

AGRICULTURAL POLICIES IN SELECTED OECD COUNTRIES: OPPORTUNITIES FOR REFORM

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INTRODUCTION

Governments have long intervened in domestic and international markets for food and agriculture products. The apparent rationale for doing so has changed over time, but the nature of the policies in place across the OECD-area has evolved much more slowly. The result today is a complex web of policies, generally aimed at a diversity of sometimes competing objectives, and an assortment of both intended and unintended effects.

This paper highlights the links, and the disconnections, between food and agriculture policy objectives, instruments, and impacts in Canada, Mexico, the United States (the NAFTA countries) and the European Union (EU). These countries account for more than one-third of world trade in food and agriculture products, and at the same time provide their farmers with more than two-thirds of the support available to farmers across the OECD area. What are their farm policies trying to achieve? How are they pursuing their objectives? What are the effects of these efforts, domestically and internationally? Are there more effective policy alternatives? What are the prospects for further agricultural policy reform? The following sections draw primarily on work undertaken at the OECD to address these questions.¹

AGRICULTURAL POLICY OBJECTIVES

The objectives of agricultural policy are not always precisely and explicitly stated; this, of course, makes assessment of policy performance more difficult. But in general terms, at least, the 'shared goals' agreed by OECD Agriculture Ministers in 1998 reflect the range of

1. In particular, this paper extends a 2001 (unpublished) presentation by the author to the Société Française d'Economie Rurale, entitled "EU and US Agriculture Policies: More Similarities than Differences?", and incorporates subsequent material published by OECD in 2002, entitled "Agricultural Policies in OECD Countries: A Positive Reform Agenda".

current policy interests in the NAFTA countries as well as in the EU. These include, "... (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;
- contributes to food security at the national and global levels".²

Farm policy goals

Canada introduced its Agricultural Policy Framework in 2003, marking an explicit effort to set out an integrated and comprehensive policy framework. Specific objectives are to enhance the profitability of the agriculture and agri-food sector, to reduce agricultural risks and provide benefits to the health of water, air, and soils, to ensure compatibility between biodiversity and agriculture, and to increase the level of investment in innovation in agricultural products. See http://www.agr.gc.ca/cb/apf/index_e.php?section=info&group=accord&page=accord

Mexico approved its National Agreement on Agriculture (Acuerdo Nacional para el Campo) in 2003. This document is not a law but an agreement between farmers' organizations and the Federal Government, which results from a broad national consultation and defines the main lines of agricultural policies in the medium run. Two main broad objectives are identified: social development of rural areas particularly focused on achieving equal opportunities for rural and urban inhabitants; and ensuring sufficient and healthy food for the Mexican population. Other objectives are also noted, such as protecting the right of farmers and the indigenous population in rural areas to preserve and improve their own forms of production.

There are no specific objectives contained in the US Farm Security and Rural Investment Act of 2002, though the implicit objectives of the various Titles of the legislation seem evident. A number of USDA publications can be drawn upon to specify American farm policy interests (for example, *Food and Agricultural Policy: Taking Stock for the New Century* and *A Safety Net for Farm Households*).

In the case of the EU, objectives assigned to the Common Agricultural Policy (CAP) are found in Article 33 (formerly Article 39) of the EC Treaty. These have since been enhanced, and are outlined in a 2002 Communication from the Commission, *Mid-Term Review of the Common Agricultural Policy*.

2. Text of the full Ministerial Communiqué is available at: <http://www.oecd.org/agr>.

Clearly, much is expected of the food and agriculture sector. Some decades ago a primary aim of farm policy was to increase output, particularly for domestic consumption and soon thereafter for export markets as well. Explicit interests today are more diverse, and encompass contributions to rural community well-being, rural amenities, biodiversity, landscape, flood control, and other issues often associated with the concepts of multifunctionality and non-trade concerns. On the other hand, the aim of protecting and supporting the incomes of farm households has long been, and remains, a conspicuous element of farm policy in many OECD countries.

Overall, agricultural policy objectives continue to change, implicitly and explicitly, in response to societal interests, some objectives can be in conflict with others, and trade-offs amongst these interests are often required. How are these changing objectives being translated into policy action?

AGRICULTURAL POLICY SUPPORT: LEVELS AND INSTRUMENTS

The OECD Food, Agriculture and Fisheries Directorate has been monitoring and evaluating agricultural policies in OECD countries for almost twenty years. A substantial database covering both the level and the nature of agricultural support has been developed within the framework of the Producer Support Estimate (PSE) methodology. In this context, the associated level of support to agriculture is measured and the nature of the policy instruments is described, with a view to assessing the potential impacts of various categories of support on production, consumption, trade, incomes and the environment.³

In 2003, support to producers in OECD countries, as measured by the PSE, was 257 billion USD (the NAFTA countries, taken together, and the EU accounted for USD 50 billion and USD 121 billion, respectively). To enable meaningful cross-country comparisons, the (absolute) PSE is expressed as a percentage of the value of gross farm receipts (% PSE). The % PSE for the OECD area as a whole was 32% in 2003, compared with an average of 37% in the 1986-88 period. In 2003 the %PSE in Canada was 21%, Mexico 19%, the US 18%, and the EU 37%.

