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Joint Working Party on Agriculture and Trade

AGRICULTURAL POLICIES IN OECD COUNTRIES: A POSITIVE REFORM AGENDA

Note: This document is no longer "for official use", but is now "declassified".

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Foreword

This document outlines an agenda for agricultural policy reform in OECD countries. Without making judgements on specific policies in individual countries, or pre-judging negotiations at the WTO or elsewhere, it suggests ways in which agricultural policies in Member countries can further the shared goals agreed to at the OECD Committee for Agriculture at Ministerial Level in 1998. These goals correspond to several areas of consensus among OECD Member government; namely that governments should provide an appropriate framework to ensure that the agro-food sector:

- is responsive to market signals;
- is efficient, sustainable, viable and innovative, so as to provide opportunities to improve standards of living for producers;
- is further integrated into the multilateral trading system;
- provides consumers with access to adequate and reliable supplies of food, which meets their concerns, in particular with regard to safety and quality;
- contributes to the sustainable management of natural resources and the quality of the environment;
- contributes to the socio-economic development of rural areas including the generation of employment opportunities through its multifunctional characteristics, the policies for which must be transparent;
- contributes to food security at the national and global levels.

Ministers recognised that these shared goals should be viewed as an integrated and complementary whole, and that agro-food policies should seek to strengthen their inherent complementarities. In particular, the multifunctional character of agriculture was explicitly recognised. It was agreed that the challenge lay in designing well-targeted policies, in order that concerns with respect to food safety, food security, environmental protection and the viability of rural areas be met in ways that maximise benefits, are most cost-efficient and avoid distortions to production and trade.

The positive reform agenda suggested in this paper is guided by a set of policy principles also adopted by Ministers in 1998 as a way of furthering the shared goals. These principles build on the agricultural policy reform principles agreed by OECD Ministers in 1987 and reiterated by Agriculture Ministers in 1992. They include a reaffirmation of support for Article 20 of the Uruguay Round Agreement on Agriculture, which recognises the long-term objective of substantial and progressive reductions in support and protection resulting in fundamental reform, and a recognition of the need for innovative policy reforms in several areas related to both trade and domestic (non-trade) policy concerns.

Despite a broad consensus on the inherent complementarities of the shared goals, OECD Member countries have faced a number of practical difficulties in designing policies that address them according to the agreed principles. In this context, the OECD's work on multifunctionality has sought to address the practical compatibility of non trade-distorting measures with the pursuit of a wide range of domestic policy objectives. An analytical framework has been developed for determining appropriate policy responses in cases where policy objectives derive from the multifunctional character of agriculture, while ongoing work in this area seeks to provide more insight into the empirical character of these issues.

Even where empirical information is not yet complete, policy decisions need to be taken in accordance with the overall strength of the available evidence. This means that the reform agenda provides a broad consideration of the overall scope for moving towards policies under which the sector is more responsive to market price signals and trade distortions are avoided.

Policy formation invariably has to take place on the basis of incomplete information. The ongoing process of gathering information, and assessing its implications for policy, means that elements of the positive reform agenda will need to be refined and elaborated progressively over time.

EXECUTIVE SUMMARY

This paper sets out the key elements of a positive reform agenda for agricultural policies in OECD countries. Its objective is to outline ways in which Member countries can reap the gains of market-orientation and open trade, while simultaneously addressing a broad range of domestic objectives, including those related to farm household incomes, the environment, food security, food safety and the viability of rural areas. The paper is forward looking and avoids judgements of specific policies in individual countries. Without pre-empting agricultural trade negotiations, it considers the economic consequences of alternative approaches to agricultural policy reform.

A central premise is that the pursuit of multiple policy objectives is only possible if each objective is defined in an explicit and measurable way. With clear objectives, countries are in a better position to consider which policy instruments are most efficient and effective, and can be used without imposing an unfair burden on other countries. Domestic agricultural policies fall into two categories: those concerned with correcting market failures, for example by providing public goods such as cleaner environment or an attractive countryside, and those focused on the incomes of agricultural households.

To a greater extent than is currently the case, market failures could be tackled more efficiently at source, for example by charging for social costs (such as pollution) and by paying for social benefits that the market alone may under-provide (such as a pleasing countryside). There may be instances in which “jointness” between production and the provision of public goods, and administrative costs, could make this prescription impracticable. On the income side, policies not linked to production and consumption decisions can deliver targeted support to households much more effectively than sectoral solutions such as price support.

Policies to correct market failure will affect farmers’ incomes, so it makes sense to address any income concerns in the light of measures to correct market failure. In such a context, for example, shocks to income, such as those arising from policy reform, might warrant transitory decoupled payments, while cases of structurally depressed incomes could be addressed through support along the lines of economy-wide tax and social policies.

The net costs of inefficient domestic policies spill over and are magnified on international markets. Trade reform is thus essential in its own right, while broad based multilateral negotiations may have an important role to play in promoting valuable domestic reforms. The post-Doha negotiations can build on the good start made by the Uruguay Round Agreement on Agriculture.

Yet while agricultural trade reform should be of widespread benefit, not everyone will gain in the short run. To facilitate adjustment there may be a need for transitional assistance aimed at those who may be negatively affected.

In the case of non-OECD developing countries, improved access to OECD country markets would be of great benefit, along with assistance in a range of areas including export capacity building and special and differential treatment.

This paper recognises that the elements of a positive reform agenda will need to be refined progressively over time. It concludes that agricultural policy reform will improve overall economic well-being and open the door for new policy approaches which can underpin a more sustainable global food and agricultural system.

1. Introduction

This paper sets out the key elements of a reform agenda for agricultural policies in OECD countries.

The proposed agenda seeks to reconcile countries' commitments to market orientation with their desires to address a range of domestic policy objectives.

The paper distils the key policy implications from recent work...

...and considers how reform commitments might be translated into concrete action.

1. This paper sets out and discusses the key elements of a reform agenda for agricultural policies in OECD countries. The proposed agenda builds on a longstanding consensus among OECD Members; namely that there are important economic benefits to be obtained from allowing market signals to guide the allocation of resources in the agricultural sector, both through domestic efficiency gains and from an efficient pattern of international specialisation and trade.¹

2. At the same time, the proposed agenda acknowledges that the benefits of market orientation need to be reconciled with other domestic policy objectives, including those related to food safety, food security, environmental protection and the viability of rural areas. In June 2000, OECD Ministers agreed that this set of wider objectives should be pursued via policies that avoid distorting production and trade. In so doing, they acknowledged that, in principle, there is no conflict between a country's commitment to market orientation and its desire to address legitimate domestic concerns. This is because market-oriented policies typically conform to other criteria of good policy design. In particular, targeted policy measures tend to be more effective and cause fewer market distortions than blanket support. In practical terms, however, countries have found it difficult to identify how such policies should operate. Accordingly, a positive agenda for agricultural policy reform needs to consider how domestic policies that are more consistent with the principle of market orientation can be introduced and implemented.

3. To help reconcile these diverse policy concerns, this paper distils the policy implications deriving from recent OECD analyses of both domestic and trade policy interventions in Member countries. Most of the policy recommendations have already been made in existing pieces of work; others emerge from the process of connecting the separate elements. The basic objective is to produce a set of integrated policy recommendations that reflect the collective insights of a broad range of OECD work.

4. In order to suggest how agricultural reform might proceed, however, there is a need not just to compare existing policies with ideal alternatives, but also for fresh thinking on why reform has proven so intractable and what positive steps can be taken to smooth the reform process. Accordingly, the paper is organised as follows:

- Section 2 assesses the performance of domestic policy programmes. What objectives are they intended to address? How well do they perform? In the cases where they have failed, why have they done so?
- Section 3 makes the link between domestic and international policies.

¹. The origin of this consensus is the 1987 OECD Council at Ministerial Level, which adopted a number of principles for agricultural policy reform. These principles have been reaffirmed and extended through subsequent Ministerial communiqués.

What consequences have domestic policies had for international markets? Who has benefited and who has not? What progress has been made in trade reform? If progress has been limited, why?

- Section 4 maps out an agenda for agricultural policy reform. It examines how the broader benefits of well-targeted domestic policies and open international markets can be reaped, while still leaving policy-makers with the room to address key policy objectives. Finally, it tackles the most difficult subject of all. How to put such an agenda into practice?

2. Domestic agricultural policy

How extensive is agricultural support?

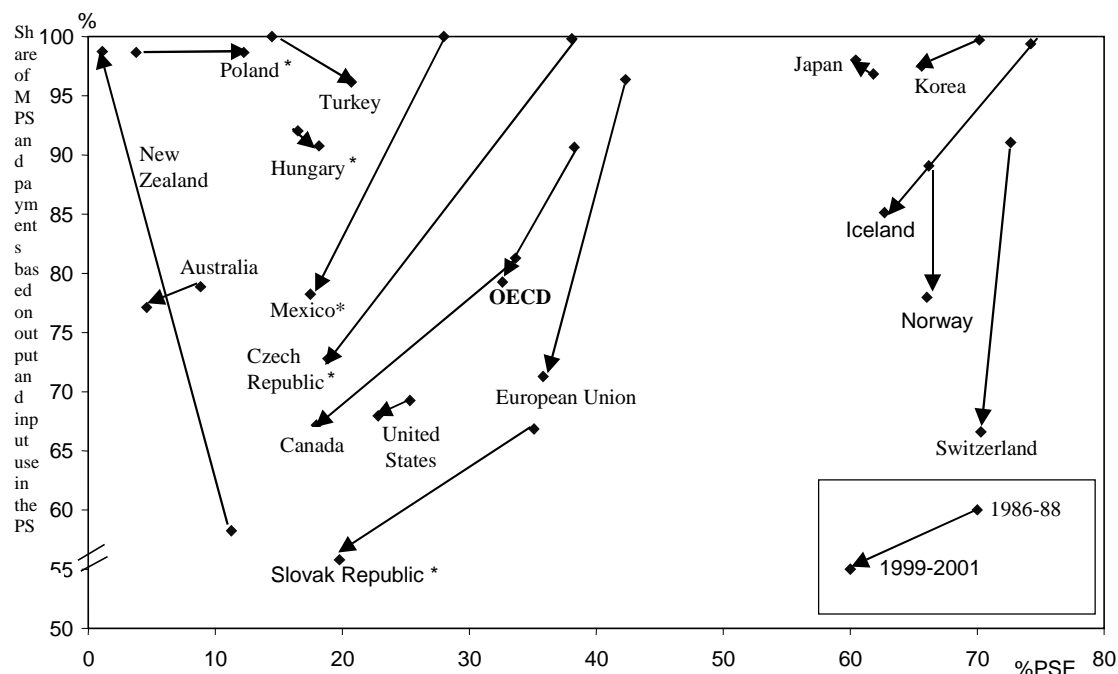
Support to the agricultural sector remains extensive...

