



Good domestic policy is good for trade

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Outline

- Agricultural policy reform in OECD countries
- Domestic policy objectives
- Trade policy instruments to achieve domestic objectives?
- Decoupling policies
- WTO and constraints on domestic policies

Just released 23 October



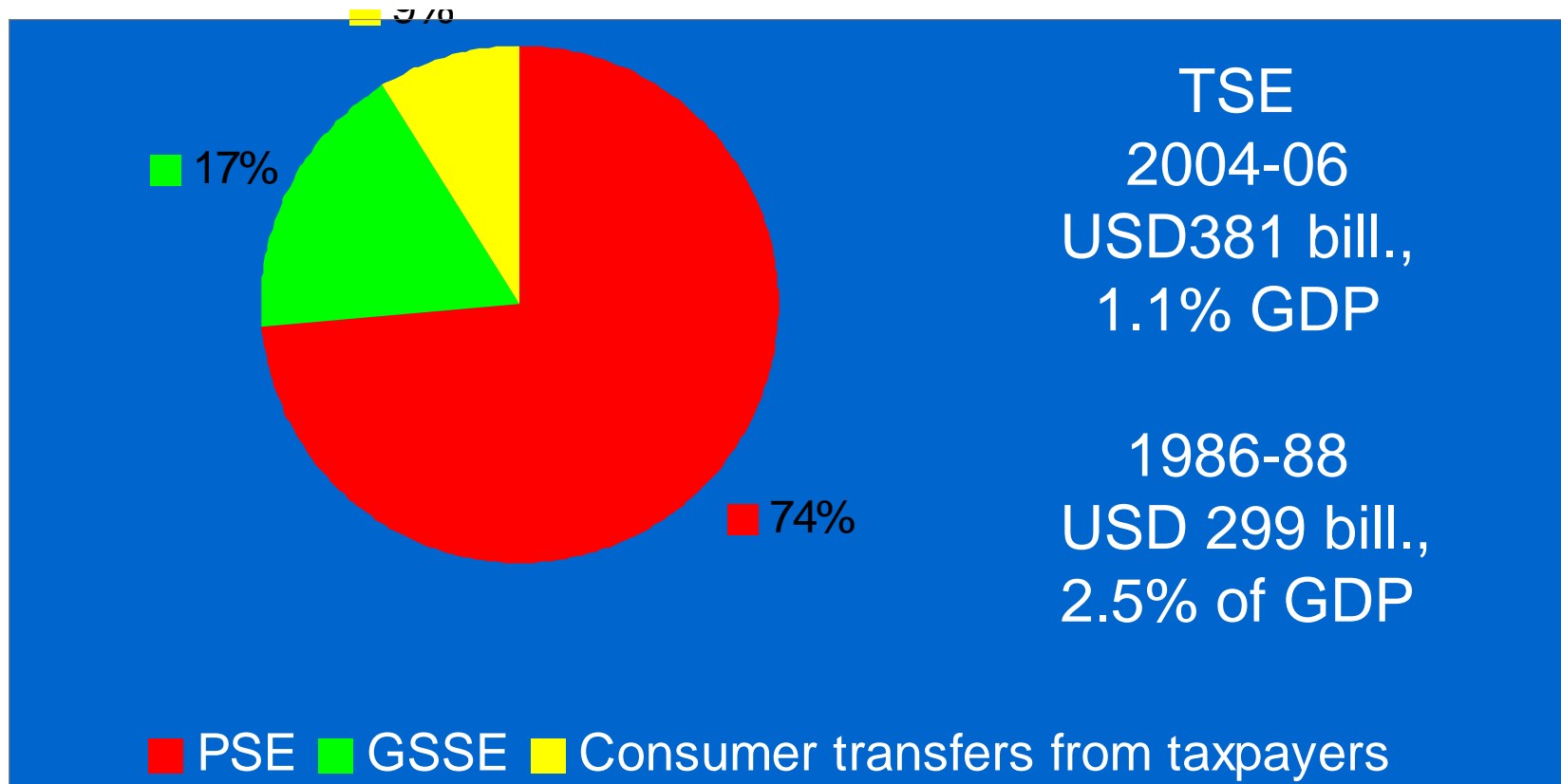
Progress in OECD policy reform

- Support gradually decoupled from production,
 - but not yet targeted to specific objectives
- Narrowing gap between domestic and world commodity prices – but great variations
- Reforms increase farmers production flexibility,
 - but biofuels policies distort markets and land use
- Overall - more market orientation, but not enough

