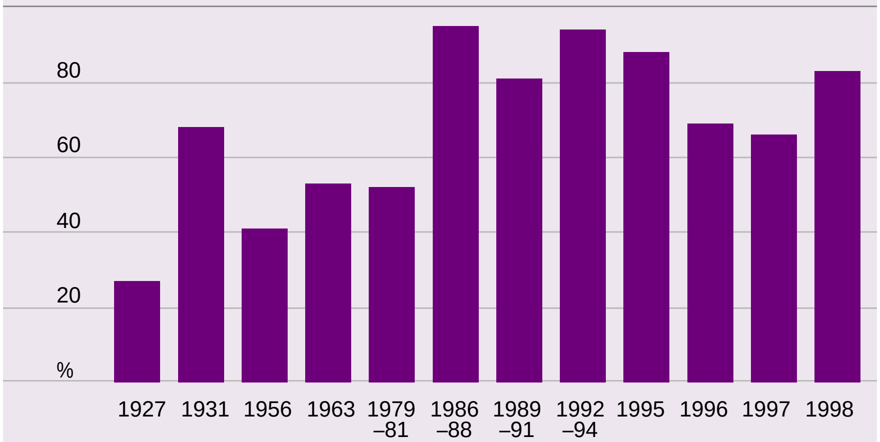
> Agricultural support will remain high or increase further in 1999

shown in figure 2 (Tyers and Anderson 1992; OECD 1998, 1999).

In 1998 aggregate levels of agricultural support in the OECD were still similar to those in the early 1990s. This is despite 1998 being the fourth of the six years in the implementation period of the WTO Agreement on Agriculture for developed countries.

Furthermore, there is evidence that levels will remain very high or increase further in 1999. For example, US direct payment support that constituted half of total support in 1998 (OECD 1999) is estimated to increase by 80 per cent in US fiscal year 1999 (US Department of Agriculture 1999, p. 57).

2 Nominal rates of assistance for agriculture in western Europe



Lack of progress

The apparent lack of progress in reducing support levels reflects, in part, the nature of the WTO Agreement on Agriculture. Under that agreement, reductions for developed countries were negotiated in:

- bound tariff rates and the tariff equivalents of other import barriers — an average reduction of 36 per cent and a minimum reduction of 15 per cent for individual items;
- domestic support — an overall reduction of 20 per cent; and
- subsidised exports — reductions of 21 per cent in volume and 36 per cent in value of subsidies for individual items.

In addition to the cuts to support levels, three key elements of the agreement related to reforming the instruments used to provide support to agriculture:

Tariffication

Tariffication involved the conversion of all nontariff barriers to tariffs or tariff-quotas. As part of this process the impact of different border protection measures was calculated as a tariff equivalent. This became the maximum tariff that could be applied and was the basis for agreed tariff reductions.

Tariff-quotas

Tariff-quotas were used to ensure minimum access levels for imports. This was done by setting a quota at least equal to the agreed minimum access level and applying a lower tariff to this amount. Amounts in excess of the quota could be imported but at a higher tariff rate.

Decoupled support

Decoupled support breaks the links between support payments and key market variables including production, prices and input use. In so doing it makes producers and consumers more responsive to world prices and therefore can lower market distortions. Such support was excluded from reduction commitments by being placed in the so-called ‘green box’.

Factors weakening reforms

The reductions in support and reforms to support instruments appear impressive. However, a number of factors have weakened their impact substantially.

Unrepresentative starting points

For tariffs and domestic support, negotiated reductions were from levels in the base period 1986–88. For export subsidies the reductions were from the 1986–90 base period. It is obvious from figures 1 and 2 that such base periods were times of unrepresentative high protection. Consequently, countries have had to do little, if anything, to meet their commitments to reduce support.

Averaging of tariff cuts

Tariff cuts across a broad range of products could be combined as a simple average to calculate the overall tariff cut achieved by countries. This means that cuts to tariffs on items traded little were given as much weight as cuts to tariffs on items traded heavily.

Consequently, many of the major sensitive agricultural products in developed countries with high protection have been subject only to the minimum 15 per cent tariff cut. At the same time, many relatively obscure, less sensitive items were subject to larger cuts to bring averages up to the required 36 per cent.