5. OECD countries continue to provide high levels of support to the agricultural sector. In 1986-88, total transfers to the sector, as calculated annually by the OECD, cost consumers and taxpayers US\$298 billion, representing 2.3% of GDP. In 2001, the corresponding figure was US\$311 billion, or 1.3% of GDP. Three-quarters of these transfers are provided as support to farmers, accounting for one-third of their gross receipts, with general expenditures on items such as research, marketing and infrastructure accounting for the rest.

...although the extent of support varies widely across countries and commodities...

6. The level of support to producers, as captured by the Producer Support Estimate (PSE), varies widely across countries and commodities. The European Union, Japan and the United States collectively account for around four-fifths of all support, although as a percentage of the value of gross farm receipts, support is highest in Switzerland, Norway, Korea, Iceland and Japan respectively. Rice, sugar and milk are the most supported commodities, with transfers to producers exceeding 50% of gross receipts for these products. Wool, eggs and poultry receive the least support (less than 15 percent of gross receipts in all cases), with other commodities falling between these extremes. For example, support to crops averages between 40 percent and 50 percent of gross receipts.

Figure 1. Evolution of the %PSE and the share of market price support and payments based on output and input use in the PSE 1986-88 and 1999-2001



Notes: * 1991-93 average for the Czech Republic, Hungary, Mexico, Poland and the Slovak Republic.

Each point in the graph shows a combination of the %PSE and the share of total MPS payments based on output and input use in the PSE for the years covered. The point at the tail of an arrow refers to 1986-88 and the point at the head of the arrow refers to 1999-2001.

The purpose of the PSE is to measure the level of support to producers, irrespective of its nature and impacts. The PSE is a more comprehensive measure than the WTO's Aggregate Measure of Support (AMS), which includes only those forms of support agreed to be most trade-distorting. There are other differences between the two measures, notably in respect of commodity coverage, policy classification, and the measurement of market price support.

Source: OCDE, PSE/CSE database, 2002.

...and there have been some moves towards less distorting forms of assistance.

7. As Figure 1 shows, there has been some reduction in support levels and some shift away from market price support and payments based on output or input use towards budgetary payments that are less linked to production. Among the high-support countries, the European Union and other European countries have made some progress in moving away from the most distorting forms of assistance. In aggregate terms, however, output and input-related measures still account for three-quarters of all support. As countries continue to amend and in some cases redefine their policies, it is vital that there be a clear understanding of how effective this scale and composition of support is in attaining its objectives.

What are the objectives of agricultural policies?

Agricultural policies need to be evaluated relative to their

8. The starting point for an examination of agricultural policy performance needs to be a consideration of its stated objectives. For a meaningful policy appraisal to be possible, these objectives need to be framed in terms that are sufficiently explicit that the effectiveness of

objectives.

alternative instruments can be measured and compared.

9. The stated objectives of agricultural policies can be divided into two categories: those concerned with equity or distributional issues, and those designed to correct market failures. The former category relates chiefly to the incomes of farm households, while the latter refers to societal concerns (including the environment, rural amenities, land and water management, food safety and food security) where private markets alone may not produce socially desirable outcomes.

These objectives concern the incomes of farm households...

10. The need to protect or support the incomes of farm households is an accepted tenet of agricultural policy in most OECD countries. Sometimes, this is reflected formally in contemporary policy statements. In other cases, the fundamental expression of an income objective goes back several decades, to when support programmes were initiated. More commonly, however, policy-makers make informal references to their concerns about the level and/or stability of farm household incomes. Even in countries with low or minimal support, it is often determined that farmers should be protected from sharp and unexpected decreases in incomes due to factors beyond their control, and that if private contingency arrangements cannot perform this function then the government should step in.

...and the correction of market failures.

11. The market failure rationale for government intervention applies when market signals alone cannot be relied upon to produce an optimal structure of production and consumption. In this context, the most commonly advanced justifications for agricultural policy interventions are based on the existence of externalities and public goods.

The market alone cannot be relied upon to correct externalities...

12. The essence of an externality is that the decisions of one agent – be they in production, consumption or exchange – have side-effects that impinge on the interests of others. For example, farms may produce excessive nitrogen or pesticide residues (negative externalities) as well as crops; they may also produce environmental and aesthetic benefits (positive externalities). In these cases, a market-determined output level may be inefficient because of unpaid external costs or uncompensated external benefits.

...or to provide public goods.

13. Public goods (which may also be services) are goods for which the consumption by one agent does not reduce the amount available for others. Thus, whereas a private good (such as wheat) is consumed exclusively, a public good (like clean air, or a pleasing landscape) can be consumed concurrently. The market tends to under-provide public goods because this particular characteristic undercuts consumers' willingness to pay and suppliers' incentives to provide. In some cases, a public good may be a joint output, and hence an externality, of private production. The effect of farming on the countryside is one example. However, even in these cases, it may be possible to provide the public goods in question without producing more private goods. For example, it may be possible for the government to pay directly for maintenance of a pleasing countryside without also generating additional agricultural output and thereby distorting

trade.

But government intervention is not always the answer either.

14. The nature of the public good / private good distinction is not that it neatly defines a role for government. Rather, it identifies a continuum between abstract extremes along which some degree of government intervention may be warranted. Government intervention carries its own costs, and intervention would not be worthwhile if these costs exceeded any potential benefits.

A key requirement of effective policy design is that objectives should be specified separately.

15. From the standpoint of policy design, it is imperative that income objectives be specified separately from goals related to the correction of market failure. Even if the same instrument is used to address both types of objective, there needs to be some way of identifying the optimal amount of government intervention in each case. For example, it would be bad policy design to assume that a policy introduced to bring farm household incomes up to a threshold level would, by sheer coincidence, also provide for the optimal amount of any public goods.

Mixing the rationales for intervention makes measurement more difficult and reduces political accountability.

16. Mixing the two rationales for policy intervention poses a further problem. By making measurement more difficult, it effectively reduces public accountability and makes reform more difficult. For example, policy shortcomings in addressing any low-income concerns could be inappropriately supported on the basis of successes in reducing market failure and vice versa. Moreover, it detracts attention from the fact that agricultural support mechanisms have distributional implications, but the optimal allocation of support when paying for public goods may be very different. For example, the benefits of market price supports are linked to output, and hence (when there is a dispersion of farm sizes) accrue to larger farms, yet small farms may be able to provide public goods as easily as large ones.

How well do existing policies perform on the income objective?

Policy statements are seldom specific about which farm households should qualify for support.

17. Although the income objective figures prominently among the concerns of agricultural policy-makers in OECD countries, official statements are seldom clear about which households are intended to qualify for support and on what basis. In many cases, it is either stated or implied that farm households should have incomes that are comparable with incomes earned by other groups in society. A commitment to “average” incomes within the sector fails to discriminate between high-income and low-income farm households. Yet even specifying that support should be extended to those households whose incomes fall below a threshold level may not be explicit enough.

Even setting a threshold income level may not be sufficiently specific.

18. Before a commitment to support low-income farm households is made, it is important to ask *why* the incomes of these households are lower, and *on what basis* support is to be justified. For example, do low-income farmers have viable economic alternatives? If the answer is yes, then it may be worth asking whether the government should be providing income support at all. If the answer is no, then transitional assistance to some more viable economic alternative may be of greater benefit than income support.

Suppose, on the other hand, that the reason for low-incomes is simply a lack of competitiveness, but that the government is unwilling to see less efficient farmers go out of business because they provide other economic and social benefits that are not rewarded by the market. In this case, the rationale for support is provided by market failure and not by low incomes per se. The optimal policy would be to pay farmers for these benefits rather than redistribute on the basis of their lower incomes.

Not all farmers need income support.

19. A major reason for establishing explicit criteria of eligibility is that sector-wide income support is unlikely to be necessary. There are inevitably low incomes within the agricultural sector, and in some countries the farm sector has a greater proportion of low-income households than average.² Moreover, the competitive process alone implies that the incomes of less competitive farmers are under permanent pressure: prices come down in response to cost reductions and those farmers who fail to adopt up-to-date production methods will see reductions in their net income. Yet there are rich farmers as well as poor ones, and there is no evidence that farm households have systematically lower incomes than other types of household in OECD countries.³

The effectiveness of income-raising measures can be measured in terms of income transfer efficiency

20. Where income support is an objective, it is important that it be pursued in an effective and efficient way. The performance of policies intended to raise the incomes of agricultural households can be measured in terms of a “income transfer efficiency” calculation. This ratio captures the share of support that actually raises the net incomes of farm households. In an ideal world, this share would be 100%; i.e. the amount raised from taxpayers or consumers would equal the amount available for redistribution, and all the money would reach and be retained by the farmer.

Income transfer efficiency is less than 100% because of economic costs and distributive leakages.

21. Unfortunately, there are two sources of transfer loss that limit the effectiveness of agricultural policy instruments. The first is economic costs, which result from induced inefficiencies in the use of productive resources, distortions in consumption patterns, and – in the case of taxpayer financed transfers – the effect of taxation on economic incentives. The second source of loss is distributive leakages, whereby some of the benefits of support accrue to groups other than the intended beneficiaries. This latter category includes the costs of administering farm programmes, the extra payments that farmers are required to make to input suppliers or downstream industries, additional payments to landlords and income transfers to (or from) other countries. A further source of loss, excluded from the OECD calculations noted below, is leakages within the farm sector, i.e. support going to richer farm households that are outside the target group.

The results of this analysis indicate that market price support has a low income transfer

22. These losses can be added up and compared across instruments. OECD estimates of income transfer efficiency focus on the economic losses as a consequence of distortions to production and consumption decisions, and the distributive leakages that result from these distortions. This analysis

