Non-distorting farm support

THE CHALLENGE

The recent world food crisis highlighted the critical issue of food security, the fragility of the global food system and the need to expand agricultural production capacity in both the developed and developing countries to meet current and future food demands. The challenge is two-fold: to ensure food and nutrition security for the one billion hungry people in the world today and to feed a world population set to reach 9.1 billion by 2050.

A key issue is how to shape and design support to farmers in both the developed and developing countries while minimizing distortions to global markets that are potentially harmful to developing countries, and at the same time promoting global food supply adequacy, food security for the undernourished, and poverty reducing and growth incentives for the farmers, especially smaller ones, in low-income food-deficit countries.

Developed countries provide support to farmers to increase farm income, reduce income variability, improve competitiveness of the agricultural sector, protect against natural disasters and provide for safe and quality food. Farm support policies that stimulate domestic production can create distortions in world markets, such as lower prices, diminished import demand, and constrained market access, inducing disincentives in developing countries' agricultural production in the long run.

KEY ISSUES

DECOUPLED SUPPORT

While the value of overall OECD support to farming has been stable over time, periodic reforms since the onset of the Uruguay Round have changed the relative weight of different policy instruments, with increased reliance on the so-called decoupled support in line with WTO provisions. Payments based on area, historical entitlements, input constraints and total historical farm income are viewed as "decoupled" from current production decisions and hence considered to have a lesser impact on production and trade.

Decoupled policies include not only support for land set-asides, but also support for technology and farm human capital skills, incentives to maintain set-aside land in production-ready and environmentally sustainable condition and other similar policies, and could be an option with physical commodity reserves. Productive land set-aside can be brought into physical production in high-income countries within 6-10 months (the recent supply response is evidence to that), providing a powerful reserve to food shortages, while at the same time not distorting current global markets with overproduction.

THE RISE OF INSURANCE RELATED SUPPORT

As OECD farm support shifts from commodity-based to decoupled measures, farm incomes have become more variable, and public safety nets in the form of risk mitigation measures such as revenue or weather insurance are increasingly relied upon to provide protection. While in OECD countries there is private insurance available for most agricultural risks, in some cases public insurance support tends to crowd the private insurance sector out, and may create incentives for increased and riskier production activities, which can become distortive.

For publicly supported insurance schemes to be non-distortive, they need to address market failures such as the very unpredictable and low probability but highly damaging events, which are normally not insured by the private sector but which can be devastating for farmers. The other "more normal" risks can be handled by the private market and farmers themselves through a variety of instruments, including index insurance, modern risk management financial instruments, etc.

MARKET ACCESS IN OECD COUNTRIES

Border policies that restrict market access from third countries are trade distorting. Market access restrictions come in the form of tariff barriers and a wide range of non-tariff measures. They are trade and production distorting through their protective effects on local producers. Exports from developing countries into OECD markets still face high import barriers, except for countries that benefit from preferential tariff access. Analyses show that market-access restrictions vary widely across countries, and greatly impair nearly 30 developing countries. In rich countries, they are concentrated in the meat, dairy products, sugar and tobacco sectors. High tariffs on temperate zone food products and low tariff rates on tropical products seems a typical post Uruguay Round pattern of protection in many developed countries. Tariff escalation is still sizeable and could have major impacts on agro-industry development in the developing countries. Developing country agricultural trade could significantly expand if OECD countries allowed increased access to their markets and reduced their domestic agricultural subsidies and import tariffs.

EXPORT MEASURES

Export subsidies have distorting effects since they provide incentives to produce, and the export of surplus production tends to drive down world prices. Over time, the combined effect of export subsidies and domestic support by OECD countries for these commodities may have contributed to reduced developing countries' own production, greater reliance on increased imports and changed consumption patterns.

Export credits allow foreign buyers to defer payment under more favourable terms than available from financial institutions. A justification for their use is that the recipient country suffers from liquidity constraints and hence their use may enhance rather than distort trade. In practice, poorer countries appear to have received only a small proportion of available export credits.