Dirty tariffication

With dirty tariffication, countries exaggerate their base levels of tariffs. This can be done by the selective use of prices for determining tariff equivalents in the base period. Tariff equivalents are defined as the difference between domestic prices and import prices.

To elevate its base tariff equivalent a country could use base period domestic prices for a high quality product at a remote location where prices were well above representative levels. Further, they could use an import price for a low quality product at a port where prices were lower than in most other parts of the country. The result would be to make the tariff equivalents in the base period well above what were, in most cases, already extreme levels. Cuts to such exaggerated base tariffs would have only limited effects on actual tariff levels, thereby weakening the impact of agreed cuts.

Analysing the issue of dirty tariffication, Ingco (1995) concluded that the European Union had set its initial tariff bindings at unweighted average levels 61 per cent higher than actual tariff equivalents while the United States set its initial binding at 44 per cent above actual levels.

Market access

Some gains were made in assuring current access and opening up markets through minimum access arrangements, mainly through the use of tariff-quotas.

However, those gains were not large. The tariffs for beyond-quota imports were generally prohibitive, enabling tariff-quotas to be used as tools for managing trade within highly distorting support systems.

Inappropriate use of special safeguards

Special safeguards are supposed to provide a cushion for producers against surges in imports and precipitous reductions in world prices. Such changes give countries the option to use import control mechanisms.

However, in some instances safeguards are being used as an integral part of market management systems. With European Union sugar, for example, they render the negotiated reduction in the tariff effectively irrelevant as sugar entering the European Union at world prices would be sufficient to trigger the special safeguard arrangements in most years.

Green and blue box exemptions

Decoupled support (in the ‘green box’) and support provided under production limiting arrangements (in the ‘blue box’) were exempted from cuts.

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Several factors have weakened the impact of negotiated reforms

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• Properly applied, decoupling makes producers and consumers more responsive to world prices and can lower market distortions •

Glossary

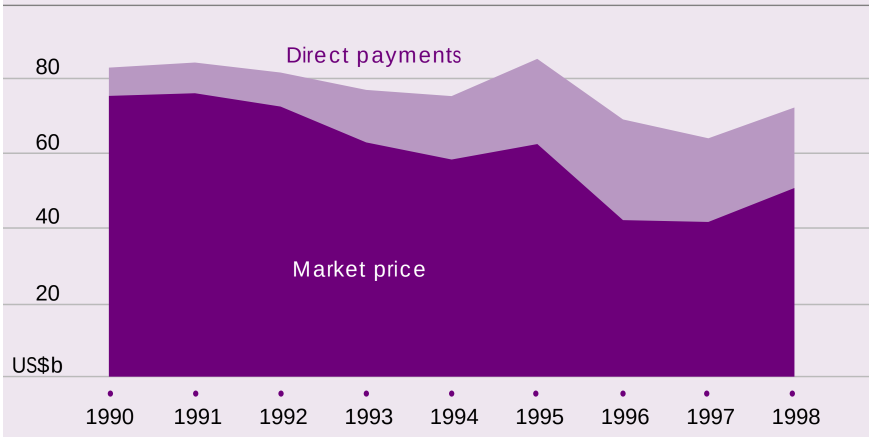
Green box support – domestic support in forms that are determined to be minimally distorting and are exempt from reductions under the WTO Agreement on Agriculture.
Blue box support – agreed production limiting arrangements under which payments are exempt from reductions under the WTO Agreement on Agriculture.
Tariff-quota – application of a reduced tariff for a specified quantity of imported goods.

The exemptions validated two trends: in the United States to replace production subsidies with payments more decoupled from production variables; and in the European Union to replace trade barriers and export subsidies with direct payments.

By breaking the links with market and production variables, decoupling makes producers and consumers more responsive to world prices and therefore can lower market distortions. But there are substantial risks.

Practical moves toward decoupling are most advanced in the United States. However, the so-called decoupled payments to US farmers have been varied to counteract world price movements. Low world prices in 1998 induced the US Congress to vote an additional US$5.6 billion in farm payments. The additional payments have reduced farm risks by acting like a farm income insurance subsidy, with the potential to distort world markets.