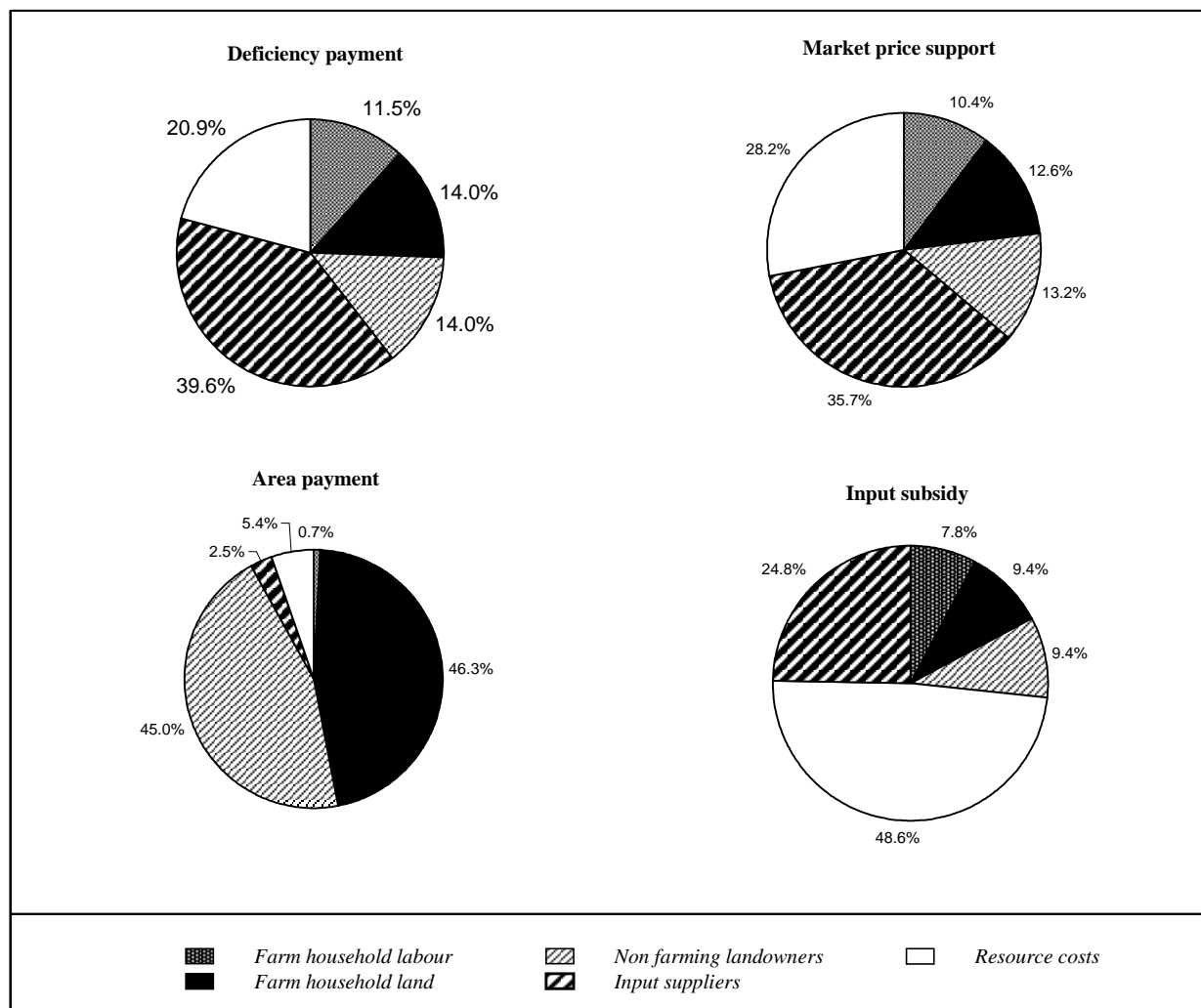
². OECD (1994), OECD (2001).

³. Ibid.

efficiency...

finds no support policy linked to agricultural activity succeeds in delivering more than half the monetary transfers from consumers and taxpayers as additional income to farm households. In the case of market price support and deficiency payments, the share is one fourth or less, for input subsidies it is less than one-fifth. Figure 2 shows OECD estimates of where the money goes for each of these policy instruments.⁴

Figure 2. Where does the money go? The income transfer efficiency of agricultural support:



Source: OECD (2002).

...as do other measures where support is linked to output.

23. In the case of market price support and deficiency payments, the stimulus to output, and hence to input demand, means that much of the increase in receipts is paid back out to input suppliers or capitalised into land values. Not surprisingly, input suppliers reap a large share of the benefits of input subsidies. In the case of area payments, nearly all the benefits are absorbed in increased land values. This raises costs for farmers

⁴. OECD (1995), OECD (2002).

buying or leasing land, thus placing a burden on new entrants. Farmers that own land do benefit, but this increase in wealth should not be interpreted as additional income, since it does not improve the long-term economic welfare of farm households as a whole.

Yet approximately two-thirds of all support in OECD countries is provided through price maintenance.

24. Despite its low income transfer efficiency, approximately two-thirds of agricultural support in OECD countries is provided through policies that keep producers' prices above levels that would otherwise prevail.⁵ A feature of all programmes based on agricultural activity is that they cannot be targeted to individual households. In the case of open-ended price support, the size of transfer is directly proportional to the level of output. This means that the majority of the support that does get through accrues to larger farmers, many of whom may have higher incomes anyway.⁶ Area payments, which effectively accrue to landowners, are of little benefit to tenant farmers, a group that often includes the poorest farm households. Extending the concept of income transfer efficiency to capture the share of benefits reaching poorer farm households, the fractions are therefore likely to become tiny.⁷

Targeted income payments have a much higher income transfer efficiency.

25. In contrast with the above programmes, direct income payments have a high income transfer efficiency, particularly if they are decoupled from agricultural activity altogether. Moreover, direct income payments can be targeted and delivered to those households that policy-makers deem to warrant assistance. Naturally, the administrative costs of such programmes still have to be factored in. These are likely to vary from one country to the next, and will depend on the institutions in place and the way that the policies are formulated and implemented. In many cases, the general tax and social security system may be better placed to identify low incomes among agricultural households and ensure equal treatment vis-à-vis other classes of household.

How well do existing policies perform in correcting market failure?

Government policies may be needed to correct market failures in agriculture.

26. Agriculture is perceived to be more prone to market failure than other sectors. In particular, farming is associated with a range of public goods and externalities. Many of these are environmental, while others, such as contributions to a pleasing landscape, come down to cultural beliefs about the contribution that agriculture makes to national life. Market failures in these areas provide a possible, but not inevitable, reason for government intervention.

As with the income objective, the question is how well do current policies address these

27. How well do agricultural policies perform in providing public goods and correcting for externalities? This question is difficult to answer, chiefly because much analysis assumes the status quo. Agricultural policies that are in place are often assumed to provide close to the optimal amount of public goods and net positive externalities. To provide a clear answer, the

5. OECD (2001a).

6. OECD (1999).

7. OECD (1996).

concerns?

following question needs to be asked: if current policies were removed, how much market failure would there be, and how much would alternative policy solutions cost?

To answer this question, the presence of market failure needs to be identified, and the effectiveness of alternative remedies compared.

28. Putting the question this way raises several issues. First, it re-emphasises the importance of separating income objectives from market failure objectives. If costs and benefits are to be estimated, there needs to be a consistent estimate of what share of the cost of agricultural programmes should be attributed to addressing market failures. Second, it implies that market failure needs to be confirmed rather than assumed. Specifically, it cannot be assumed that a market-oriented agriculture would always under-provide public goods. Third, it implies that the relevant benchmark is not the status quo, but rather the extent of market failure that would prevail in the absence of current policies. This is the reference from which alternative agricultural and non-agricultural policies should be compared. A fourth issue is that the optimal degree of intervention will depend on both the benefits *and* the costs. If the cost comes down, the optimal public good provision will be higher.

In principle, it is best to tackle market failure at source.

29. A general, and on the face of it obvious, principle of economics is that it is more efficient to address an objective directly than indirectly. Thus it is generally better to subsidise the provision of a public good than to subsidise production in order to obtain that public good in the form of an externality. In addition, since the cost of providing a public good is likely to be lower with a targeted instrument, the optimal provision of that public good should be higher. In other words, if we can save money on policies designed to provide public goods, we will choose more public goods.

But “jointness” between production and the provision of public goods, and administrative costs, could make this prescription impracticable.

30. The exception to this principle arises if the direct provision of a public good results in higher administrative and transactions cost, and those additional costs outweigh the gains from greater economic efficiency. The likelihood of that being the case increases when the efficiency gains from direct provision are small, i.e. there is a close relationship between agricultural production and provision of the public good. The key empirical questions, therefore, relate to the degree of “jointness” between agricultural production and the provision of public goods, and the relative size of administrative and transactions costs. Answers to these questions need to take account of how the degree of jointness varies from one public good to the next, and how such jointness relates to the structure and scale of production.⁸

What is the scale of market failure, and how much intervention does it warrant?

31. More fundamental than jointness is the question of whether there is a market failure issue in the first place. For example, it may be that agriculture produces a landscape that is valued socially more highly than land in other uses. But would these benefits be under-provided in the absence of government intervention? The existence or otherwise of market failure will naturally vary from one specific case to the next. But at the

⁸. Answering these questions forms a key element of the OECD’s work on Multifunctionality. See OECD (2001b).

aggregate level, OECD countries provide over \$300 billion a year on agricultural support. Is this support the source of large amounts of public goods and net positive externalities that would not otherwise be provided?

The evidence of market failures is not comprehensive...

32. In overall terms, there is a lack of comprehensive evidence on the extent to which agriculture provides public goods, and on the degree to which it is the source of net positive or negative externalities. The benefits may be identified in conceptual terms, or estimated via case studies, but there are few systematic attempts to weigh the benefits next to the costs of government intervention, or to compare the efficiency of different agricultural and non-agricultural policy interventions. In other words, there is little systematic measurement analogous to the income transfer efficiency calculations reported above.

The effect of agriculture on the environment is mixed and varies locally...

33. In the case of the environment, agriculture is the source of many externalities, especially with respect to land, water and biodiversity. Some of these externalities are positive, others negative. Over the last 10-15 years, the environmental performance of agriculture has been mixed. Nitrogen and pesticide loading in water remain relatively high and risks of soil erosion and water resource depletion persist in many regions and countries. In recent years there have been improvements in wildlife habitats, landscapes and sinks for greenhouse gases provided by agriculture, and the most significant progress has occurred where environmental pressures have been greatest. Many of the policy requirements are local and there is no one-way link between farm support and environmental benefits. In cases where there is no clearly established link, reform could release resources for environmental policies with proven and direct benefit.⁹

...while other public goods also tend to be locally defined.

34. Agriculture is also associated with a broader range of public goods, such as the provision of a pleasing landscape. Yet agriculture's role in providing these public goods may not be dependent on the scale of production. Often the agriculture responsible for the bulk of production does not produce the desired landscape and countryside. Because these public good attributes are locally defined, the appropriate degree of policy intervention is likely to vary among regions, meaning that broad-based national measures may be unnecessary and inefficient. Similar observations hold for the impact of agriculture on local rural economies. Agriculture may act as a hub for other businesses, and provide local employment. But agricultural resources, like any other, have an opportunity cost, and other economic activities may also be able to provide these benefits. And similarly, if policy measures are needed, local initiatives (such as infrastructure development) may be more appropriate.

Overall, there is scope for shifting to market-based instruments that tackle market failures at source.

35. Clearly, there are many unanswered questions about what the role of agricultural policy should be in correcting the market failures associated with public goods and externalities. The OECD's ongoing work on multifunctionality seeks to address these questions. Overall, however, only 4% of all agricultural support in OECD countries is not tied to output or input use. This suggests that there is considerable scope for shifting towards

⁹. OECD (2001c).

market-oriented instruments that identify market failures explicitly and tackle them at source. How much scope there is for moving towards targeted measures will depend on both the economic efficiency of different policy options, and the size of transactions costs associated with each alternative instrument. The appropriate pace of change will depend on how quickly and accurately policy-makers can assess the performance of new policies. In general terms, however, such a reorientation of policies not only promises cost savings, it also opens the door to a more positive agenda in respect of a diversity of policy objectives, including those related to the environment and rural communities.

How should income and market failure objectives be reconciled?

An integrated approach would address income concerns in the light of policies to correct market failure.