3. OECD (2004), *Agricultural Policies in OECD Countries: Monitoring and Evaluation*.

These averages do not tell the whole story as there are wide variations in support levels across commodities, and a number of “sensitive” products receive support at levels well above the (already high) OECD average (figures 1.a – 1.d). In Canada, milk stands out as the commodity that receives a very high level of support (55%), while most other commodities receive much lower levels of support (less than 20%). For Mexico, oilseeds (53%), sugar (48%), milk (40%), maize (39%), rice (35%), other grains (32%) and wheat (31%) receive very high levels of support. In the US, commodities receiving very high levels of support include sugar (58%), milk (48%), rice (46%), wheat and other grains (each 35%); other commodities receive support at much lower levels (generally 20% and less). Commodities receiving very high levels of support in the EU include beef and veal (74%), sugar (56%), sheepmeat (53%), other grains (52%), milk (47%), wheat (45%), rice and poultry (37%), and oilseeds and maize (36%).

While the level of support provided to producers is certainly relevant, the nature of this support is even more important in understanding alternative policy approaches and their impacts. Policies in place in OECD countries are categorised as follows.

Market price support (MPS) measures the gap between higher domestic prices received by producers and paid by consumers, relative to prices on world markets. These higher prices are regulated (or administered) by governments, and maintained via border protection. This type of support distorts production, consumption and trade, and can have a negative effect on the environment. By raising domestic prices, it effectively acts as a regressive tax on consumers. *Payments based on output* are budget (taxpayer) financed, and affect prices received by producers. As such, they distort production and trade and can harm the environment to the same extent as MPS, but do not directly affect consumption. *Payments based on input use* are also budget financed, and serve to reduce certain input costs. They can be more or less distorting than the above two categories, depending on the input concerned, and can also have a negative effect on the environment. These three production linked forms of support are all highly trade distorting.

The remaining types of support are all budget financed and are, to varying degrees, more decoupled from production decisions and therefore less trade distorting. *Payments based on area planted/animal numbers* remain linked to production, but not to intensity of production nor to output. They encourage production at higher than otherwise levels and

hence distort trade, but at much lower levels than the above noted measures. *Payments based on historical entitlements* (that are not updated nor otherwise revised) no longer influence current production decisions in a direct way, and have a still smaller impact on production and trade. *Other payments*, such as those based on farm income, can be more targeted to specific objectives and beneficiaries and generally have the least impact on production and trade of any farm policies.

In the mid-80s price and output based support and input subsidies accounted for 90% of support to farmers across the OECD area, and by 2003 this had declined to 75%. Within these aggregates, significant differences are evident in the pace of reform across countries (figure 2). Market price support, payments based on output, and payments based on input use, taken together, have declined more significantly in Canada and the EU than in Mexico and the US. However, even after these reforms the composition of support in all four cases continues to be dominated by production linked measures. And as shown in figure 1, reliance on these different policy instruments varies considerably across commodities, even within countries. How are farm households and world markets affected by this mix of current policies?

AGRICULTURAL POLICY IMPACTS

Across the OECD area, only about 25 cents of every dollar of production-based support actually finds its way into the producer's pocket. The balance of the support is either capitalised into asset values, particularly land, or is transferred up or down the food chain to input suppliers, processors and distributors. Because so much of the support is reflected in higher land values, the result over time is a higher cost structure and reduced farm competitiveness. While there is a wealth gain for farmers that own land at the time such policies are introduced, farmers who subsequently rent or purchase land at these higher prices will face reduced profitability and lower incomes.⁴ The same applies, of course, to land costs for alternative, non-farm uses in rural areas.

There is another consequence of such a high reliance on price and output based support. The largest farm operations, which generally are also the most profitable, and the most wealthy, receive most of the benefits (figure 3). In Canada, the largest 25% of farms have average gross farm receipts of 300 000 \$CDN. They produce 63% of farm output and

4. OECD (2002), *The Incidence and Income Transfer Efficiency of Farm Support Measures*.

receive 75% of support. In the US, the largest 25% of farms have average gross farm receipts of over 275 000 USD and average farm net worth of over 780 000 USD. They produce 90% of farm output and receive 89% of support. In the EU, the largest 25% of farms have average gross farm receipts of over 180 000 euros and average farm net worth of almost 500 000 euros. They produce 73% of farm output and receive 70% of support. In all cases, the remaining 75% of farms, produce relatively little, receive little support, but often have a sizeable average farm net worth.⁵

Much of the support provided by existing policies may in fact widen the income gap between large and small farmers, rather than narrow it. This seems to be confirmed by structural trends which broadly confirm an increasing number of large farms, a more stable number of small farms (with a high reliance on off-farm income), and continuing decreases in the number of medium size farms. Farm household income levels are, on average, equivalent to those of other households, more as a result of increases in off-farm income than as a consequence of current policies. And there is also a higher incidence of low income amongst farm households, which is not addressed by current policies.

Neither do many current policies effectively address policy objectives not explicitly linked to income. For example, measures aimed at one widely shared policy objective - encouraging provision of environmental services or reducing environmental damage - represent less than 4% of support to producers in both NAFTA countries and the EU. In some cases, these policies may simply offset some of the negative effects of production-linked support. As a result, any benefits realised are at a higher cost than would be the case in the absence of the very policies that comprise the majority of support. Similarly, measures aimed at improving rural community well-being represent no more than 4% of support in NAFTA countries and the EU. While in both cases support has increased somewhat in recent years, it is from a relatively low base and remains dwarfed by traditional commodity production support.

Production linked policies also have important international spill-overs. Existing policies provide significant incentives to produce, thereby increasing global supplies and lowering world prices, to the detriment of competitive suppliers elsewhere. Market

5. OECD (2003), Farm Household Incomes: Issues and Policy Responses. Note, corresponding data on Mexico is not available.

interventions, which dominate current policies, typically need trade policies to hold them 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. When the extent of support is 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.