3 **Agricultural support, European Union**



Agricultural policy reforms in the European Union since 1992 have focused on the gradual replacement of trade barriers and export subsidies with direct payments that are exempt from cuts under the blue box arrangements (figure 3). These direct payments are not decoupled and continue to lock in most of the previous production distortions.

For crops in the European Union, individual farmers receive payments on areas actually planted subject to commitments under area reduction programs, although there are (rarely enforced) regional limits to payments. Such arrangements lock in production capacity at the highly distorted base period levels. At the same time advances in productivity, in particular, the responsiveness of cereal production to fertilisers, are continuing to increase production.

For beef in the European Union, headage payments are linked to animal numbers with maximum levels per farm, and provide incentives to sustain animal numbers and production at around the distorted base period levels.

Export subsidies

The reduction in subsidised exports is perhaps the main gain from the Uruguay Round. Subsidised exports in the wheat market that was plagued by competitive export subsidisation have declined greatly.

However, that advance is partly illusory, as the European Union has replaced much of its export subsidies for cereals with direct compensation payments that cover the quantities exported as well as output for domestic consumption. Those payments retain several production and trade distorting features but are excluded from reduction commitments. Similarly the US direct payments for farmers producing for export as well as domestic sale have risen when world prices have fallen. These payments have some market distorting characteristics. Also, the agreed upper limit on subsidised exports provides ample scope for increasing subsidisation in future (figure 4).

For dairy products, negotiated limits on export subsidies are constraining subsidised exports only somewhat. The limits for butter far exceed any expectations of subsidised export volumes and are not a constraint. For skim milk powder, subsidising countries are using unused credits on exports from early years in the implementation period, when prices were high, to enable them to exceed the annual volume limits in subsequent years.

US and EU subsidised exports for 1997-98 is an estimate

Ingredients for a successful outcome to the negotiations

Perhaps the most significant legacy of the Uruguay Round was the framework that was set in place for reducing world market distortions in agriculture. Within the WTO Agreement on Agriculture, the acceptance of tariffication and the treatment of all forms of support under categories of market access, domestic support and export subsidies, provides a ready made approach for addressing issues in the next negotiations.

Also, within the WTO's ongoing agenda there are other WTO agreements in areas such as intellectual property rights and technical barriers to trade, where there are issues with the potential to markedly influence trade in agricultural products. These areas will require review or further negotiations.

In the coming negotiations, to achieve benefits from agricultural policy reform, the balance of production must be reoriented from currently high support countries to low support countries. This would enable more agricultural production to take place in countries where the costs of production are lowest.

Keys to success

The key to this change is to move to a situation in which producers and consumers in all countries face domestic market prices that approach and vary with world market prices.

Target the biggest distortions

The largest benefits from support reduction would be achieved by targeting the largest support reductions toward those items with the largest market distorting policies.

Key areas include rice, wheat, feed grains, sugar and milk in Japan; wheat, feed grains, oilseeds, sugar, milk, beef and sheep meat in the European Union; and sugar and milk in the United States.

Target high levels of support

Additionally, many agricultural products in OECD countries such as the Republic of Korea, Iceland, Norway, Switzerland and Turkey continue to receive high levels of support. These levels must be reduced if the countries are to contribute to a significant reduction in world market distortions.

Address systemic issues

At a systemic level a range of issues must be addressed:

- Base periods for support reductions should be representative of 'normal' years or cuts must be sufficient to achieve actual reductions in support.
- Methods of measuring support should be agreed so that the scope for exaggerating support levels is minimised.

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The next WTO negotiations represent a moment of truth for multilateral trade reform in agriculture

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Safeguards should provide protection only against large falls in world prices or import surges that would harm domestic markets. They should not be used to exclude imports under normal world market conditions.

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The tariff-quota mechanism should be transitory, with trade eventually flowing past the beyond-quota quantity. Otherwise, tariff-quotas would be used in much the same way as the import quotas that tariffication was supposed to eliminate.