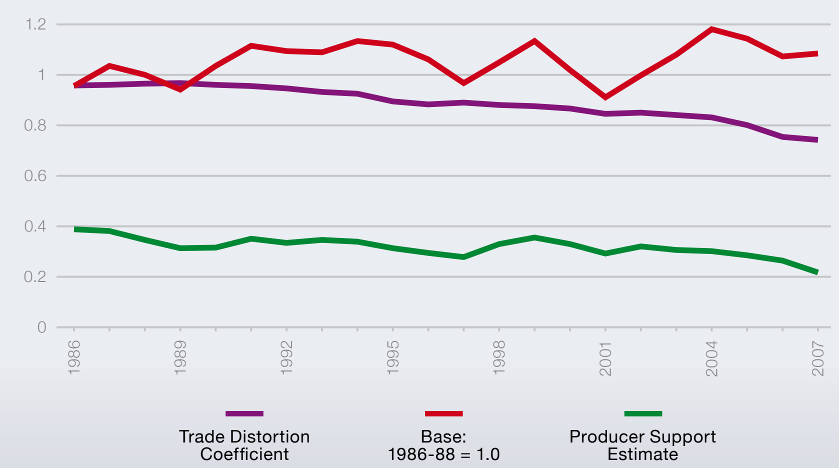
Food aid may also distort trade if there is no "consumption additionality". Emergency food aid is fully additional since recipients are without access to the additional food needed. Non-emergency food aid has varying degrees of additionality and hence distortive effects.

SUPPORT TO AGRICULTURE DURING DEVELOPMENT

In developing countries, farm policies have been driven largely by the goal to accelerate a transition from low-income agrarian structures and rural economies into more developed industry-based economies. At early stages of this transition, the policies adopted are usually aimed at keeping food prices and hence wages low. The overall effect of such policies, as measured by Nominal Rates of Assistance (NRA), has largely been to tax agricultural producers (namely negative NRAs) (Figure 2). By and large the agricultural sectors in many developing countries have faced negative policy biases, low growth rates, and high poverty incidence, while resulting in increased food import dependency.

At later stages of the transition, namely when average incomes grow (typically at a per capita income level of USD 8000 or

Figure 1: OECD Agricultural Support 1986-2007



Source: Skully, 2009

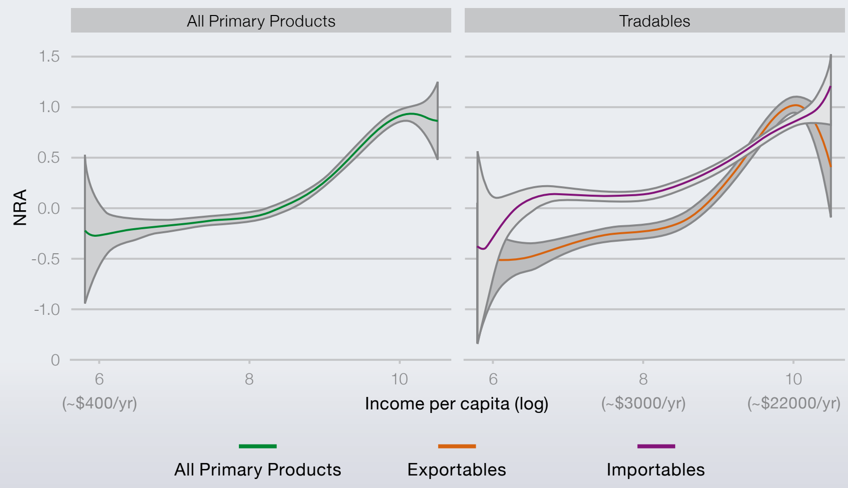
SOME BASIC FACTS

- **The monetary value of total OECD support to farming has been more or less stable over time, despite periodic reforms since the onset of the Uruguay Round. According to OECD, from 1986-87 to 2005-07, the ratio of producer support to the value of production declined from 40 to 29 percent. Consequently, the aggregate trade-distortion coefficient for OECD agricultural support declined from 0.96 in 1986 to 0.74 in 2007 (Figure 1).**
- **The global environment under which the OECD support policies operate has changed over time, from endemic excess supply and falling real commodity prices, to rising prices despite slower demand growth.**
- **Rising bioenergy demand is estimated to have accounted for 30% of the increase in weighted average grain prices between 2000 and 2007. Although food commodity prices have decreased since their peak in 2008, they are expected to remain higher by historical standards.**

more), and the share of farmers in total employment declines, the farm support policies in developing countries seem to turn positive with NRAs increasing as the share of agriculture in the economy declines and average agricultural and total incomes increase (Figure 2).

Today, however, there is growing agreement that agricultural growth is key to expansion of the entire economy. There is empirical evidence that GDP growth originating in agriculture is more effective in alleviating poverty than growth originating in non-farm sectors. This has stimulated a shift in policy in support of agriculture, particularly smallholder, and related activities. The *L'Aquila Food Security Initiative* of the G8 (July 2009) is a case in point.