The agricultural policy reform story in OECD members in charts

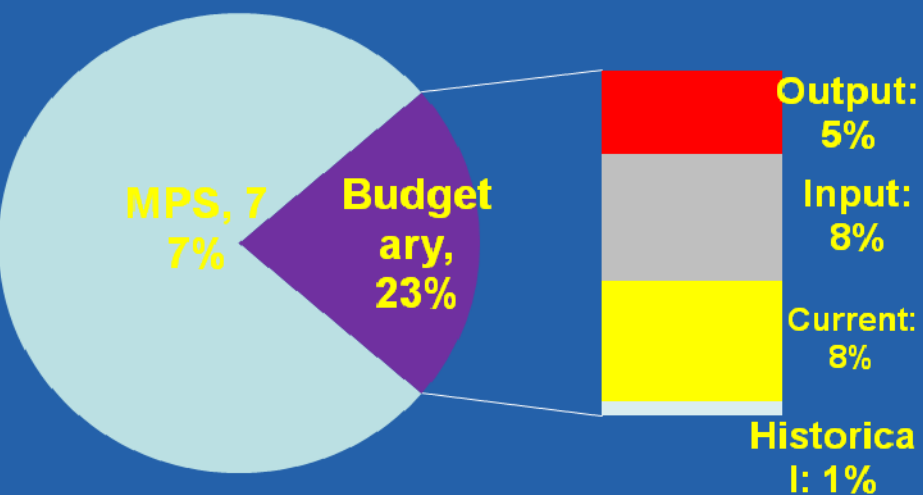
Agricultural policies: total support estimate from policies, OECD 2004-06

\$US 381 billion (1.1% GDP)