The Producer Nominal Protection Coefficient is derived from PSE data, and measures the ratio between the average price received at the farm gate and the border price. It is an indicator of protection from external competitors, rather than an indicator of support per se. For example, support for milk is mainly a result of maintaining high domestic prices, relative to world prices, and the associated level of market protection is exceptionally high. Prices received by producers and paid by consumers for these commodities in the NAFTA countries and the EU are in the range of 50 - 100% higher than world market prices. While support to wheat remains high in these countries as well, it is provided primarily in the form of direct payments rather than regulated prices. As a result, prices received by producers are much closer to world market prices for wheat. Overall, across the OECD area, the level of protection resulting from alternative policy instruments varies widely across commodities (figure 4). Clearly, the link between domestic and trade policies is highly dependant on the nature of the domestic policy instrument.

The long-term trend of agricultural productivity growing more rapidly than demand implies continued adjustment pressures at the global level. Trade protection does not change this fact; it simply shifts the burden of adjustment to other countries, and often triggers other country efforts to protect their own farmers from this 'imported' adjustment pressure. The result, especially prior to multilateral efforts to redress this process, has been an upward spiral of support and protection.

In light of changing policy objectives and the poor performance of many existing farm policies it is striking that there have not been more significant shifts in the composition of support. Policies put in place decades ago primarily to encourage production and to support farm incomes, whatever their actual impacts may have been, are unlikely to happen to be the policies that would most effectively contribute to achieving the wider diversity of interests that comprise so much of the public policy debate today.

Various studies have been undertaken to assess the gains from reducing or eliminating trade protection in agriculture. While estimates vary, the potential gains are very large, and while they accrue to both developing and developed countries, the largest beneficiaries are the countries which currently have the highest levels of trade distorting support and protection. This would include many countries in the OECD-area.

In short, much of current food and agriculture policy is not working as intended. Some policy instruments serve primarily to raise prices and increase output, whereas the apparent objective is something entirely different. Benefits mainly accrue to the highest income and wealthiest segment of the farm population (at the expense of less well-off consumers), and not to the farm households who may often be the intended beneficiaries. Some policy objectives (such as supporting aggregate or average farm income levels) appear to be founded on structural and financial conditions that no longer exist. The range and relative importance of policy objectives have changed, while the policy instruments in place have not. Current production-based policies are not effective in achieving the diversity of other objectives (such as environmental sustainability or rural development) often attributed to them. The unintended spill-over effects on global markets, and other countries, are large and are negative. Are there more effective alternatives?

How large are the gains from trade liberalisation? ⁶

A standard tool used by economists to estimate the income gains generated by trade liberalisation ⁶ and the distribution of those gains ⁶ 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 USD 56 billion a year. 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 USD 53 billion a year by 2010. If a 50% cut were also applied to protection of textiles, motor vehicles and other manufactures, the welfare gains would increase to USD 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 USD 220 billion. These gains jump to USD 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 USD 260 billion a year from the liberalisation of all goods markets.

6. OECD (2002), *Agricultural Policies in OECD Countries: A Positive Reform Agenda*

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 USD 2.6 billion.

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 modeled 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.

ALTERNATIVE POLICY APPROACHES

There are alternatives to many existing farm policies that would both improve domestic performance and eliminate the need for all trade protection other than science-based measures necessary to protect plant, animal and human health.

Moving from trade protection and production linked support to more decoupled and targeted measures would greatly reduce, but not completely eliminate, trade distortions. Agriculture-specific subsidies of any kind, especially if they are large, have an impact on trade, because they provide an incentive to produce and therefore influence the pattern of specialisation among countries. But the severity of these impacts depends very much 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.

The Positive Reform Agenda elaborated at the OECD, and agreed by all member countries, sets out alternative agricultural policy options for governments which would enable them to achieve their stated objectives and at the same time avoid negative, unintended consequences at home and abroad. The fundamental tenets of this agenda are straightforward.

The first requirement is that governments need to be clear about what their objectives are. In particular, policy objectives need to be defined in a measurable way, such that the cost-effectiveness of alternative approaches can be compared. This would improve the transparency of policy-making and help overcome some of the political obstacles to reform.

The stated objectives of agricultural policies in OECD countries fall into two categories: those concerned with the incomes of farm households, and those designed to address other societal concerns such as the environment, the provision of rural amenities, land and water management, food safety and food security. In each case, government policies are introduced because of the belief that private markets alone may not lead to optimal outcomes.

The Positive Reform Agenda suggests that if policies in each of these areas are to be fully effective, they need to address their objectives directly. In the case of agricultural incomes, targeted direct income payments to households that are de-linked from production are much more effective at raising net incomes than sector-wide market interventions such as price support. Similarly, the wider costs and benefits of agricultural activity 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).

Such a re-focusing of policies would in turn enable a reduction in the overall level of support. Moving away from blunt instruments such as price supports to more targeted policies would not only be more effective, it would reduce the domestic burden on consumers and taxpayers, and enable harmful import barriers and export subsidies to be eliminated. Three examples demonstrate how these principles could begin to be put into practice.

Ensuring adequate **farm household income** from one year to the next is a longstanding policy objective in many OECD countries. Although there is no evidence of a widespread income problem in agriculture, some farm households in all OECD countries do have systemically low incomes. Effective policy responses would address the root causes of their low incomes. In some cases, policies to improve farm profitability might be needed, for example through initiatives to upgrade skills or adopt new technologies. In other cases, measures to improve off-farm income or create employment opportunities in other sectors might be more appropriate, for example via broader economic and rural development initiatives. In attempting to protect low income farm households, and provide them with better

alternatives, the social policies available for low income households generally might be the most effective. Farm households also face risks that are beyond their control, such as exceptionally bad weather or some plant or animal diseases. Governments may wish to ensure that households have the tools they need to manage such risks effectively, by providing a viable environment for futures markets or whole farm income insurance schemes.

