FARM SUPPORT POLICIES THAT MINIMIZE GLOBAL DISTORTIONARY EFFECTS

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Outline

I. OECD farm support
II. Developing Countries Policy Strategies & Options
III. Doha Round and Trading System
IV. Biofuels, carbon offsets
I. OECD farm support: Changing composition; lower market support; more decoupled payments

Composition of OECD Producer Support

- Market Price Support
- Output + Input
- Area Headage
- Non-Current
- Decoupled
I. OECD farm support:
Overall distortion coefficient is down; but still high

OECD Agricultural Support 1986-2007

<table>
<thead>
<tr>
<th>Support Policy</th>
<th>Illustrative Trade-Distortion Coefficient</th>
</tr>
</thead>
<tbody>
<tr>
<td>Market price support</td>
<td>1.00</td>
</tr>
<tr>
<td>Output-based payments</td>
<td>0.90</td>
</tr>
<tr>
<td>Input-based payments</td>
<td>1.30</td>
</tr>
<tr>
<td>Current A/An/R/I</td>
<td>0.40</td>
</tr>
<tr>
<td>Non-current A/An/R/I, fixed payment</td>
<td>0.10</td>
</tr>
<tr>
<td>Other, non-commodity based</td>
<td>0.05</td>
</tr>
</tbody>
</table>

Source: Skully, 2009
I. OECD farm support: With increased decoupling, more focus on farm income risk

- More variable farm income due to shift from commodity-to decoupled support
- Crop (or multi-purpose farm) insurance as a mean of non-distortive safety net to OECD farmers
- In OECD, crop insurance is either part of farm support (US) or under consideration (non-Spain EU)
- Normally, let market-based insurance schemes handle majority of private farm operations
- Government supported schemes only justified for “market failure” cases of Ag risks
I. OECD farm support: Decoupled policies to maintain production “reserve”

- Support for land set asides (kept in ready production mode)
- Support for technology and farm human capital skills,
- Could be win-win: stabilizing reserve to any future food shortages; yet not distorting current global markets with overproduction.
I. OECD farm support in the future: Set to continue, more decoupled, different structure

- Farm support expected to continue; slightly lower, but with different instruments
- Likely drivers of future OECD farm support:
  - Budget constraints
  - New imperatives – Ag/rural; Energy; Environment
  - More responsive to consumers’ concerns (transparency);
- Uncertainty- net effect of all domestic support on supply and demand (biofuels created a counter-balance to the Excess Supply paradigm)
II. Developing Countries (DC) Policy Strategies & Options

- Investments to boost productive capacity
- Input markets – Effective Input subsidies
- Trade Policy and Policy Coordination
- Risk reducing/coping and safety nets
- Market development: Value Chain approach
II. DC Policy Strategies: Gov’t Spending for Public goods or private rent transfers!

Illustration from Latin America:

Government expenditures too small in Latin American countries?

Index of government expenditure: Government agricultural expenditure share relative to agriculture’s share of GDP

<table>
<thead>
<tr>
<th></th>
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</thead>
<tbody>
<tr>
<td>Mexico</td>
<td>7.1</td>
<td>1.6</td>
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<tr>
<td>Venezuela</td>
<td>1.7</td>
<td>1.2</td>
</tr>
<tr>
<td>Dominican Rep.</td>
<td>1.1</td>
<td>0.7</td>
</tr>
<tr>
<td>Brazil</td>
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<td>0.7</td>
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<tr>
<td>LAC</td>
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<td>Nicaragua</td>
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<td>Panama</td>
<td>1.6</td>
<td>0.5</td>
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<tr>
<td>Costa Rica</td>
<td>3.5</td>
<td>0.5</td>
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<tr>
<td>Ecuador</td>
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<td>Chile</td>
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<td>0.3</td>
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<tr>
<td>Peru</td>
<td>0.2</td>
<td>0.3</td>
</tr>
<tr>
<td>Uruguay</td>
<td>0.5</td>
<td>0.3</td>
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<tr>
<td>Argentina</td>
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<td>0.2</td>
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<tr>
<td>Paraguay</td>
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<td>0.2</td>
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<td>Honduras</td>
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<td>El Salvador</td>
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<td>Bolivia</td>
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<td>0.1</td>
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<td>Guatemala</td>
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<td>0.1</td>
</tr>
<tr>
<td>Jamaica</td>
<td>0.4</td>
<td>0.1</td>
</tr>
<tr>
<td>Colombia</td>
<td>n.a.</td>
<td>n.a.</td>
</tr>
<tr>
<td>Cuba</td>
<td>n.a.</td>
<td>n.a.</td>
</tr>
</tbody>
</table>

Source: Alberto Valdes (2009)
II. DC Policy Strategies: Input Markets– Key is supply infrastructure; Subsidies if necessary