36. An integrated response to these two separate sets of objectives needs to acknowledge that policies to correct market failures in the agricultural sector will have a fundamental impact on the incomes of farmers. For example, if a farm is taxed for a negative externality such as polluting the environment, then the associated income may well fall. Conversely, if a farm receives payment for a public good that society recognises then income will rise. Accordingly, there is a logical case for applying measures that first correct market failures and then address any outstanding concerns about incomes. Just as specific instruments are likely to be required for different public goods, the income objective itself may require more than one instrument. Hence, shocks to income, such as those arising from policy reform, may warrant transitory decoupled payments, while cases of structurally depressed incomes may be best addressed through economy wide social and tax policies.

Markets may fail for a variety of reasons...

37. Of course, public goods and externalities are not the only potential sources of market failure. For example, markets may also produce sub-optimal outcomes when there is a lack of competition among buyers and sellers. However, this is essentially a regulatory issue, rather than a reason for support. Similarly, governments may be reluctant to place exclusive reliance on the market as a guarantor of food security, which may be threatened by a sharp increase in prices that makes food unaffordable, or by wars or embargoes that interrupt supplies. For richer OECD countries, the former case is unlikely to apply, especially if domestic prices are already much higher than world prices. Any supply interruption can be insured against via a combination of domestic production, maintenance of domestic production capacities, stockholding and access to a wide diversity of international suppliers. Exclusive reliance on domestic production may pose a bigger risk for two reasons. One is the possibility of crop failure at the national, but not international, level. Another is the fact that, in extreme circumstances, the supply of key inputs (such as fuel) may be at least as vulnerable to interruption as the supply of food. In developing countries, trade liberalisation may cause import bills to rise modestly for some countries, with a negative effect on food security. However, these impacts may be outweighed by the wider benefits of open markets in terms of higher

incomes and purchasing power.¹⁰

...some of which may warrant government intervention.

38. Similarly, concern for the incomes of farm households pertains as much to the variability of income as its average level. Regular support may stabilise farm incomes, but, in addition to its low income transfer efficiency, it also acts as a disincentive to income diversification and to private income risk management. Moreover, there are few things as destabilising as a support policy that becomes unsustainable. That said, governments may have an important role to play in the development of contingency arrangements, such as insurance and futures markets.¹¹

3. Agricultural trade policies

Why does agricultural trade reform matter?

Domestic programmes often need trade policies to hold them in place.

39. Domestic agricultural policies are fundamentally linked with international trade. The chief reason is that trade policies are often necessary to keep domestic support programmes in place. For example, a support measure that sustains the domestic price above the level at which a country can import requires an accompanying restriction on imports. Equally, stand-alone trade policies can provide the mechanism through which domestic support is maintained. When the extent of support becomes extreme, such that a country is transformed from a net importer to one with a disposable surplus, the use of export subsidies may also be required. In short, trade policies are often a by-product of domestic policies.

They also have the potential to distort trade even if explicit protection is not required.

40. Yet even if domestic policies do not necessitate the use of trade protection, they nevertheless have an impact on trade. Agricultural subsidies of any kind have some effect on the incentive to produce and therefore influence the pattern of specialisation among countries. The severity of these impacts depends on the policy instrument that is used. For example, open-ended price supports provide a direct stimulus to production (and choke off consumption), leading to a strong impact on trade. Area payments have a weaker production effect because they provide an incentive to bring additional land into production, but not necessarily to increase yield on that land. Direct income payments have a smaller impact still.¹²

These two effects compound the income losses associated with farm policies...

41. Trade policies, and the trade distortions caused by domestic policies, compound the income losses incurred due to the domestic misallocation of resources. In effect, countries forgo the benefits that derive from specialisation and trade according to the principle of comparative advantage. This principle holds that a country can gain from specialising in those goods (or services) in which its *relative* costs of production are lower than in other countries, and exporting them in return for products in which it has a comparative disadvantage. The basic case for multilateral trade

¹⁰. OECD (2002a).

¹¹. For a discussion of this potential role, see OECD (2000).

¹². For a detailed discussion, see OECD (2001d).

liberalisation rests on the potential for large global benefits if countries follow this principle. Box 1 provides a discussion of recent attempts to establish the size of these gains.¹³

...and shift the burden of adjustment onto other countries. 42. The structural propensity for agricultural productivity increases to outpace demand growth means that there is adjustment pressure at the global level. Nearly all countries have an ever decreasing share of national resources, including labour, engaged in agriculture. Trade protection cannot make this global tendency disappear; it can only shift the burden of adjustment onto other countries.

Box 1. How large are the gains from trade liberalisation?

A standard tool used by economists to estimate the income gains generated by trade liberalisation – and the distribution of those gains – is a computable general equilibrium (CGE) model. The virtue of CGE models is that they take into account the linkages between different sectors and economies, and can therefore account for the impacts that trade reforms have on the patterns of specialisation and trade. National governments, international organisations and independent researchers have all used CGE models, many of them based on the Global Trade Analysis Project (GTAP) model maintained at Purdue University in the United States.

A study undertaken by the Economic Research Service of the United States Department of Agriculture (2001) using a modified version of GTAP finds that a full elimination of all agricultural policy distortions would yield long-term global welfare gains of US\$56 billion a year.¹⁴ ABARE (2000), using its own CGE model (based partly on GTAP) finds larger benefits, estimating that a 50% cut in agricultural protection between 2005 and 2010 would lead to total welfare gains of US\$53 billion a year by 2010.¹⁵ If a 50% cut were also applied to protection of textiles, motor vehicles and other manufactures, the welfare gains would increase to US\$94 billion by 2010. A more general study published by the European Commission (1999) uses GTAP to consider the impact of across-the-board reductions in border protection in all sectors and all countries. This study finds that a 20% global cut in protection, accompanied by a modest amount of trade facilitation (reducing transactions costs by 1%), would yield annual welfare gains of US\$220 billion.¹⁶ These gains jump to US\$400 billion a year in the case of a 50% cut. The results are similar to those of the World Bank (1999), which finds gains of US\$260 billion a year from the liberalisation of all goods markets.¹⁷

These estimates provide context for the narrower results of the OECD's Policy Evaluation Matrix (PEM) model (2001), which considers the benefits to producers, consumers and taxpayers of a 10% reduction in support to crop producers in Canada, the European Union, Japan, Mexico, Switzerland and the United States. The PEM model estimates that such a modest reform package would produce annual welfare gains of US\$2.6 billion.¹⁸

The above model estimates are difficult to compare. Even when the same CGE model is used, different liberalisation scenarios are applied and policies may be modelled in different ways. Nevertheless, some common points stand out. First, the potential gains from agricultural trade reform are large. Second agriculture accounts for a substantial share of the total potential gains from economy-wide trade reforms. Third, most countries are likely to benefit, while some of those net food importers that lose from agricultural reforms may nevertheless benefit from a broader liberalisation package. Fourth, developing countries would be major beneficiaries, although a small number of net-importers and highly specialised exporters may lose out, in the absence of appropriate adjustment strategies and assistance.

Some policy-makers, notably in developing countries, have questioned the robustness of these results, on the grounds that similarly large gains were also predicted prior to the Uruguay Round yet have failed to materialise. However, as this paper points out, the Uruguay Round Agreement resulted in much more modest reductions in actual protection than were originally envisaged. For the estimated benefits to be realised reductions in actual protection levels would need to be of the magnitudes assumed in these analyses.

¹³. Naturally, these models, like any other, are limited by the assumptions that they make, such as those of perfect competition, and the absence of positive or negative externalities, or public goods.

¹⁴. USDA (2001).

Trade reform causes adjustment stress in sectors that formerly benefited from protection.

43. Yet, as with domestic policies, some people benefit from trade intervention despite the aggregate losses. From the standpoint of reform, the withdrawal of protection is likely to be more keenly felt by its recipients than the gains are likely to be appreciated by the rest of society. However, as noted in the previous section, the benefits from supporting prices above world market levels do not all accrue to farm households, while many would be able to mitigate the impact of lower prices by further diversifying their income sources. That said, it is important to acknowledge that trade reform does cause stress in sectors that do not have a comparative advantage, and that some government policy may be necessary to smooth the process of transition and ensure adequate incomes for those with few viable economic alternatives. These policies should ideally follow the principles set out in Section 2.

Caveats to free trade arguments have few practical implications for agricultural policy.

44. Qualifications to the arguments for free trade have sometimes been used to question the case for agricultural trade reform. These arguments include possible gains from subsidisation based on economies of scale and imperfect competition. In these cases, however, the possible benefits of protection must be weighed against the efficiency gains that come from increased exposure to international competition. Moreover, the theoretical benefits of protectionism often hinge on the assumption that the protecting country still has access to a broadly open trading environment. Such a view is at odds with the principle of the common good, and unsustainable globally. Empirically, these arguments have been shown to have little validity for agriculture (most agricultural markets are relatively price competitive). Indeed, most studies, including the general equilibrium applications in Box 1, suggest that the majority of countries would gain from unilateral as well as multilateral trade reform, due to the more efficient allocation of domestic resources.

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15. Freeman, F., J. Melanie, I. Roberts, D. Vanzetti, A. Tielu and B. Beutre (2000).
 16. European Commission (1999).
 17. Anderson, K., B. Hoekman and A. Strutt (1999).
 18. OECD (2001e).

Box 2. Agricultural trade liberalisation and the environment¹⁹

An important concern for agricultural policy-makers is that the economic benefits of more open trade in food and agricultural products should not occur at the expense of the environment. How well founded is this concern and how should policy-makers respond?

In the first place, it is important to recognise that a reduction in trade barriers will affect the environment in a number of ways, both beneficial and harmful. These impacts occur through changes in the scale of economic activities, the structure of production in different countries, the mix of inputs and outputs, and in production technologies. Some of the impacts are felt domestically, for example groundwater and surface-water pollution from fertiliser and pesticide run-offs, and changes in land-use that affect landscape appearance, flood protection, soil quality and biodiversity. Others occur internationally, such as trans-boundary spillovers (like greenhouse gases), changes in international transport flows, and the potential introduction of non-native species, pests and diseases along with agricultural imports.

The first challenge is to measure these various effects. This is a difficult task, as the wide diversity of agricultural production systems, natural conditions and regulatory approaches means that environmental impacts will vary between countries, regions and locations. Indeed, many environmental impacts are site-specific. The available evidence suggests that lower trade barriers will cause production intensity to decrease in countries with historically high levels of fertiliser and pesticide application, relieving environmental stresses in these areas. At the same time, output intensity is likely to increase in countries that can accommodate more agro-chemicals relatively easily, owing to low levels of fertiliser and pesticide application. Against this overall improvement, some impacts are likely to be negative. For example, projected increases in ruminant livestock numbers as a result of economic growth could lead to substantial increases in methane emissions in some OECD countries.

Policy-makers will seek to reap the positive environmental impacts of reform, while mitigating the negative ones. In general, the appropriate policies are likely to conform to those prescribed in the case of market failure generally. Where trade improves the environment through positive (or fewer negative) externalities, the benefits of further reform are clear. In the case of additional negative externalities, there may be a need for policy measures that redress these impacts. In general, this is more likely to involve correcting the externality at source, for example by taxing or regulating production practices, than by erecting trade barriers. In the case of global public goods (e.g. biodiversity) or bads (e.g. greenhouse gases) national policies may need to be complemented by international environmental agreements, such as those covering ozone depletion, biodiversity and climate change.