The well-being of **rural communities** is also a widely held policy objective. In general, across the OECD area, agriculture no longer constitutes a major element of economic activity in rural areas. There are exceptions, of course, and agriculture does remain an important source of employment and income in some regions. At the same time, it is clear that farm policy is not synonymous with rural policy, and that farm policy does not constitute effective rural policy. Effective policy actions would target the underlying causes of economic disadvantages in specific places and regions. In particular, there may be systemic policy bias against some rural and remote areas that could be eliminated. For example, physical infrastructure and essential public services might be more costly to establish and to maintain, resulting in underinvestment in some rural areas. This would exacerbate disadvantages relating to distance from populations and markets. Strategic investments in information technology could, for example, enable rural businesses to compete effectively from relatively remote areas. In some cases, initiatives to encourage entrepreneurship, small business start-up, and risk taking (for example, venture capital schemes or business training and advisory services) might be helpful. Overall, local multi-sector initiatives, rather than traditional farm commodity programmes, would be expected to perform more effectively in contributing to sustainable economic development in rural areas.

OECD countries seek to ensure **environmental sustainability**. But the majority of current support, being linked to output, provides farmers with incentives to increase the intensity of production and also to expand farm production on environmentally sensitive land. While more attention is now given to agri-environmental issues, notably in the form of regulation, relatively little support is targeted to environmental objectives. Effective policy actions would pay directly for any positive impacts (such as the maintenance of biodiversity or the provision of a particular type of landscape), and tax or regulate negative ones. Both types of policy responses would be more effective if accompanied by the withdrawal of longstanding policies that encourage production of traditional commodities. It may also be appropriate to look for policy options outside the agricultural sector. Broader environmental

policy might be further integrated with agriculture specific measures, with the aim of improving the performance of both sets of policies.

OECD consumers and taxpayers will gain considerably from implementing the Positive Reform Agenda. So too will competitive food and agriculture suppliers in both developed and developing countries. Despite the prospect of aggregate gains, not everyone gains from liberalisation, at least in the short run. Some countries (notably some low income developing countries) may lose from agricultural trade liberalisation, including exporters with preferential trading arrangements who could see their preference margins eroded, and net food importers who could see their food import bills rise relative to what they would otherwise be. However, these countries can gain from a multi-sector agreement, and the challenge is to find ways of addressing their specific concerns in the context of a liberal trading environment (e.g. through Special and Differential Treatment), rather than to use such effects as a reason not to reform. Within countries, there will inevitably be winners and losers, with those who formerly benefited from protection standing to lose. Again, the optimal approach is to address those issues directly, via policies that ease the transition into more productive (and ultimately remunerative) activities, rather than to eschew reform altogether.

But there will inevitably be some dislocation. For reform to be sustainable, these adjustment challenges need to be recognised and addressed. In some cases, it will be possible for farm households to adapt and remain within the sector, in which case temporary measures may facilitate a change in farming practices or scale of operation. In other cases, transitional support to enable farm households to shift into more viable employment opportunities may be needed, for example through labour market policies. Finally, reform can be facilitated with the backing of economy-wide social programmes.

These examples of alternative policy approaches are illustrative, not prescriptive. The appropriate mix of policies will vary from one country to the next, and the process of reform will need to be managed carefully in each case. Reform can also be facilitated by explanation of the rationale for reform, by preparing people for its consequences, and by ensuring that agricultural reforms proceed consistently with reforms in other sectors. The overall direction that agricultural policy reforms should take is nevertheless clear, and the sooner those reforms are enacted, the sooner the benefits will be realised and the lower will be the associated costs. The reality today, of course, is that few countries have implemented such reforms, although a

number of important steps in these directions have been made. What are the prospects for further reform?

PROSPECTS FOR REFORM⁷

There have been notable farm policy developments recently in NAFTA countries and in the EU.

In Canada, major reforms to agricultural policy were introduced in the mid-90s as one element of a government-wide *program review*. Amongst other actions taken, support under the Western Grain Transportation Act was abolished. Other budgetary support in Canada has primarily been aimed at supporting incomes in the grains sector, combining crop insurance with program payments based on revenue or income. The 2003 Agricultural Policy Framework (APF) integrates direct income related initiatives into a comprehensive policy agenda that encompasses the environment, food safety, sector renewal, and science and innovation. The discovery of BSE in the Canadian beef herd immediately put a strain on this new policy framework, and a number of exceptional payments were announced to support beef producers. In terms of multilateral trade negotiations, Canada has pursued reform across all three pillars of the URAA – market access, export subsidies and domestic support. At the same time, it continues to defend its supply management scheme, including associated border protection, for the dairy and poultry sector.

During the 90's Mexico undertook major reform of agricultural policies. Land reform in 1992 (that required a constitutional change) allowed the movement from social forms of land ownership (*Ejidors* and Community land) to private ownership. This was followed by the progressive dismantling of the agencies in charge of administering domestic prices and the introduction of direct payments to farmers based on historical land entitlements. In 1994 PROCAMPO payments were introduced for historical producers of most crops, and in 1999 the state agency CONASUPO was closed. Trade policy reforms, in the context of both the NAFTA and the URAA, should lead to the opening of agricultural markets with North America by 2008. Mexico has also signed a number of regional free trade agreements, though none would lead to completely free trade in agriculture. Recently, a new

7. While this section draws on insights gained from analysis of farm policies in OECD countries, views expressed here are subjective and are the sole responsibility of the author. They do not necessarily represent the views of the OECD or any of its Member countries.

target price system for crops was introduced and additional subsidies to electricity used for agriculture were decided. While this may signal some risk of slipping backwards, reforms to date remain impressive.