Figure 2. Average Nominal Rate of Assistance (NRA) to agricultural producers as a function of country per capita income



Source: Masters, 2009

TRADE POLICY IN DEVELOPING COUNTRIES

Trade policies in developing countries range from very low applied tariffs in lower income countries to middle and higher applied tariffs in some middle income developing countries. Trade policies need to complement domestic investment policies and strategies. As such, policy space, for instance in the form of border measure flexibility such as Special Product provisions to allow for "development gaps", needs to be justified in terms of ability to support domestic investments or smallholder farmers.

Many developing countries have undertaken major economic reforms since the 1980s, including phasing out agricultural export taxes, reducing manufacturing protection and allowing markets to determine the value of their currency. However, product and especially factor market distortions in many agricultural sectors continue to be large. Trade policy must be integrated in such a way that it contributes to the fundamental objectives of poverty reduction and sustainable development to benefit the poor and food insecure people. It should foster equitable growth, promote human development, and ensure the proper management of natural resources and the protection of the environment.

INPUT SUBSIDIES

If effectively applied, input subsidies could play an important role in agricultural development and stimulate food production, raise farm income and improve food and nutrition security. However, there are risks of costly and ineffective design and implementation using scarce resources. Depending on local conditions, input subsidies are most effective in boosting production and inducing growth multiplier effects in staple foods, especially in countries with incomplete or non-existent markets, and may necessitate complementary investment policies. Input subsidies in the past have suffered from weaknesses in design and implementation

- **Developing countries and households are not affected uniformly by the trade distortions from OECD policies owing to selective trade preferences for some countries and different net import or export positions among countries and among different households (rural, urban) within the same country.**
- **For developing countries, declining agricultural investments over two decades due partly to low prices, combined with removal of support services (credit, marketing, input assistance etc.), have had negative impact on agricultural growth (and in some cases outright decline of production, yields and quality). This has led to sharp reductions in farm incomes and rising rural poverty.**

in some regions, and greater emphasis may need to be placed on developing the infrastructure for input supply and accessibility as part of long term investment strategy.

SMALLHOLDER SAFETY NETS

Developing countries agriculture is much more exposed to various natural and market risks. For lack of other instruments and safety nets, much of developing country small producers' savings capacity is spent in self insurance. In addition they often become trapped in low-return but low-risk production activities. Policies to reduce the risks faced by low-income farmers and to help such producers cope with negative shocks could be instrumental in unleashing their own savings potential and moving them out of their poverty traps. In addition, public policies should also incorporate safety nets that address threats to food and nutrition security, as well as payments to farmers for environment services. Market-based safety nets, including weather index-based insurance, could be useful supplements to other relevant domestic support measures. Examples of measures that reduce income and price risks and uncertainty include investing in information infrastructure to enable insurance markets, market information systems to improve market transparency and facilitate exchange, clear and stable laws and legal frameworks and targeted insurance and safety nets against crop failures, droughts and other catastrophes.

MANAGING GLOBAL FOOD CRISES

Recent events suggest that there is a need for the establishment of global safety mechanisms against food crises emanating from economic shocks. One possibility could be an early reaction system designed to revive food production particularly in low-income food-deficit countries, building on mechanisms already in place for natural disasters or conflict crises. Another mechanism could deal with the issue of inadequate import trade finance during periods of high food prices. There is a need for strategies and institutions to assure all net food importing countries proper access to supplies in times of crises.

QUESTIONS FOR POLICY CONSIDERATION

A key challenge for policy-makers is how to shape and design support to farmers in both developed and developing countries to meet their separate national objectives without hurting farmers in third countries, while at the same time promoting global food adequacy and food security, and minimizing trade and market distortions.

- What types of support measures can be used to ensure that farmers who remain in rural activities boost their agricultural productivity and production to meet future food economy challenges? What forms of non-distorting support may be appropriate in developing and developed countries? Do smallholder farmers in developing countries require specific coupled support in the short, medium and long run to become more productive and competitive?
- Could decoupling in OECD support policies be expanded more evenly among OECD countries and for all agricultural commodities? Could decoupled policies be linked to maintenance of agricultural "production reserves" in high income countries?
- Given the continued levels of support to developed country farmers, could OECD countries offer compensatory financing for agricultural investments or other agricultural growth enhancing measures to low income countries?
- Should OECD countries limit publicly supported agricultural insurance to deal mostly with extreme and unpredictable agricultural risks that cause market failures, and leave other risks to be covered by the private sector?
- What may be the characteristics of an early reaction fund to help farmers in low-income food-deficit countries to revive their production in case of a food crisis due to economic shocks?
- What types of institutions and arrangements can assure net food importing countries proper access in times of global food crises?
- Can mechanisms be developed for smallholders to benefit from the carbon credit offset system?

For further information

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