There are also concerns that increased agricultural trade may threaten the environment and undermine food safety standards.

45. There are also specific concerns about the possible consequences of increased trade in agricultural products. Some of these reflect a broader fear about the implications of globalisation; namely that an expansion in commercial trading opportunities may threaten vital societal interests. In the context of agriculture, two key areas of such concern are the effects that increased trade in food and agricultural products may have on the environment, and that additional trade could undermine food safety standards. The nature of these concerns, and possible policy responses, are addressed in Boxes 2 and 3 respectively.

¹⁹. For a more detailed discussion, see OECD (2001c).

Box 3. Agricultural trade liberalisation and food safety²⁰

Governments in OECD countries face the difficult task of making sure that their commitments to open trade in food and agricultural products do not compromise the safety of the food supply.

Food safety regulations in the form of technical standards, rules and procedures provide the mechanism through which governments protect consumers. These regulations can have both positive and negative effects on trade. They can enhance trade by increasing consumer confidence in imported products, and by establishing a clear set of procedures for exporters. On the other hand, there are concerns, prompted by the accelerating use of such measures, that they may also be used as a pretext for trade protection.

The WTO Agreement on the Application of Sanitary and Phyto-Sanitary Measures (the SPS Agreement) maintains the sovereign right of governments to provide the level of protection of plant, animal and human health that they deem appropriate. At the same time, it seeks to ensure that this right is not misused for protectionist purposes. Accordingly, WTO members are encouraged to adopt international standards when designing their policies and to recognise other country's compliance procedures as equivalent to their own, if the same level of sanitary and phytosanitary protection is achieved. Countries wishing apply a higher level of protection than international standards are required to base their measures on a scientific risk assessment.

One practical difficulty is that countries use a diverse range of technical measures to address their food safety concerns, including labelling requirements; rules on testing, inspection and quarantine; specifications on product characteristics; and prohibitions of imports. The trade effects of these measures vary considerably, making it difficult to determine whether a given degree of safety is provided with the minimum disruption to international trade. As a consequence there is a need for governments to understand better the possible trade effects of alternative regulatory systems and to work towards greater harmonisation of adopted measures.

Work in the OECD has sought to address these needs, initially by documenting the evolution of food safety systems and emerging concerns, and more recently by initiating analytical work on the economic and trade aspects of food safety issues. These efforts are intended to complement, and not duplicate, the activities of organisations with recognised responsibilities for food safety, in particular FAO, WHO, Codex and the WTO.

How will agricultural trade reform affect developing countries?

Agricultural trade reform is a major issue for most developing countries.

46. According to World Bank estimates, around 1.2 billion people live on less than one US dollar a day. Nearly 3 billion people, or half the world's population, get by on less than two dollars a day. OECD countries clearly need to respond to the huge development challenge these numbers represent. This will involve paying close attention to the prospective impacts of agricultural trade reforms. In general, the poorer the country, the more important the agricultural sector. Agriculture accounts for 35% of GDP in least developed countries, compared with 17% in lower-middle income countries and 8% in upper-middle income developing countries.

In principle many should benefit from improved market access...

47. In principle, agricultural trade reform should bring down the estimated USD16 billion that OECD countries collect in tariff revenues from developing countries and provide an important springboard for export-led growth in these countries. In practice, however, there is doubt over whether these potential benefits will materialise. The Uruguay Round led to only a modest reduction in actual protection levels, and hence did not improve market access for developing countries very significantly. A task

²⁰.

For a more detailed discussion of these issues, see OECD (1999a) and (2000a).

for ongoing and future negotiations is to create better opportunities for developing country exports of food and agricultural products. At the same time, import barriers are only one side of the equation. For developing countries to benefit from lower protection, they also need to overcome a wide range of capacity constraints that implicitly tax exports. These include everything from a lack of finance to poor infrastructure and port facilities.

...but the costs of adjustment cannot be ignored.

48. Against these potential benefits, agricultural trade reform is likely to impose costs on some groups, including exporters who have benefited from preferential market access, and consumers who have effectively been subsidised, either directly through OECD export subsidies or indirectly via policies that have boosted supplies on world markets. On the first count, the short term costs of reform are undeniable, but need to be set against the efficiency losses that have resulted from not having to compete with rival exporters, and from having local production systems undermined by the disposal of OECD country surpluses. For some commodities, it is also doubtful whether the induced specialisation (often based on former colonial ties) has been good for broader based development. On the second issue, it is unlikely that the subsidisation of food consumption provides an effective means of targeting the needs of the poor.

The economic substance of these concerns, and their political implications, present major challenges to OECD countries.

49. Nevertheless, a number of developing countries fear that a trade reform package similar to the Uruguay Round will result in more costs from higher import bills than benefits through improved market access, and that the complicated distributional effects of reform will end up hurting the poor. This fear is amplified by the perception that the adjustments in policy required by WTO rules do not give sufficient consideration to the specific concerns of developing countries, and that the process of negotiating and implementing a trade agreement has favoured high-income OECD countries with greater resources.²¹ For economic and political reasons, OECD countries need to ensure that developing countries do indeed benefit from a prospective multilateral agreement. The scale of the challenge is enormous. By 2025, the world's population will have grown from 6 billion to 8 billion. Nearly all the additional 2 billion will live in what are now developing countries, most will be born in rural areas and many will become farmers. Some ways in which the concerns of developing countries may be addressed are suggested in Box 4.

²¹. These concerns were addressed in OECD (2000b).

Box 4. What can OECD countries do to ensure that the concerns of developing countries are accommodated in a prospective WTO agreement?

The need for trade negotiations to take account of the specific concerns of developing countries features prominently in the 2001 WTO Ministerial Declaration from Doha. What can OECD countries do to ensure that these concerns are properly reflected in a prospective WTO agreement?

Developing country exporters have a strong interest in obtaining improved access to food and agricultural markets in OECD countries. The fundamental importance of market access is recognised by several proposals to grant tariff-free access for all imports other than arms from least developed countries. These proposals are likely to produce tangible benefits to the extent that they are co-ordinated with efforts to enhance productivity and strengthen trade capacity. The OECD's Development Assistance Committee has recently produced a set of guidelines, one aim of which is to ensure greater policy coherence in this area.²² The more immediate beneficiaries of increased market access are likely to be middle-income developing countries with existing supply capacity, and it is important that these countries also benefit from improved export opportunities.

The concerns of import-competing sectors within developing countries are very different. The WTO commitments of developing countries allow for some flexibility in the setting of tariffs within bound rates, and this may dampen the immediate shocks of the reform process. However, many developing countries feel that these flexibilities were not constructed on the basis of their development needs, and that there is a strong need to reconsider the appropriateness of existing WTO provisions. A recent OECD study suggests several ways in which the specific concerns of developing countries could be addressed more systematically.²³ These include a consideration of which countries have developing country status and whether countries should progress from developing country status, and whether special safeguards should be made more effectively available.

Finally, there is a need to account for how the impacts of agricultural trade reform are felt at the household level. Who is made better off? Who is made worse off? What approaches to adjustment would best serve the interests of those households who may lose out, either through higher food bills or from having to compete with more efficient suppliers? How can OECD countries help developing countries converge on a pattern of specialisation and trade that enables them to build on their comparative advantage, and can simultaneously underpin sustainable economic growth? These are complicated policy questions, but – given the prospect of large aggregate gains – ones that need to be addressed in the context of a more open agricultural trading system, rather than through a second-best approach of protecting established trading patterns.

Achievements of the Uruguay Round

The Uruguay Round provides a benchmark for assessing progress in agricultural trade reform.

50. Given the predominantly harmful impacts of agricultural trade policies, and the trade distorting potential of domestic policies, it is important to consider what progress has been made in reducing agricultural protection, what still needs to be done, and how reform might be pursued in a multilateral context. The benchmark for such an assessment is the Uruguay Round Agreement of 1994.²⁴ This agreement represented the first time that agricultural policies were subjected to multilateral rules and disciplines. Under the Uruguay Round Agreement on Agriculture (URAA), bound tariffs replaced non-tariff import barriers; countries were obliged to open closed markets; export subsidies were curbed; domestic programmes were categorised on the basis of their potential to distort trade; and the most

²². OECD (2001f).

²³. OECD (2001g).

²⁴. For a detailed assessment, see OECD (2001h).

trade-distorting forms of support were disciplined.²⁵

51. In order to assess the extent of progress in containing the damaging impacts of agricultural policies, and to make practical suggestions regarding how these impacts might be limited, reforms are considered under the three categories established by the URAA; namely, market access, export subsidies and domestic support. Reforms in the first two categories were designed to limit the use of explicit trade measures; those in the third to restrict the trade distortions caused by domestic policies.²⁶

Market access reforms

Tariffication was a major accomplishment of the Uruguay Round.

52. A major achievement of the URAA was that agricultural trade among WTO members became subject to a tariff-based regime. Tariffs have a number of important advantages over non-tariff barriers. They are more transparent, less discriminatory when applied uniformly, easier to reduce and less susceptible to corruption. They also impose fewer economic distortions by allowing world price changes to be transmitted onto domestic markets.

However, many countries bound their tariffs at high rates.

53. In contrast with the industrial sector, all agricultural tariffs are subject to upper (“bound”) limits. However, many OECD countries bound tariffs at rates above the equivalent rate of protection in the 1986-88 base period from which reductions were mandated. In some cases, this meant that countries could meet their commitments while actually increasing protection. In any event, the combined requirements that countries reduce average bound tariffs by 36% over the implementation period on a simple average basis, and by a minimum of 15%, meant that reductions on sensitive items could be kept to the minimum.

Agricultural tariffs have thus remained high, particularly on sensitive products.