The US Fair Act of 1996 was widely heralded as a major turning point in US farm policy, with predetermined and declining direct payments, for some commodities, replacing support that had been more coupled to production. Reform in other industries, such as sugar and milk, was not achieved. But this progress was short-lived. Beginning in 1998, large, ad hoc "emergency payments" were provided to producers, and this level of support was effectively entrenched in the US Farm Security and Rural Investment Act of 2002. Importantly, the type of policy instruments used to deliver this support is more directly linked to production decisions and current commodity prices. At the same time, the US approach to current multilateral trade negotiations, at least seen from afar, seems aimed at achieving significant opening of agricultural markets. If this aim is realised, domestic policy reforms will also be required.

In the EU a number of reforms have been pursued, starting in 1992 and continuing in 2000, which moved away from price based support, in particular through greater use of area and headage payments. As was the case in the US, reform was uneven across commodities, and little or no progress was achieved in the sugar and milk sectors. The "Fischler reform" of the Common Agricultural Policy takes an important step in the direction of further decoupling support from production decisions. This has to be welcomed enthusiastically by reform proponents, and the implementation experiences of EU member states will certainly be instructive in considering future policy directions across the EU. In the context of on-going multilateral negotiations, the EU has addressed the key issue of export subsidies in an unambiguous way, though its position on significant opening of markets – again, as seen from afar – is somewhat less clear.

So what might happen next?

Farm policy reforms can often be traced to a need to address emerging challenges (such as national budget deficits) or a desire to pursue exceptional opportunities (such as comprehensive, multilateral trade negotiations). The role of individual personalities and strong leadership can not be overlooked either. There is ample reason to be optimistic about further reforms in the near term.

At least two challenges might encourage governments in the direction outlined in the Positive Reform Agenda. The fiscal situation in some countries, including the US, is increasingly receiving attention. Relatively modest prospects for future economic growth, and an associated need to address apparent policy shortcomings, such as labour market rigidities in the EU, for example, is also more widely acknowledged.

The need for concrete action in these areas might also bring with it a lower level of tolerance for traditional farm policy approaches and their high consumer and taxpayer costs. Secondly, recent experience with various animal disease outbreaks, and the inability of existing policies to prevent, rectify or even adequately manage the economic consequences might contribute to a more critical re-examination of traditional policies and a greater willingness to entertain policy change.

There are also important opportunities to be pursued. There are significant economic benefits on offer to governments for reform of ineffective farm policies, even on a unilateral basis. Multilateral reform, though, has more to offer, as global markets are further opened to competitive suppliers. The largest gains would accrue to those countries which currently intervene in the sector the most, so there is a clear self-interest in pursuing more effective and efficient policies along the lines described earlier. In addition, a strong commitment to less developed countries remains on the table. If the promise of the agreed Doha Development Agenda is to be realised, NAFTA countries and the EU, and others of course, will simply have to deliver freer and fairer trade in agriculture and food products. Detailed modalities are always difficult, but the aim and the purpose can not be in doubt.

CONCLUSION

A striking characteristic of the business environment in which many farms in the NAFTA countries and the EU operate is their relative isolation from many of the market and policy conditions that apply to other business activities. Many farm businesses are more strongly influenced by current and expected future farm policies than by market conditions and broader economy-wide policies. The economic rationale for such high reliance on relatively blunt output-based policy instruments is not evident. Given the diversity of policy objectives being pursued, a greater role for markets, for non-sectoral policies, and for

coherent, complementary targeted farm policies is desirable. Such reforms are possible on a unilateral as well as a multilateral basis.

This does not mean that farm policy support needs to fall to zero, but it does mean that support levels need to be reduced. It also means that new policy approaches are needed to balance a nation's right to re-distribute income and wealth and to ensure a suitable provision of public goods, with a nation's responsibility to avoid taking any actions that impose unfair burdens on other countries. In practical terms, an essential first step is to formulate clear statements of explicit policy objectives, associated costs, intended beneficiaries, and desired outcomes. Only then can informed public policy choices be made.

Markets themselves may address some interests. For example, farm households can benefit significantly from non-farm employment and income opportunities. Many rural amenities can be supplied by various individuals and enterprises, and not just by farmers. Non-sectoral policies may address other objectives. For example, social security policy can provide support for farm households with systemic low incomes. Public investments in physical infrastructure, education and training, and research and development can contribute to various economic, environmental and social goals. Some environmental objectives can be addressed through economy-wide regulations and taxes (Polluter Pays Principle) or subsidies (where desired services are not otherwise available). And of course there is scope for targeted farm policies to address interests and objectives that are unique and specific to agriculture.

Good policy design requires consideration of a wide range of economic, social, and environmental factors that can vary across and within countries. Increased efforts to define alternative policy approaches, in response to clearly expressed interests and conditions, are warranted, by international organisations - such as OECD - as well as by national governments themselves. The choice of policy instrument to achieve explicit domestic goals is at the heart of food and agricultural policy reform. While trade policies form the basis of multilateral negotiations, there would be few trade tensions - and little to negotiate - if the Positive Reform Agenda were more aggressively implemented.

The available evidence makes a compelling case for further reform of agricultural policies, and for increased market openness. The benefits would be substantial: reduced costs to consumers and taxpayers, improved trade opportunities for competitive suppliers, less

stress on the environment, and more effective policies that achieve their goals more efficiently.