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A move toward genuinely decoupled domestic support could, in time, achieve many of the economic gains from liberalisation while allowing some level of farm assistance. For support to be effectively decoupled, the price that farmers receive for their output must be the world market price and marginal costs should not be affected by support payments. Even then, it takes time for distortions to be markedly reduced because of capacity overhangs from previous support. If farmers believe that they can change future support levels by current production decisions, support will not be minimally distorting.

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Production limiting arrangements (blue box) as currently applied lock in distorted production capacity. They are not fully decoupled. Having them fully decoupled would be an advance. If this does not occur, the support payments under such schemes must be subject to the same reductions as other forms of distorting support if distortions are to be reduced.

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The elimination of export subsidies appears to be a reasonable objective. Such an outcome would be an important feature of a successful agreement.

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Care must be taken to prevent reductions to support in one area being replaced with distorting support in other areas.

Closing comment

ABARE has estimated annual gains to the global economy of US$34 billion from reducing all forms of agricultural support by 36 per cent. With the largest share of gains going to the European Union, Japan and the United States.

These results highlight an apparent paradox with agricultural protection. Most economies gain from liberalising trade and reducing market distorting subsidies and the ones with the most to gain are those with the highest protection and largest distortions.

However, the governments of these same countries tend to be the least willing to reform, for political reasons.

The benefits from liberalisation are widespread, but adjustments are typically regionally concentrated. With liberalisation, the previous recipients of support face adjustment costs and may incur financial losses. The potential losers are visible and vocal while the more numerous gainers are widely dispersed, with individual gains often small. In addition, the links between liberalisation and the subsequent gains are not usually evident to the gainers. So domestic consensus for agricultural reform can be difficult to achieve.

The path to reform can be eased through cooperative international approaches to reduce agricultural support. If all reduce support, world prices rise and become more stable and adjustment costs are less. As others also reduce support, fears that others' subsidised products will undercut domestic producers are reduced

The next WTO negotiations represent a moment of truth for multilateral trade reform in agriculture. Much preparatory work has gone into bringing agriculture fully into the multilateral trading system. However, that work will be of limited value unless market distortions in agriculture can be reduced substantially toward levels for other major traded goods.

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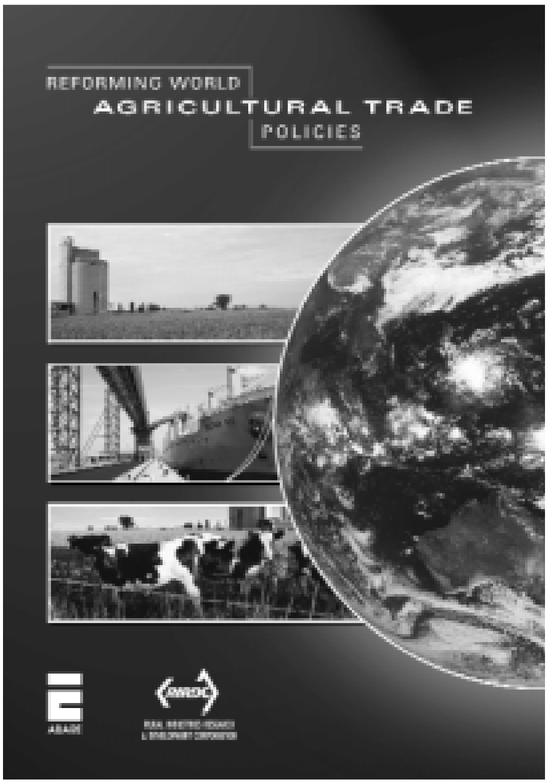

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REFORMING WORLD AGRICULTURAL TRADE POLICIES

The next World Trade Organisation multilateral agricultural trade negotiations that are to commence at the end of 1999 are of special significance for trade liberalising reform for agriculture. A framework for negotiating reductions was developed in the Uruguay Round in the mid-1990s. However, much was left, in terms of negotiating actual reductions in market distorting support, to the negotiations that commence in 1999. The coming round provides an opportunity to achieve fundamental reform of distorting policies. It is an opportunity that must not be missed.

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