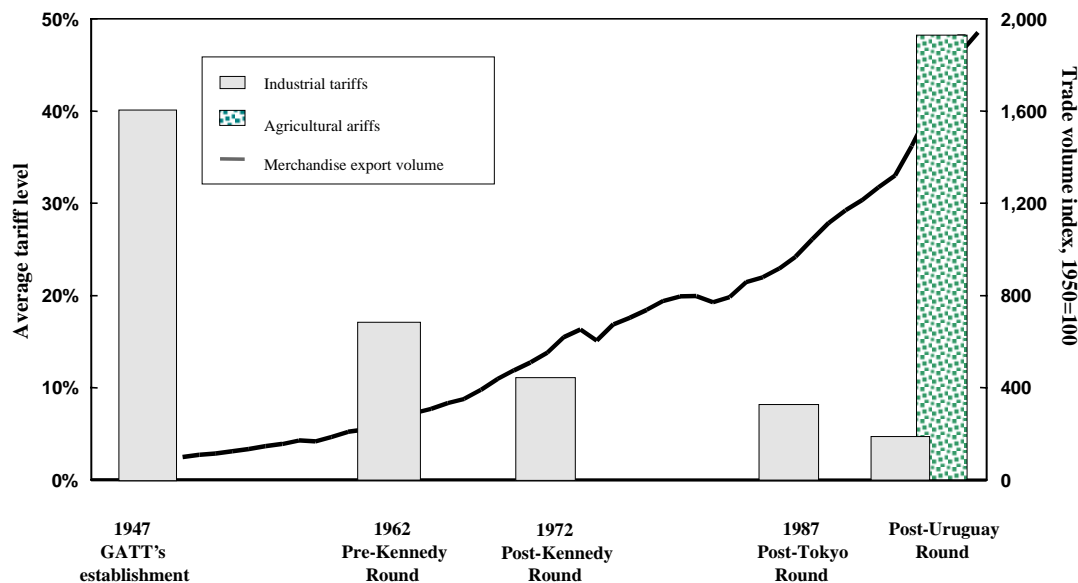
54. The combination of high levels of protection before the Uruguay Round, and the scope for establishing high bound tariffs, has meant that mean bound tariffs are generally higher for agriculture than for industry. For OECD countries, the average bound tariff for agricultural products is 60%, compared with an average bound rate of 5% for industrial goods. At the global level, agricultural tariffs remain higher than industrial tariffs were when the GATT was founded in 1947 (Figure 3). Only Australia, Canada and New Zealand have tariffs that are lower in agriculture than in industry. In addition, most countries have very high tariffs on sensitive items – in some cases as high as 500%. Only Australia, the Czech Republic, Hungary, the Slovak Republic and New Zealand have all agricultural tariffs

²⁵ . The formal provisions of the Uruguay Round Agreement on Agriculture are summarised in OECD (2001h). Agriculture was also affected by a number of other aspects of the Uruguay Round Agreement. Agreements were reached on the application of SPS and TBT regulations, with the aim of forestalling the use of such measures for purposes of trade protection. Other agreements having an effect on agriculture included those covering dispute settlements and the use of countervailing measures. In addition, the existing articles of the General Agreement on Tariffs and Trade remained both operative and applicable to agriculture.

²⁶ . This assessment draws on information contained in OECD (2000b) and OECD (2001h).

below 150%. Preferential trade at lower tariffs may be important for some countries. For example, a large share of the European Union's agricultural imports comes from countries with which it holds preferential trade agreements.

Figure 3. Tariffs and the growth of international trade



Source: OECD (2000b)

High bound rates have in some cases provided a target for protectionist pressure.

55. The setting of bound rates that were higher than applied tariffs has, in some cases, opened the door to a reversal of reforms. For some EU applicants, high bound rates meant that applied rates could converge upwards to those in the European Union without causing countries to violate their commitments. Moreover, once established, a high bound rate can become a target for protectionist pressure.

The use of different tariff systems makes measurement and comparison difficult.

56. The use of different tariff systems has made measurement on a comparable basis across countries difficult. For example, Australia, Mexico, Turkey, Japan, Korea, New Zealand and Iceland apply predominantly ad valorem tariffs to agricultural products. In contrast, specific or compound (i.e. mixed ad valorem and specific) tariffs are dominant in Switzerland, Norway and the United States, and common in the European Union and Canada. Ad valorem tariffs are more transparent than specific (or compound) tariffs in the sense that they are easier to compare across countries and commodities. One source of difficulty is that the ad valorem equivalent of a given specific rate depends on the world price and the exchange rate, each of which may vary considerably from one reference period to the next.

Ad valorem and specific tariff systems each have

57. While ad valorem tariffs may have their advantages, several factors need to be borne in mind. First, a change in the tariff regime might

their strengths and weaknesses.

enable countries to set new ad valorem rates that are higher than the ad valorem equivalents of the specific rates in place. Second, importers may be able to reduce their duty payments by declaring a traded price that is lower than the actual price paid. This kind of under-invoicing can be difficult to monitor, particularly in the case of intra-firm trade. Together these factors are likely to increase administrative costs. Furthermore, if the price of a commodity increases, then so, in absolute terms, does the amount of duty. The tendency for prices and duty payments to move together may therefore contribute to instability in the purchased prices of imports. For developing countries, on the other hand, an advantage of ad valorem tariffs is that, unlike specific tariffs, they do not discriminate against lower quality exports. This consideration is particularly important for those commodities where prices vary widely according to quality (notably livestock and horticultural products) and for processed food products.

Tariff rate quotas were necessary to administer minimum access requirements, but have compromised the benefits from tariffification.

58. In many cases, a two-tier tariff rate quota (TRQ) system has been necessary to administer the Agreement's minimum and current access requirements. Under this system, a limited volume of (within-quota) imports enjoys access at a lower rate, with above quota imports subject to a higher (potentially prohibitive) rate. The within quota volume is determined by current access or minimum access provisions. The TRQ system used to administer minimum access provisions left scope for discretion in the allocation of within-quota volumes and so retained a number of the drawbacks of quantitative restrictions.

One problem has been low fill rates for within quota volumes.

59. About 65% of TRQs are under-filled, with more than one-quarter less than 20% filled.²⁷ This suggests that the current and minimum access provisions of the URAA have not had all of their intended effects. Low TRQ fill rates may be a result of the mechanism according to which the right to import is determined. Several methods are used for administering tariff-quota allocations, including: uniform applied tariffs (where the higher over-quota tariffs are not applied); the issuing of import licences on demand; a first-come-first-served system; historical import shares; various types of auction; and purchases by state trading enterprises (STEs), producer groups or other associations. In principle, there should be a broad policy interest in systems that are transparent, non-discriminatory, and do not induce rent-seeking or additional costs on the part of exporters. Auctions are transparent and equitable and should, in theory, minimise the trade distortions inherent in TRQ systems. Yet, for TRQs established under the URAA, auctions have on average had one of the lowest fill rates, suggesting that other factors (such as participation costs) may also be important.

Contingency measures were offered as a quid pro quo for tariffification, which effectively denied them to developing

60. The special agricultural safeguard (SSG) was designed to address disturbances to domestic markets that might arise from the removal of non-tariff measures, either via import surges or world price declines. Countries were entitled to claim the SSG for those commodities which underwent tariffification, with the consequence that about 15% of all tariff lines are eligible for the SSG. In practice, this measure has been used lightly (not

²⁷ .

OECD (2002b).

countries.

least because many tariffs remain very high), suggesting that fears of market disruption were overstated. One issue is that developing countries, which are often more vulnerable to market disturbances, typically do not have access to the SSG, because most used simple tariffs prior to the conclusion of the Uruguay Round.

A number of other market access issues were not addressed substantively by the URAA.

61. A number of other market access issues were not addressed substantively by the URAA. These include the tendency of tariffs to escalate according to the degree of processing undertaken and the potential of state trading importers to impede market access.

These include tariff escalation...

62. Tariff escalation is a significant problem for countries that would otherwise have a comparative advantage in semi-processed and processed food products. All tariffs limit export opportunities, but escalating tariffs further discriminate against value added products. The extent of the problem varies widely from country to country and across commodities. Overall, however, there is general evidence of tariff escalation in OECD countries, and this stands out in particular product groups, notably, coffee, cocoa, oilseeds, vegetables and fruits and nuts. In general, tariff reductions on agricultural products exceeded reductions on processed food products in Australia, Canada, the European Union and Mexico.²⁸ On the other hand, the reverse was true in New Zealand. Article 11 of the URAA states that an export subsidy on an “incorporated” primary product cannot exceed the subsidy payable on the primary product. There is no comparable rule for tariffs.

...the potential of state trading enterprises to restrict imports.

63. From a trade policy standpoint, the concerns about state-trading importers relate to their potential to restrict imports. There are several ways in which they may do this. For example, they may fail to purchase the full volume of a TRQ allocation, or import products of a quality that complements rather than competes with domestic supplies. From a legislative standpoint, it is instructive to distinguish the activities of STEs from the policies that they implement on behalf of their governments. In this respect, a situation whereby STE purchases result in TRQ underfill may be no different from other causes of underfill. It may reflect a lack of import demand; equally, it may be due to a deliberate government policy to limit imports. On average, STE purchases exhibit the highest rate of quota fill among all the TRQ allocation mechanisms. In general, there is no universal critique that applies to all STEs. Their activities are of interest to the extent that they impede market access and thwart competition.²⁹

64. If market access is to be improved further, each of the above concerns will need to be addressed. The precise mechanisms through which tariff reductions and TRQ reforms should be effected are the subject of ongoing negotiations at the WTO. The economic characteristics of alternative possibilities have been examined in previous OECD

²⁸ . OECD (1997).

²⁹ . OECD (2001i).

publications.³⁰

Reforms on export subsidisation

Commitments on export subsidies were more restrictive than other disciplines.

65. Export subsidies have been prohibited for non-agricultural products since the late 1940s. Their use continues in agriculture, although the URAA imposed limits on their application. The cuts mandated by the URAA made the export subsidy disciplines the most binding of the three sets of disciplines, even though few countries needed to change their policies in order to conform with the requirements. The European Union alone accounts for approximately 90% of all export subsidies notified to the WTO by OECD countries.

Countries were required to cut both the volume of subsidised exports and the value of export subsidies.

66. The URAA required cuts in both the volume of subsidised exports and the value of export subsidies. Between 1995 and 1998, 64% of the permitted volumes and 42% of the permitted budgetary outlays were used. However, the early years of the implementation coincided with relatively high world cereal prices, which enabled countries to meet most of their commitments easily. In fact, the European Union even taxed cereal exports in this period. Some commodities, notably beef and dairy, still receive subsidies on the bulk of their exports; a commodity focus which reflects the dominance of the European Union in these markets.

But their impact was limited by the carry-over of unused subsidies...

67. The fact that countries were allowed to carry over unused export subsidies and count them towards the following year's allowance weakened the constraint imposed by the URAA's provisions. Between 1995 and 1998, six OECD countries (counting the European Union as one) made use of this option regarding either the volume or value limit on at least one commodity. However, the terms of Article 9 of the URAA require that countries must meet their annual commitment levels from 2000 onwards

...and the use of aggregated commitments.

68. As with market access commitments, the effective constraint on national policies also depends on the level of aggregation at which commitments are made. As one example, Switzerland has one overall commitment for dairy products, while the European Union has separate commitments for butter, skim milk powder, cheese and "other dairy products". This means that Switzerland has the scope to stay within its commitment by reallocating support from one category of dairy product to another. In some cases, particularly those where prices within the aggregation do not move together closely, this means that subsidies can be shifted onto those commodities facing the greatest downward price pressure on international markets.

A further problem has been delayed notifications.

69. For a number of OECD countries, export subsidy notifications have been delayed by two years or more. Delayed notifications make it difficult to monitor the effectiveness of WTO disciplines, and can make timely responses difficult in cases where countries are thought to have exceeded their commitments.

30. OECD (2000b), OECD (2001h).

Implicit subsidies may also be provide by food aid...