There have been some positive developments recently. The share of producer support that is provided through more decoupled and better targeted policy instruments is increasing somewhat, and reliance on many traditional production-linked policies is gradually declining. The farm policy debate seems to be shifting as the unintended consequences of many traditional policy approaches and the benefits of focussing policy efforts more precisely on the desired outcomes and beneficiaries are becoming more widely understood. But concrete policy actions are lagging behind the public debate, and there is still a very long way to go. Given their economic size and importance, the NAFTA countries and the EU have a particular contribution to make in assuring a more sustainable global food and agriculture production system. On-going multilateral trade negotiations provide an enticing opportunity for these countries to demonstrate the leadership necessary to achieve their own domestic aims, along with the ambitions of the Doha Development Agenda.

Figure 1.a. % PSE by commodity, 2001-03 average - Canada

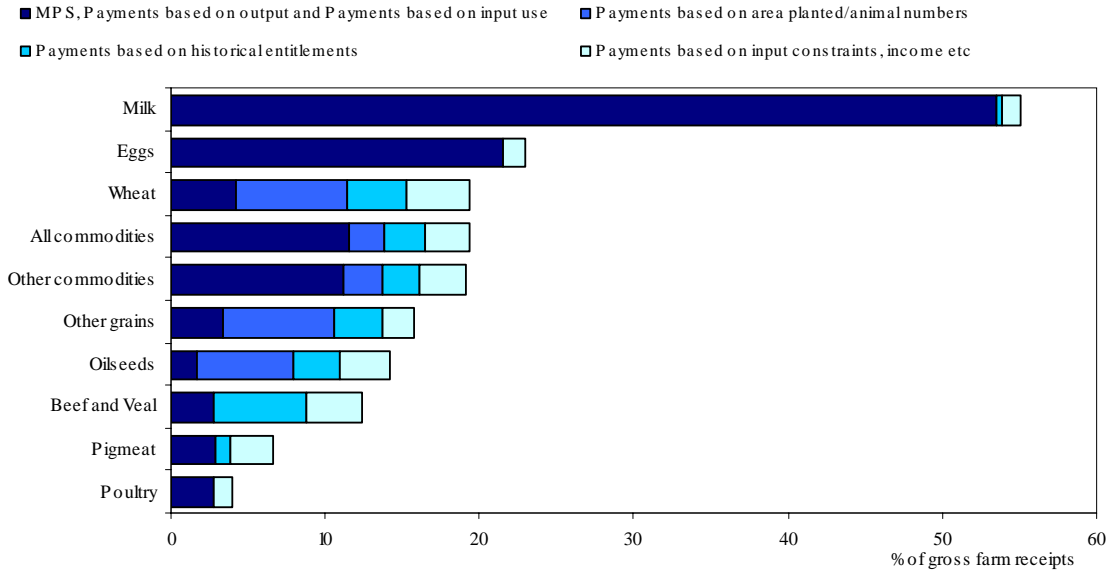


Figure 1.b. % PSE by commodity, 2001-03 average – Mexico

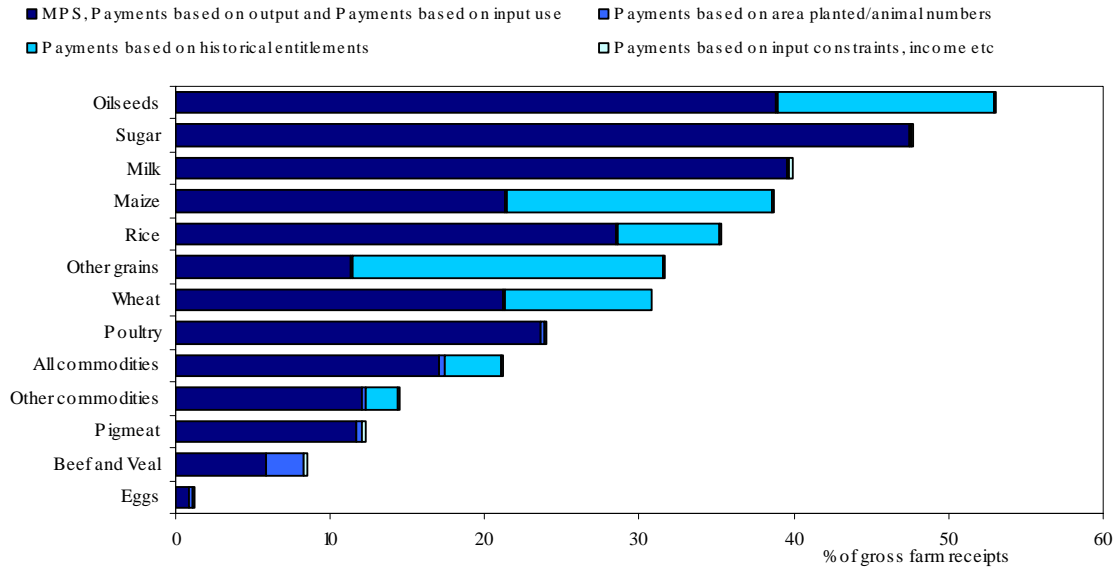


Figure 1.c. % PSE by commodity, 2001-03 average – US

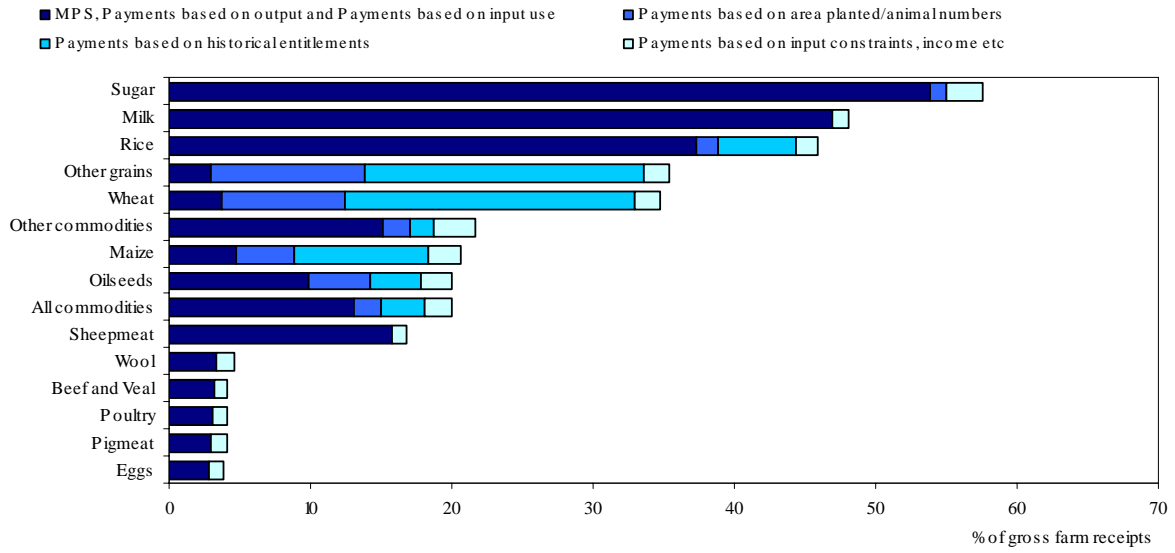


Figure 1.d. % PSE by commodity, 2001-03 average – EU

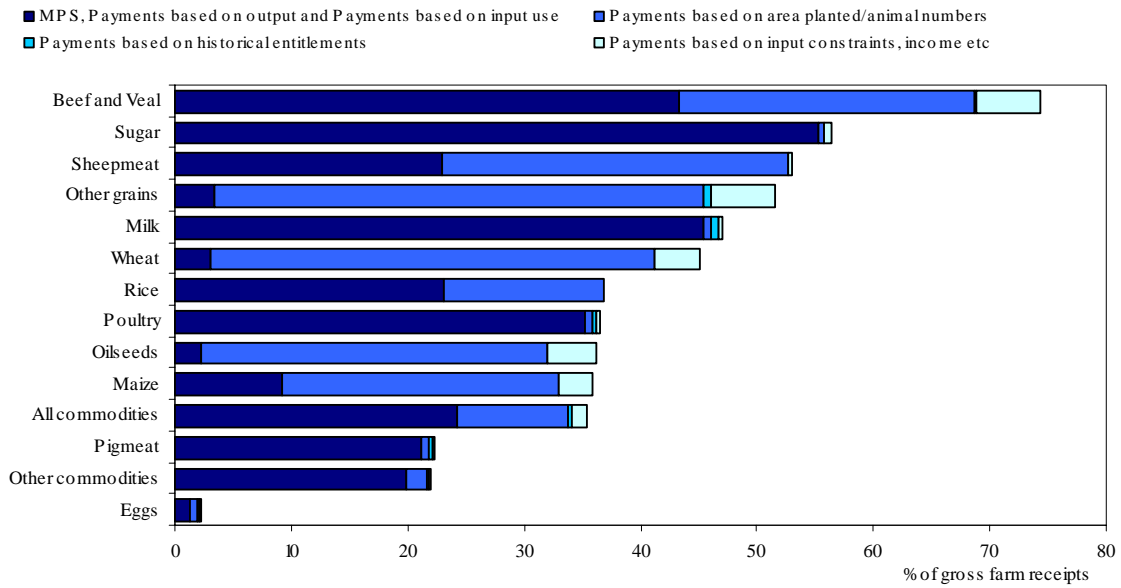


Figure 2. Composition of Producer Support Estimate by country, 1986-88 and 2001-03
(percentage share in PSE)