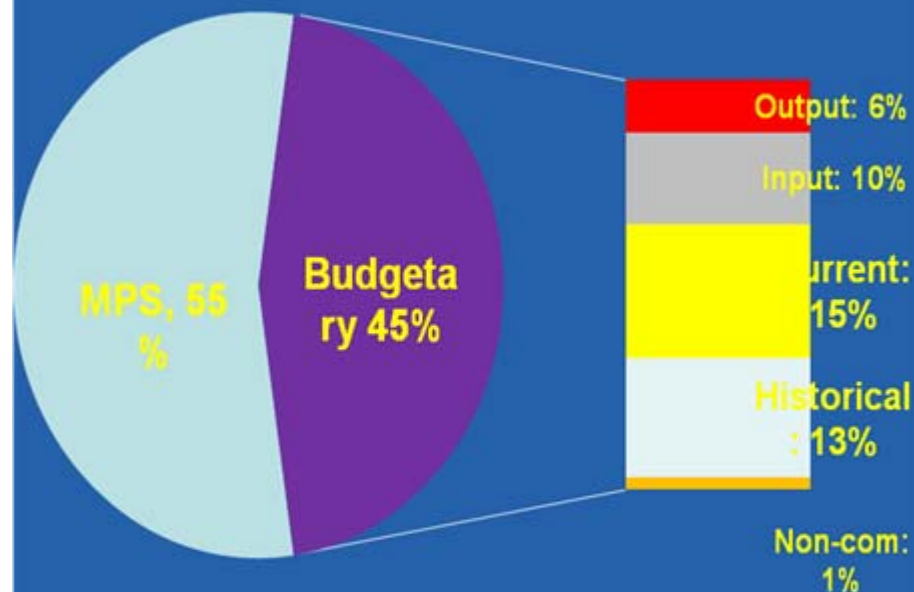


Composition of producer support in OECD countries, 1986-88 and 2004-06

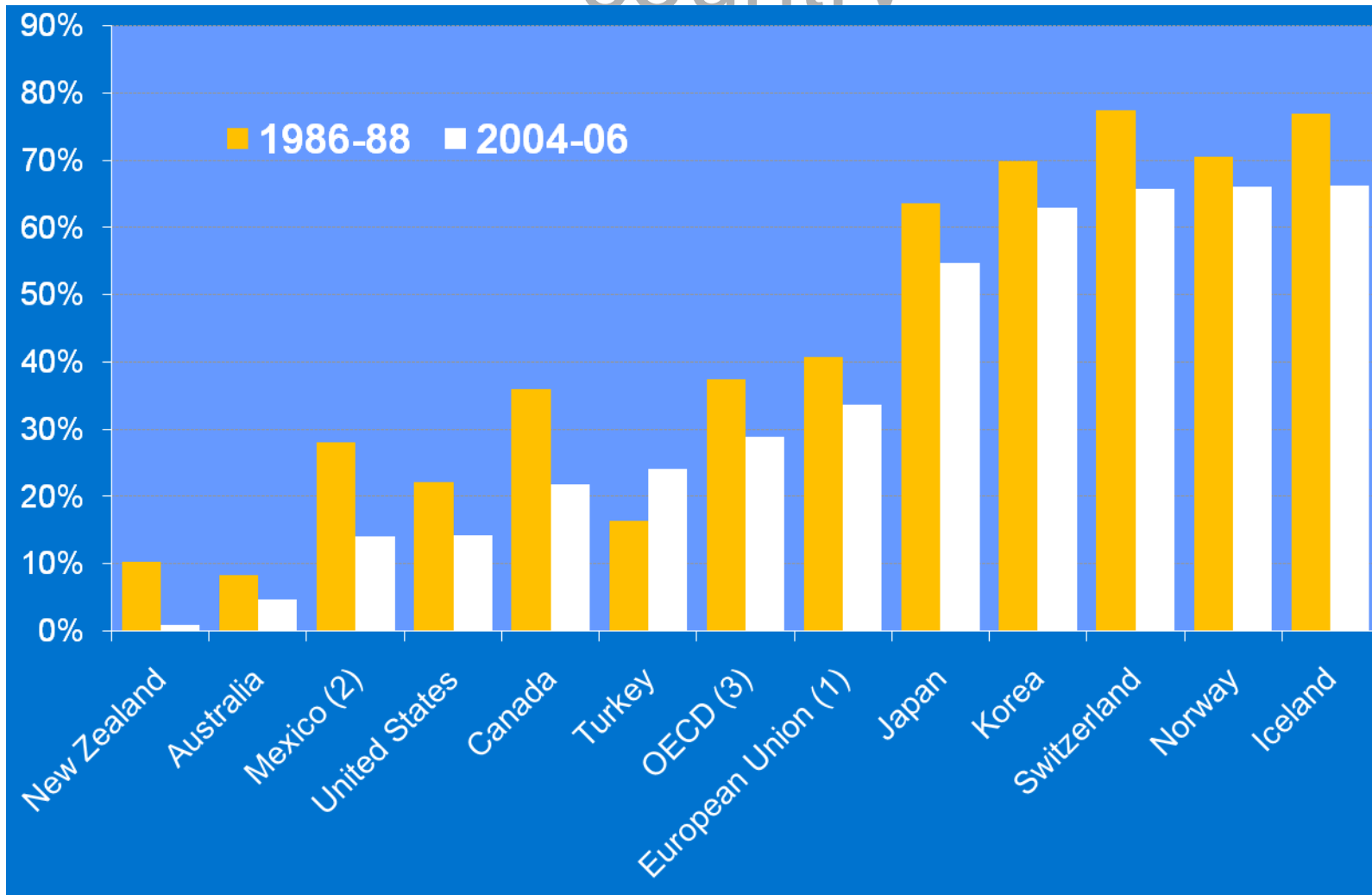
1986-88



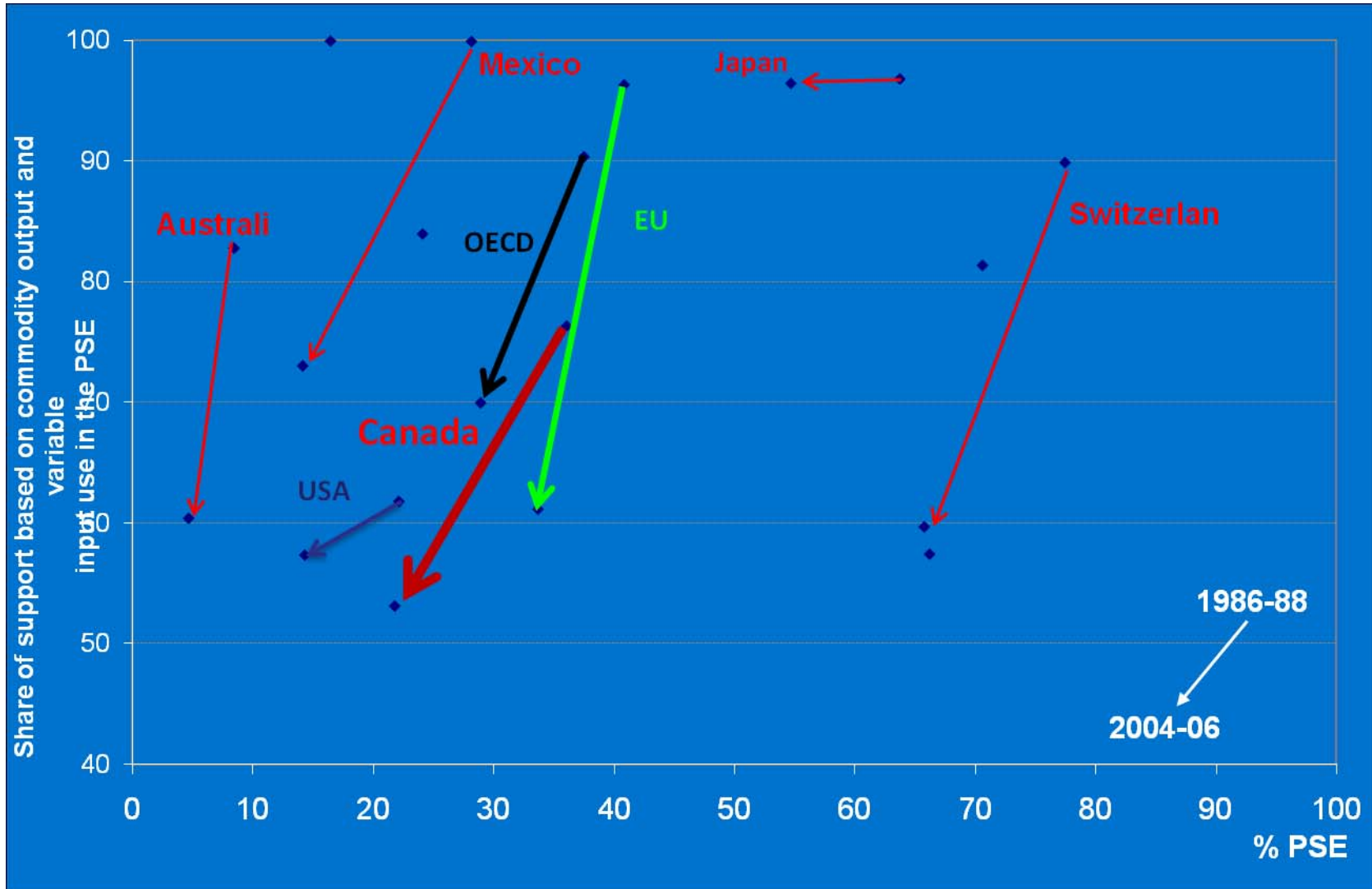
2004-06



Producer support (% PSE) by country



Mapping progress in policy reform



Domestic policy objectives

- Market access brings largest direct gains amongst the 3 pillars
- But: domestic reform is key to achieve these gains
- ... because trade policies are used to achieve domestic goals

A menu of objectives

- Classical objectives:
 - Income
 - Stable and reasonable prices for consumers
 - food security
- More recent additions to the menu
 - Food quality
 - competitiveness
 - viable rural area
 - environment, landscape, biodiversity
 - Animal welfare
 - energy security
 - cultural heritage
- Policies that restrict trade are widely used to employ domestic instruments to achieve such goals