70. Food aid has the potential to act as an implicit export subsidy. Recognising this possibility, Article 10 of the URAA contained three recommendations about the terms under which food aid should be distributed. The first was that it should not be tied to commercial sales of agricultural products. The second was that it should comply with the FAO's "Principles of Surplus Disposal and Consultative Obligations". The third was that it should be provided "to the extent possible" in fully grant form, or on terms no less favourable than those provided for in the 1986 Food Aid Convention. Under the 1999 Food Aid Convention, countries further agreed that grant food aid should represent not less than 80% of each member's total food aid contributions (which may be expressed in either volumes, values or a combination of both). The aim of the convention was to make the requirements for donors sufficiently onerous that they would not use them as *de facto* export subsidies.

...export credits...

71. Officially supported export credits comprise financial inducements that may effectively lower an importer's costs. They include direct credits or financing, guarantees or insurance for loans, and interest rate support. Recognising their potential to act as implicit export subsidies, signatories to the URAA agreed to "undertake to work toward the development of internationally agreed disciplines to govern the provisions of export credits, export credit guarantees and insurance programmes". OECD countries are in fact the chief providers of export credits, and while the share of exports receiving them remains small, their use is nevertheless increasing. Moreover, OECD analysis suggests that some programmes, though not all, reduce importers' costs by allowing more favourable financing than the private market would offer. In recent years, the US has been the largest user of export credits and has accounted for the majority of the distortions that these programmes impose on world markets.³¹ Officially supported export credits have the potential to ease liquidity constraints in developing countries; however, the fact that most are provided to other OECD countries indicates that they rarely fill this function. Despite their relatively limited use, the danger is that as export subsidies are reined in, the use of export credits could escalate, both in terms of the volume of use and the per unit subsidy provided. Negotiations at the OECD resulted in a draft agreement in 2001; however, in the absence of unanimity there remain no disciplines in place.

...and state trading enterprises.

72. Exporting STEs may also be a source of implicit export subsidies. One possibility is that the government mandates the STE to pay farmers more than the market price, and covers any losses that may arise from the need to sell the resulting surpluses at a discount on world markets. A similar effect would occur if the STE were provided with credits or tax breaks that were linked to exports, or if it were able to price discriminate between the domestic and the world market. However, such distortions are not limited to STEs. The devices used for discriminating between domestic and international markets, such as domestic price pooling schemes, can also be applied by producer boards, or by private trading monopolies. Similarly,

³¹ . OECD (2001j).

non-public bodies can also serve as a conduit for export subsidies.

The removal of all forms of export subsidies would produce important benefits, especially for developing countries.

73. Export subsidies, be they explicit or implicit, are among the most damaging of all trade policy instruments. They can set up a “race to the bottom” among exporting countries, to the detriment of those exporters that either cannot or will not provide matching subsidies. Because they are more often applied when world prices are low, they can exacerbate international price volatility. And although they may benefit some developing countries by lowering import prices, they can also undermine local markets, with potentially crippling consequences. WTO members have recently committed “without prejudging the outcome of the negotiations” to “reductions of, with a view to phasing out, all forms of export subsidies”. Although they did not agree that the elimination of export subsidies would be an inevitable outcome of forthcoming negotiations, the removal of all forms of export subsidies would produce widespread net benefits.

Export limiting policies also distort international trade.

74. Export taxes, embargoes and other export restricting policies also distort international trade. During times of tight supply, the introduction of export restraints reduces food availability on world markets and raises international prices. This reduces the reliability of the world market as a source of food at affordable prices. The URAA did not impose any significant limitations on export restrictions, although under Article 12 countries agreed to “give due consideration” to the impact of new export prohibitions or restrictions on the food security of importing countries.³²

Reforms to domestic support policies

Domestic policies were classified according to their potential to distort trade.

75. Under the URAA, domestic policy instruments were placed into “Amber”, “Blue”, and “Green” boxes, with Amber Box instruments deemed to be the most trade distorting and Green Box instruments the least (“minimally”) trade distorting. The Amber Box contains the Aggregate Measurement of Support (AMS), which is the cornerstone of domestic support commitments. The AMS is measured as the total value in nominal terms of (non-exempt) domestic support (including budgetary outlays and consumer-producer transfers), and is subject to annual reduction commitments.³³

The most distorting forms of support were subject to reductions

76. Blue Box policies are included in the base AMS calculations, but are not subject to reduction commitments. This category provides an exemption for policies that are based on fixed areas and yields in the case of crops, and fixed animal numbers in the case of livestock, or are based on no more than 85% of the base level of production. This classification included compensation payments in the European Union and some deficiency payments in the United States. Under the “Peace Clause”, which expires in 2003, Blue Box policies may be subject to countervailing duties but are exempt from other GATT challenges, provided support does not

³² . The provisions of this article are not applicable to developing countries, unless the country is a net exporter of the foodstuff in question.

³³ . The specification in nominal terms makes the constraint more binding with inflation.

exceed the level decided in 1992.

77. Green Box measures are deemed to be “minimally trade-distorting”, and, as such are exempted from reduction commitments. The term “minimally trade distorting” is not defined, except according to the policies that negotiators agreed should qualify for the Green Box. Thus, it includes measures such as government expenditures on research, disaster relief payments and direct income payments, and excludes measures that are linked to production or input use.

Few countries have had difficulties meeting their commitments.

78. In practice, few countries have so far had difficulties meeting their AMS obligations. The principal reason is that the commitments were weakened by a number of compromises made during the negotiations. First, the base period (1986-88) was a time of unusually high domestic support. Second, some trade distorting policy measures were placed in the Blue Box and thereby exempted from reduction commitments. Third, the AMS was calculated on the basis of total support rather than on a commodity by commodity basis. This meant that support not used on one commodity could be provided to another. A remaining policy question is whether these compromises should be retained or dispensed with. As with export subsidies, delayed notifications have compromised the process of monitoring and oversight.

The extent to which policies deemed to be “decoupled” continue to distort production and trade is not clear.

79. Relatively high world cereal prices in the early years of implementation reduced the extent of support necessary to maintain prices at a given level. The reversal of these price trends, and the subsequent increases in support, have made the domestic support discipline a potentially more binding constraint. However, several countries have shifted to less trade-distorting forms of support, which they have notified as eligible for the Green Box and therefore exempt from reduction commitments. From an economic standpoint, the extent to which such policies nevertheless continue to distort production and trade is not clear. In aggregate terms, the European Union, Japan and the United States account for more than 90% of total domestic support in OECD countries (i.e. Amber Box, Blue Box, Green Box, de minimis and special and differential treatment), so it is reforms in these countries that will have the biggest impact on world markets.

No support policy linked to agricultural activity is perfectly decoupled.

80. The URAA provisions for domestic support constitute a consistent *ranking* of policies, in that those qualifying for the Green Box are less trade-distorting than those in the Blue Box, which in turn are less trade-distorting than those in the Amber Box. However, the question of *how much less* distorting is a critical empirical question. In theoretical terms, no specifically agricultural policy is fully decoupled from production and therefore without consequences for trade. If, in any way, the terms of a support measure are tied to the process of farming, then that measure is likely to alter the relative incentive to farm production *vis-à-vis* other economic activities. Ostensibly decoupled policy measures affect production through their impact on other variables, notably income, wealth, expectations and risk. In a number of cases, there may be no incentive to increase production at the margin; however, there may still be a production

effect insofar as more resources are retained in farming than would otherwise be the case.

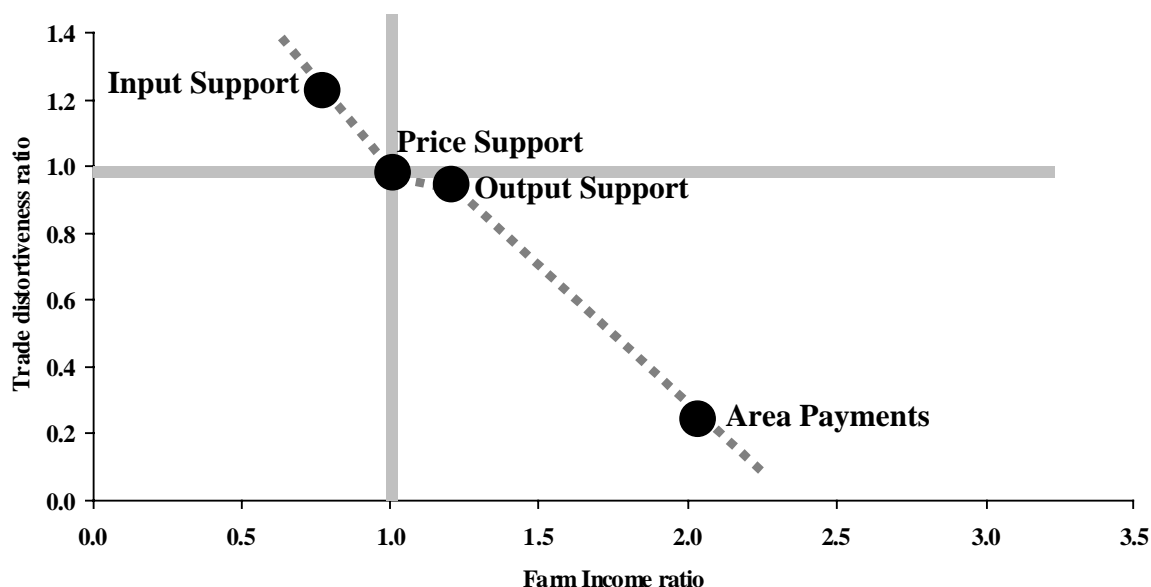
Production quotas can limit the trade consequences of domestic policies, but at a cost.

81. The degree of decoupling also depends on the mix of policy instruments that is used. For example, a price support with quota limits may have a smaller effect on trade than an ostensibly decoupled instrument. From the standpoint of trade negotiations, offsetting production limits constrain the costs of coupled support programmes and hence their contribution to the AMS. Measures that provide concentrated benefits to a fixed amount of production further impede structural reform, but do at least limit the losses to more competitive suppliers in other countries.

There is a clear inverse link between the income transfer efficiency of a policy measure and its tendency to distort trade.

82. In principle, policy reform should be eased by evidence of a win-win relationship between the income transfer efficiency of domestic policies and their tendency to distort trade. Put simply, the more a policy pays to a farmer without affecting his/her production decisions, the greater the share of income retained by the household *and* the smaller the impact on production and trade. Figure 4 presents these trade-offs, which were calculated using the OECD's PEM model.³⁴

Figure 4. The Relationship between Trade Distortions and the Transfer Efficiency of Farm Support



Source: Dewbre, Anton and Thompson (2001). The trade distortiveness ratio measures the impact of policy on net traded quantities relative to the impact of market price support, while the farm income ratio measures the effect of policy on farm income, also relative to that of market price support.