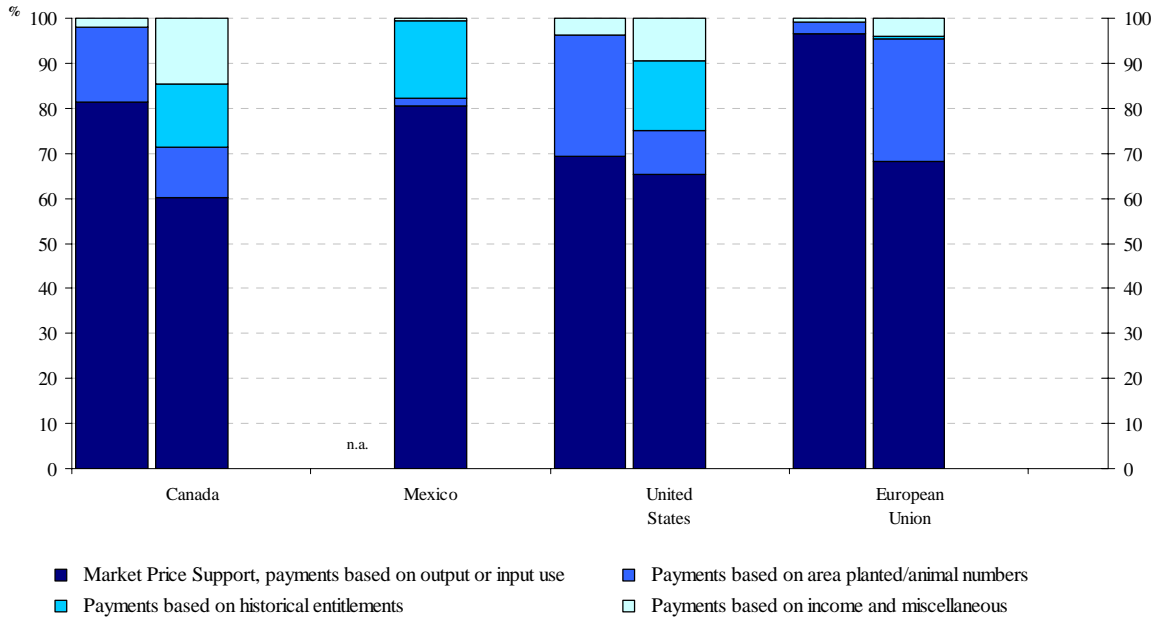


Figure 3. Share of the 25% largest farms

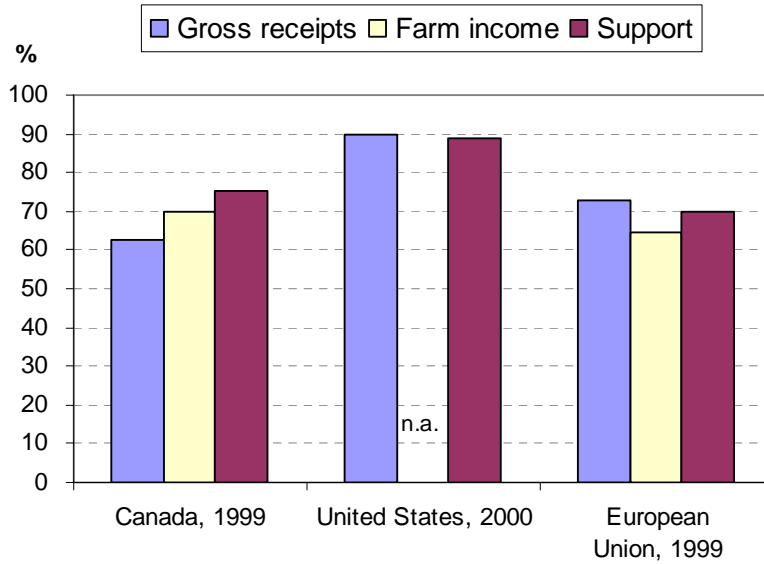
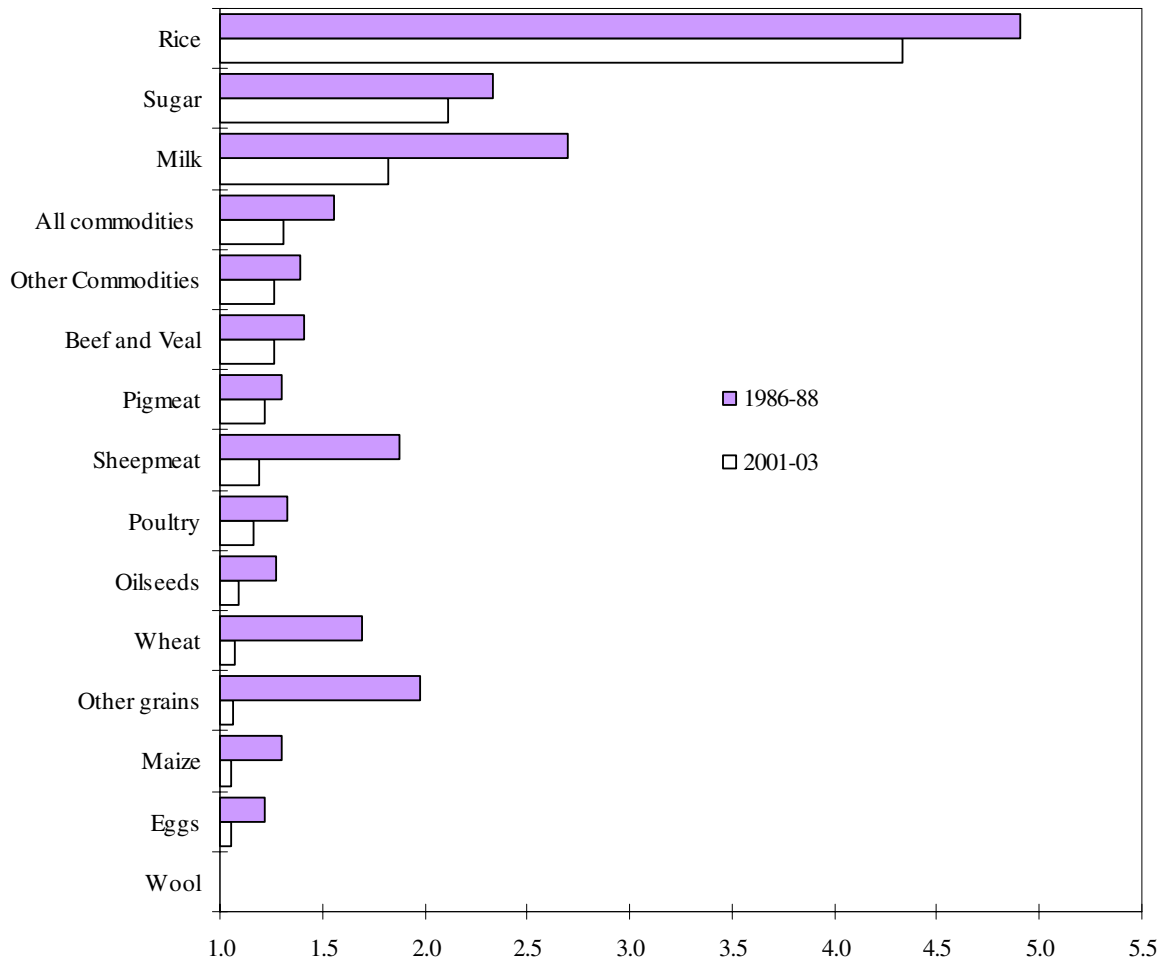


Figure 4. Producer Nominal Protection Coefficient by commodity, OECD average



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