Classical objectives and instruments

- Price support to achieve income and price objectives
- Target price (usually 50% to 100% above world price)
 - Variable tariff on imports (levy)
 - Variable subsidies on exports (restitutions)
- Intervention
 - Open ended commitment to buy

Market price support

- Encourages more supply (objective: food self sufficiency)
- Raises farm revenues and income (objective: income)
- Raises domestic food prices above world price levels
- If open-ended leads to oversupply and distorts world markets through export subsidies

MPS is inadequate farm income policy in OECD countries

- Market price support sustained through border protection is:
 - **Unnecessary:** farm household incomes in OECD countries are not generally low
 - **Inefficient:** \$ 1 of extra price support transfers only \$0.25 to farm income
 - **Inequitable:** in OECD countries the largest farms receive most support

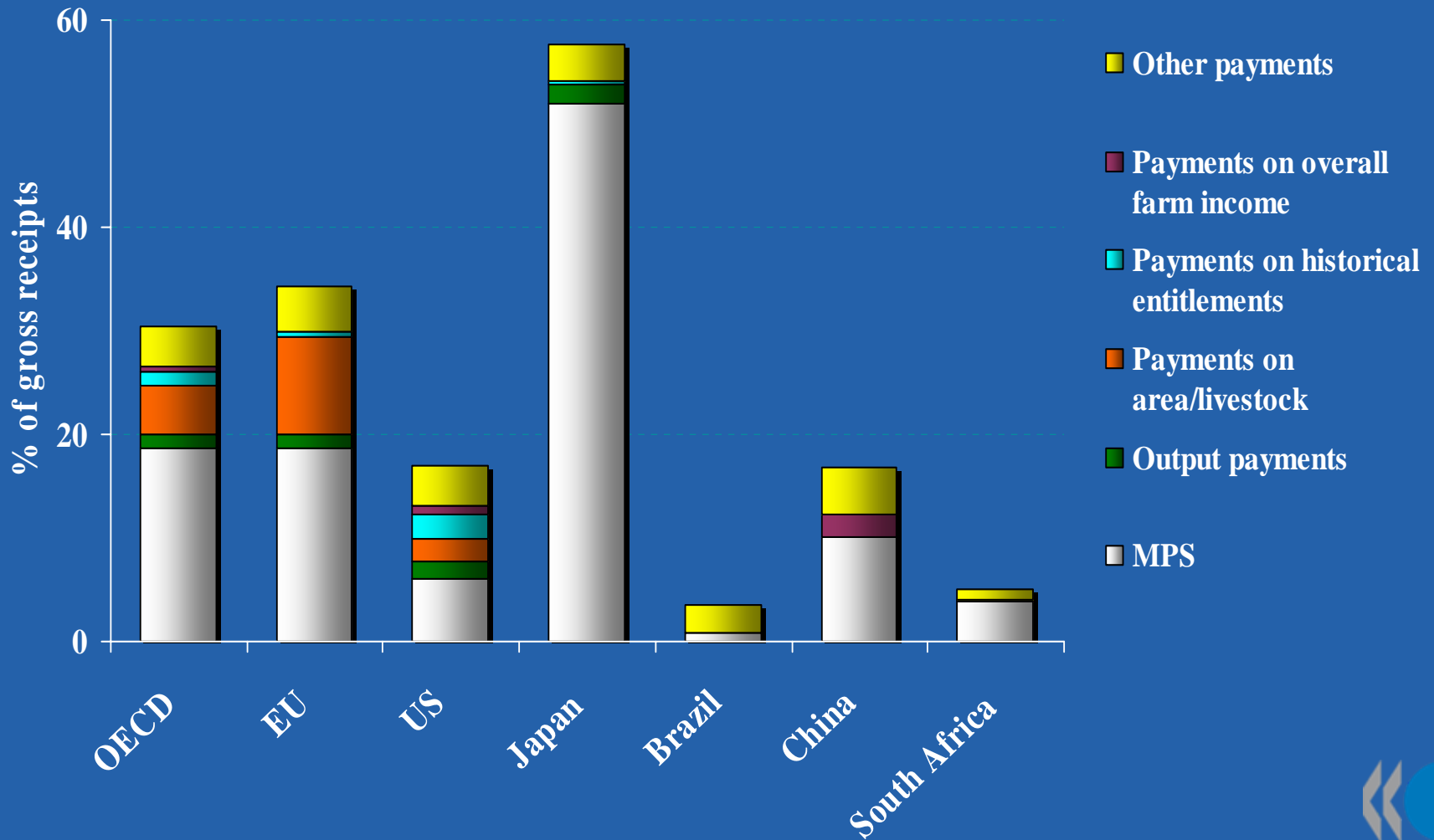
Market price support

- MPS is inefficient
 - Leakages of support to suppliers of inputs
 - ‘dead weight losses’
- But in developing countries often applied because of administrative feasibility
 - Complex domestic support schemes need complex administration
 - MPS has no visible budget implications
 - ... but large invisible cost to society

Decoupling is a move in the right direction

- Instruments (partially) decoupled from production
 - Reduce production impact
 - Reduce trade impact
 - Preserve payment levels
 - .. while allowing to address specific domestic policy objectives
- But not completely neutral:
 - Relative price effects (land)
 - Risk effects: lower downside risk of being in business
 - Dynamic effects: investment behaviour

Relative Level and Composition of Farm Support in Major Countries, 2002-04



Source: OECD

Policy reform in the EU has moved from price support to direct income support

McSharry 1992	Agenda 2000	MTR 2004
Price reductions	Price reductions	Price reductions
Full compensation through direct payments linked to area and animals	Partial compensation through direct payments linked to area and animals National envelope	Bundling of payments in single farm payment (or flat rate per hectare per region) Cross compliance National envelope Modulation

Successive reforms of EU CAP

- First 're-instrumentation' from price support to payments based on historic entitlements
 - reduce intervention price & compensate income loss through payments per area/animals