The shift towards

83. The growing use of decoupled support measures in OECD

³⁴ . Dewbre, Anton and Thompson (2001).

decoupled measures will not reverse the accumulated impacts of decades of support.

countries should limit the tendency for marginal increases in support to add to the already large distortions in world markets. However, unflinching farm support has provided farmers with an incentive to make sure that planted area (or the number of livestock) does not fall. If producers anticipate that some measure of size is to be the criterion for support, even if that measure is fixed once and for all, then they will be reluctant to take steps that reduce their potential eligibility. If the rules change from one year to the next, yet support is nevertheless fundamentally guaranteed, farmers will be reluctant to take steps that could ultimately deprive them of support. Hence production in those OECD countries with high support has not adjusted downwards as support has shifted to more decoupled measures, and recent reforms are unlikely to reverse the accumulated impacts that decades of support have had on producers' incentives.

Fundamental reform entails a reduction in – not just a reorientation of – support.

84. The key point is that while a reorientation of support is itself significant, the effects are stronger if there is also a reduction in the overall level of support, as measured for example by the PSE. In the context of high overall support, and with farmers operating under the assumption that they will continue to receive large amounts of sector-based support in one form or another, its impact is likely to be much more modest.

4. An agenda for agricultural policy reform

The need for reform is accepted in principle, but has been difficult to achieve in practice.

85. OECD countries have long recognised the need for fundamental agricultural policy reform, but translating broad principles into specific policy recommendations that can be collectively agreed upon has proven difficult. The need for greater market orientation in Members' agricultural policies has been recognised and reiterated in several Ministerial communiqués since 1987. OECD Ministers noted in 1998 that agricultural policy also needs to give due consideration to non-trade concerns, as referred to in Article 20 of the URAA. The concept of market orientation holds that if market signals are allowed to guide the allocation of resources, then the resulting economic gains will benefit the economy as a whole. Greater market orientation is synonymous with fewer distortions to production and consumption and, by extension, to international trade.

Market orientation increases economic efficiency and improves the effectiveness of government policies.

86. Although the case for market orientation has traditionally been couched in terms of efficiency considerations, the arguments become even more compelling when other policy rationales are taken into account. If equity or distributional concerns are factored in, the OECD's work on income transfer efficiency clearly demonstrates that market-oriented policies – i.e. those that are not linked with agricultural production and consumption decisions – deliver support to targeted households more effectively than market-based interventions. Similarly, if the government intervenes to correct market failure (e.g. by providing a public good), then there are many cases in which the market-oriented solution – tackling the market failure at source – will be the most efficient.

A positive reform agenda should focus on how

87. The challenge for governments is to find ways of balancing their right to redistribute incomes and wealth, and to ensure a suitable provision

governments can address their objectives as efficiently as possible, and without harming other countries. of public goods, with their global responsibility to avoid taking actions that impose an unfair burden on other countries. Thus, the choice of policy instruments is at the heart of the issue, rather than the objectives themselves. In most cases, there are alternative policy options available that would enable governments to pursue their objectives with minimal disruption to international markets.

Domestic reform is the key. 88. The first point to note is that domestic reform is the key. Trade policies form the basis for multilateral negotiations, but there would be few trade tensions among OECD countries, and between OECD countries and developing countries, if already accepted criteria governing the effective design of domestic policies were met. In particular, domestic policies need to be formulated on the basis of explicit objectives, where the performance of alternative instruments can be measured and compared. Moreover, the process of policy appraisal should be transparent and publicised, so that all stakeholders are informed, and policy-makers are accountable for their decisions. In practical terms, the development of explicit objectives is likely to lead to a fundamental reorientation of the way in which equity and market failure objectives are pursued.

Any concerns about low farm household incomes could be addressed through economy-wide programmes... 89. For example, any objective related to low farm household incomes could be addressed through general tax and social security programmes. These have the highest income transfer efficiency, and would support incomes without distorting production and trade. Such a focus would enable market failures to be targeted directly and independently. Note that a subsidy to provide a public good, or to stimulate production of a positive externality, will raise farmers' incomes. This will then have a determining influence on whether they are eligible for support.

...that would treat farmers the same as other members of society. 90. Effectively, this would put farmers on the same footing as other members of society. They would be rewarded for the private and public goods they produce, and if their incomes were to fall below a threshold level they would qualify for support. By contrast, production-linked support cannot simultaneously provide an optimal amount of public goods and deliver the desired amount of support to targeted beneficiaries. Indeed the distributional consequences of such policies are typically regressive, since they benefit large-scale (and more profitable) farmers more than small-scale ones, tax consumers according to the share of their budgets on food, and impose net costs on developing countries.

Other policy objectives could be pursued through markets,... 91. Markets themselves may address some social objectives. For example, the impact of systemic declines in real agricultural prices on household incomes is automatically cushioned by the additional incentive for less efficient farmers to exit the sector, and to diversify their sources of income. In many OECD countries, for example, farm income now accounts for an average of less than half the income of agricultural households.³⁵ Adjustments according to market signals have thus cushioned the impact of declining prices. In other cases, markets can be created. In the case of public goods, for instance, governments could open up a competitive tender

³⁵ . OECD (1994), OECD (2001).

process, which would reveal whether farmers are in fact the most efficient providers of the public goods in question, and if so which ones.

...economy-wide measures and targeted agricultural policies.

92. Other social objectives can be pursued through broader development initiatives, such as rural or community development schemes. Similarly, environmental objectives can be addressed through an economy-wide system of regulations, taxes (in line with the polluter pays principle) and subsidies (if the desired environmental services are not otherwise provided). Finally, there will be instances where societal interests have an agriculture-specific component that cannot be adequately accommodated by markets or economy-wide policies. In these cases, agricultural policies will be necessary. The explicit identification of these unique characteristics (for example in protecting the environment or the rural landscape) is itself a major step forward in designing policies that can be both tailored to an identifiable objective and then monitored.

In addition, there are legitimate areas for public investment.

93. In a wider context, the OECD's Growth Project has shown that governments can foster faster economic growth by investing in infrastructure, education and training, and research and development.³⁶ The agricultural sector may benefit from both general investments in these areas, as well as agriculture-specific interventions. Similarly, general and agriculture-specific measures may be warranted to ensure public health and safety.

However, much still needs to be known about how targeted policies should be implemented.

94. Overall, the scope for more targeted policy instruments is clear. However, much still needs to be known about the practicalities of how such programmes should be designed, and how they can be operated as efficiently as possible. This is an important area for further research, and for the sharing of policy experiences in OECD countries.

Trade liberalisation is the essential corollary of domestic reforms.

95. Although domestic policy reform is the *sine qua non* of a broad reform agenda, it is the implications of domestic policies for trade and trade policies that dominate international concerns. Effectively, the net costs of inefficient domestic policies spill over and are magnified on international markets. Trade policies may also be the only instrument used to protect domestic producers in import-competing sectors. Trade policy reform is therefore important in its own right, while multilateral negotiations may have a vital role to play in promoting domestic reforms.

Trade reforms would be strengthened by deeper, tighter and broader commitments.

96. Experience from the implementation of the URAA suggests a number of ways in which the process of trade reform could be strengthened without limiting countries' scope for addressing domestic objectives, or "non-trade concerns". These include a deepening of reform commitments, a closing of loopholes and tightening of flexibilities that have limited the impact of countries' commitments, and an extension of the reform process to areas that have not yet been fully addressed.

³⁶ . OECD (2001k).

However, not everyone will benefit, and governments may need to consider appropriate adjustment policies.

97. Trade reforms form an important part of a wider mix of sound policies that should collectively translate into stronger economic growth. While this should be of widespread benefit, it is important to acknowledge that not everyone will gain from trade reform, at least in the short run. In sectors that formerly benefited from protection, some producers may have difficulty adapting to a more competitive trading environment. To facilitate the process of adjustment, there may be a role for transitional assistance (both within and outside the sector). For households with few viable alternatives, social payments may be more appropriate.

Trade reform should benefit most developing countries, but it needs to be accompanied by other policies for the full potential to be realised.

98. As in OECD countries, agricultural trade liberalisation should be of broad benefit to developing countries. In particular, developing country exporters should gain from improved market access, while domestic suppliers should benefit from no longer having to compete with subsidised exports. Yet here too, some people will face immediate losses. The minority of developing country farmers that are subsidised will confront new market pressures, while consumers may pay more for imported food, and exporters that previously benefited from preferential market access will have to compete with other potential suppliers. Given a base of very low incomes, such a pattern of short-term costs and benefits is of obvious concern. As a consequence, and in order to build greater faith in the multilateral trading system, OECD countries need to find specific ways of responding to the challenges set out in the 2001 WTO Ministerial Declaration from Doha. This means making sure that those who should in theory benefit can actually do so. For example, improvements in market access for developing countries may need to be accompanied by assistance with export capacity building. Similar thought needs to be given to the best way of helping with the needs of those who may lose. Possible options are financial support for appropriate domestic policies and flexibilities in trade policy adjustments.

The WTO Ministerial Declaration provides a valuable basis for multilateral reforms.

99. The WTO Ministerial Declaration provides a valuable basis for agricultural policy reforms that would both benefit OECD countries and address a number of the key concerns of developing countries. Central to these reforms will be a reduction in the overall scale of agricultural support. A number of countries have already taken positive steps to shift away from the least efficient and most distorting forms of support, yet reform has been uneven across countries and commodities. The OECD's work on income transfer efficiency shows clearly that if current production-based supports were replaced with direct income payments, efficiency costs could be halved without reducing the incomes of farm households. Further economy-wide savings would come from targeting payments to lower income farm households on a similar basis to social policies.

A reduction in the overall scale of agricultural support opens the door to new policy approaches...

100. The freeing up of resources could then open the door to new policy approaches. In particular, governments could invest further in areas that complement, rather than impede, the functioning of agricultural markets. Some of these investments – including expenditures on infrastructure, training, research and development, and food safety systems – are relatively easy to prescribe in general terms. But translating these general recommendations into concrete proposals for effective policies will

require additional analysis and insight.

101. In addition, further thought needs to be given to the issue of why fundamental reform has proven so difficult to achieve and what can be done to smooth the transition to a more market-oriented agricultural sector. A number of possibilities tie in with the basic principles of good policy design noted earlier. In particular, an explicit articulation of policy goals makes it easier to measure and compare policies, and to match objectives with the best available instruments. In this regard, transparent policies (such as taxpayer-financed transfers) are not only likely to be more efficient than intransparent ones (such as price supports), they are also likely to increase overall awareness of who pays for, and who benefits from, specific policies.

...which will require vision and input from all stakeholders.

102. Fundamental reform continues to be difficult to achieve. For it to proceed, there will be a need for leadership and input from a broader range of stakeholders than has historically been the case, including consumers and taxpayers, industry representatives, farmers and input suppliers, as well as environmental groups. Dialogue among a wider group of interests should enable the policy debate to progress beyond long-held beliefs about the nature of agriculture, some of which are no longer valid, and focus instead on the policy needs of the 21st century. A reference point for such dialogue is the premise that market-oriented policies, which target precise goals with clearly defined beneficiaries, will generally minimise harmful spillovers and thus the potential for conflict among stakeholders. With vision, agricultural policies in OECD countries can play a central role in providing a fair, competitive and sustainable global food and agricultural system.

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