- Invest in infrastructure for input markets (seeds, fertilizer)
  - support supply & accessibility
- Promote effective input subsidies, only when necessary:
  - When markets do not yet exist
  - Promote fertilizer use as part of new technology packages
  - Facilitate competition in input supply
- Why Renewed interest in Input Subsidies (A. Dorward):
  - Questioning of liberalized policies in 1980’s and 1990’s
  - Renewed interest in supporting staple food production
  - Greater political demand for fertilizer subsidies
  - Diverging donor views (weaker resistance) against input subsidies
  - concerns about declining soil fertility and agricultural stagnation in Africa
  - Input subsidies as an instrument for social protection policies
II. DC Policy Strategies: Elements of appropriate Trade policy

- Low, uniform tariffs are desirable
- But tariff revenues may be difficult to replace in the short run; need to harmonize with tax policy
- For market facilitation, Regulation, and norm setting, may be more important than support interventions
- Trade policy must be subordinate to domestic policy and strategies
- Trade policy less effective for small farmers who are not integrated into markets;
- Active gov’t policies (infrastructure; price policy) may be necessary to integrate small farmers to markets
II. DC Policy Strategies: Institutional Support to value chain development

- Growing acceptance of new role for Gov’t in DC; something between all-out interventionism (60’s-70’s) and more or less state disengagement (1980’s-90’s)

- Gov’t role must rely on market mechanisms; but with a paradigm shift from commodities to value chain (VC)

- VC strategies rely on integrated interventions in: (i) products/technology; (ii) actors/know how; (iii) information/coordination

- Need coordinated approaches combining: (i) policy/regulations; (ii) institutional/organizational; (iii) infrastructure/capacity
II. DC Policy Strategies: Risk reduction/coping and safety nets policies

- DC Agriculture is more exposed to natural/market risks
- For lack of safety nets, DC producers typically self-insure
- Poverty trap: low return and low risk production activities
- Policies could play risk-reducing a role to small farmers:
  - Examples of interventions in insurance markets (Review by P.Conforti):
    1. minimal, only regulatory role (Argentina, Ukraine, Peru)
    2. re-insurance for extreme events (Mexico, India, Malawi)
    3. premiums subsidization (Mauritius, India, Morocco, Philippines)
III. Doha Round and Trading System: High tariff dispersion in products; Non-uniform country effects (due to preferences: EBA, GSP, AGOA)

Source: MacMap-HS6
III. Doha Round and Trading System—Import barriers by far dominate domestic support at global level

![Pie chart showing estimated global protection with import barriers as the largest category, followed by direct domestic subsidies and export subsidies. Values are in billions of US$: Import barriers = 691, Direct domestic subsidies = 97, Export subsidies = 61.](image-url)
III. Doha Round and Trading System– Market access restrictions-- largest source of distortions

Quantitative analyses consistently show that the beneficial effects of full agricultural liberalization stem mainly from the tariff dismantling.

<table>
<thead>
<tr>
<th>Contribution to economic welfare in:</th>
<th>OECD Market Access</th>
<th>OECD Export Subsidies</th>
<th>OECD Domestic Support</th>
<th>Non-OECD All pillars</th>
</tr>
</thead>
<tbody>
<tr>
<td>OECD countries</td>
<td>78%</td>
<td>5%</td>
<td>6%</td>
<td>11%</td>
</tr>
<tr>
<td>Non-OECD countries</td>
<td>84%</td>
<td>-10%</td>
<td>2%</td>
<td>24%</td>
</tr>
<tr>
<td>World</td>
<td>79%</td>
<td>2%</td>
<td>5%</td>
<td>14%</td>
</tr>
</tbody>
</table>

Source: Anderson, Martin and Valenzuela (2006)
III. Doha Round and Trading System: Financing mechanisms for DC

- OECD countries to offer **compensatory financing for developing country producers for distortionary support in OECD farming**; Creation of a global development fund to be distributed to eligible DC farmers for raising production capacity, ag.research, human capital, market/institutional support

- **Promote a Food Import Financing Facility (FIFF)** to insure LIFDCs from sudden and adverse movements in their food import bills (urgency from 2008 global food shock and inability of LIFDCs to import enough food needed). FAO has worked out the modalities of FIFF and supported by export banks

- **Promote a market-based automatic compensation scheme for negative agricultural export earnings** variations for commodity dependent low income countries. (similar to EU FLEX scheme or IMF CFF facility). The idea is to link commodity related compensatory payments to index based financial products, so that compensation can be made automatically and objectively.
IV. Biofuels and Climate Change--new growth opportunities for DC?

**BIOFUELS**
- Opportunities for DC depend on keeping trade open
- Subsidies, mandates – Net effects on trade may cut both ways
- **Sustainability** is key; but standards/certification could be discriminatory

**CLIMATE CHANGE**
- New trust for agricultural support- linking subsidies to carbon footprints—new carbon markets (US)
- Can “carbon offsets” tied to lower GHGs also benefit DC?
- Optimists SEE considerable room for promoting investments & technologies tied to lower GHGs in DC agriculture
- Pessimists POINT to the failure of CDM to take off in DC (harbour of things to come?)
- At any rate; much technical work is needed in specifying carbon emitting patterns in agricultural systems (FAO role)