- Results in lower market prices, reduced oversupply and less export subsidies
- Then make payments conditional on other objectives (animal welfare, environment etc.) and bundle into SFP
 - Problem: member states have flexibility regarding degree of decoupling of support: 'common' policy?
- Gradually reduce real payments (enlargement) and move to rural development expenditures (2nd pillar and modulation)

EU single payment scheme

- EU Single Payment Scheme: payment to farm without tying to production requirements
 - except keeping land in Good Agricultural Condition
- Make payment conditional on other criteria: ‘Cross-compliance’
 - If not fulfilling certain environmental and animal welfare criteris => reduction of payments

US policies

- Experimented early with direct and decoupled income support
- ... but retracted in 2002 Farm Bill
- Why? Adverse market effects lead to almost habitual 'emergency' bail outs
- Farm lobby pressures

Main US agricultural policy instruments

2002 Farm Bill

- Direct payments (DPs)
- Counter-cyclical payments (CCPs)
- Marketing loans and loan deficiency payments (LDPs)
- CCPs and LDPs are commodity support programs
- Open-ended budget implications (CCPs)
- Innovative environmental & resource conservation programs

What about the new objectives?

- Decoupled support is move in right direction, but does it address :
 - Food quality
 - competitiveness
 - viable rural area
 - environment, landscape, biodiversity
 - Animal welfare
 - energy security
 - cultural heritage

?

WTO constraints on domestic policies

- Even existing URAA agreement does not significantly constrain members to pursue the menu of objectives:
 - AMS has not been binding
 - Green box allows decoupled payments
- DDA round will reduce scope for coupled support:
 - Export subsidies elimination, Amber box ceilings down
 - Green box will host increasing portions of support

Conclusions

- Domestic policy objectives are key
- Tariffs and export subsidies underpin domestic price support
- Price support is inefficient and distortive
- Output payments (deficiency payments) have very similar effects
- Decoupling of payments reduces distortions greatly
- .. and do not require border protection

- Hence: using these more efficient instruments is in countries' own interest and should pave the way towards reducing import barriers
- .. so that the potential trade liberalisation gains that the models produce can indeed be realized