Non-distorting support measures to farmers

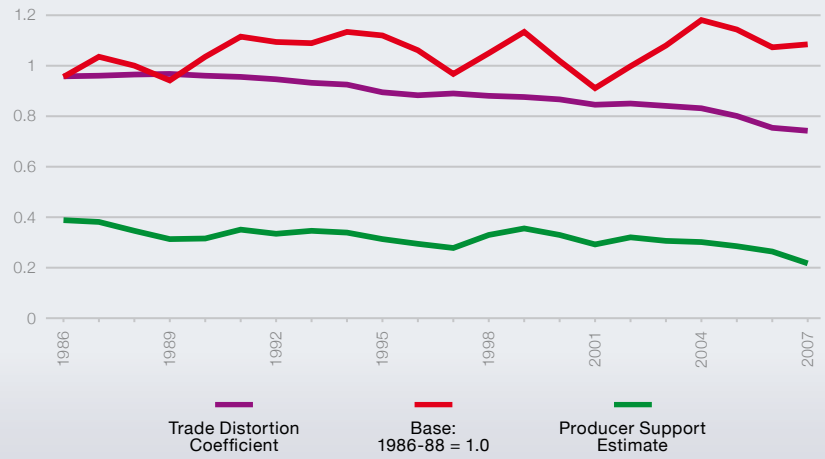
THE CHALLENGE

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 twofold: to ensure food security for the one billion hungry people and to be able to feed a world population set to reach 9.1 billion by 2050.

Increased investment in agriculture and adequate incentives to farmers are required to meet this global challenge. A key issue is how to shape and design support to farmers in both the developed and developing world 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 (in terms of production processes and health) and quality food. Farm support policies that stimulate domestic production can create distortions in world markets, such as lower world prices, diminished import demand, and constrained market access, inducing disincentives in developing countries' agricultural production in the long run. These distortions have been the object of considerable debate within the World Trade Organization agreement on agriculture (AoA).

Figure 1: OECD Agricultural Support 1986-2007



Source: Skully, 2009

KEY ISSUES

SUPPORT TO AGRICULTURE DURING DEVELOPMENT

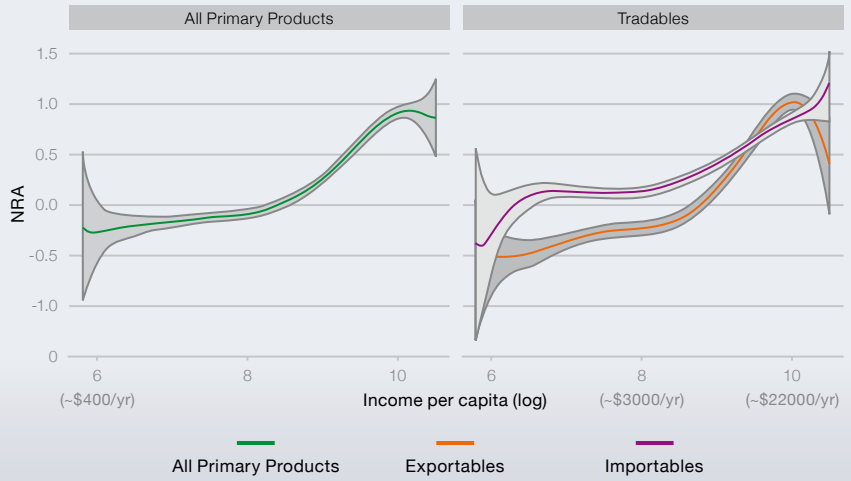
In developing countries, farm policies have been driven largely by the need to accelerate a transition from low-income agrarian structures and rural economies into more developed industry-based economies. Agriculture was viewed as providing a supporting role to industrialization, which was considered the most essential aspect of growth and development. At early stages of this transition, the policies adopted usually aimed at keeping food prices and hence wages low. The overall effect of such policies, as measured by Nominal Rates of Assistance (NRA), that have been computed for a large number of countries and products in a recently completed World Bank project on agricultural distortions, has been largely to tax agricultural producers (namely negative NRAs) (Figure 2). In the process, the agricultural sectors in many

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 US$8 000 or more), and the share of farmers in total employment declines, the farm support policies in developing countries seem to turn positive and follow patterns similar to those of now developed countries, namely 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. Also 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 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

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 as per 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 being increasingly relied upon to provide protection from unpredictable negative swings in farm incomes. 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

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.**
- **Market price support and payments based on output have decreased. Combined, support based on commodity output fell from 82 percent of total support in 1986-88 to 55 percent in 2005-07. Consequently, the aggregate trade-distortion coefficient for OECD agricultural support declined from 0.96 in 1986 to 0.74 in 2007 (Figure 1). Over the same period, payments based on area, animal numbers, receipts or income, considered as decoupled, rose from 9 percent to 32 percent of total support.**

unpredictable and low probability but high 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 (standards, seasonal restrictions, quotas, tariff-rate-quotas, etc.). Exports from developing countries into OECD markets still face high import barriers, except for countries that benefit from preferential tariff access (e.g. GSP (Plus), AGOA, EBA). 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. Tariff escalation is still sizeable and could have major impacts on agro-industry development in the developing countries. The coexistence of ad-valorem with specific tariffs makes protectionism volatile.

Market access restrictions are also production distorting through their protection effect of local producers. For instance, some studies found that high tariffs on temperate zone food products and low tariff rates on tropical products was a typical pattern of the post Uruguay Round of many developed countries.

EXPORT MEASURES

Export subsidies also have a distorting effect since they provide an incentive to produce, and the export of surplus production tends to drive down world prices. Studies analysing the consequences of export subsidy elimination suggest that the longer-term effects on world market prices may be limited for most commodities, but more significant where the subsidy comprises a large proportion of the export value, notably in dairy products, sugar and beef.

Export credits allow foreign buyers to defer payment under more favourable terms than available from financial institutions. The effect of export credits depends on the level of budgetary expenditure on the credits and terms of credit repayment. 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, however Net Food Import Dependent Countries (NFIDCs) and Least Developed Countries (LDCs) appear to have received only a small proportion of available export credits.

An indicator of the extent to which food aid may distort trade is the concept of "consumption additionality". The degree of additionality depends on the characteristics of the recipients and recipient country, as well as programme design and implementation. Emergency food aid is fully additional since recipients are without access to the additional food needed. Non-emergency food aid such as targeted food aid given to specific recipients and food aid which is monetized by selling it onto local markets has varying degrees of additionality and hence distortive effects.

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 could complement domestic investment policies and strategies. However, policy space, for instance in the form of border measure flexibility 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, these reforms remain incomplete and distortion rates across many agricultural sectors continue to be large. In this context, further analysis and debate is required to assess whether (and how) trade policy instruments can be used in support of development objectives.

INPUT SUBSIDIES

Input subsidies if effectively applied could play an important role in agricultural development and to stimulate production. However, they hold 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

- **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, driven in part by the rise of demand for biofuel feedstocks.**
- **Developing countries and households are not affected uniformly by distorting OECD policies owing to selective trade preferences between countries and different net import or net buyer structures at the country and household levels.**

DISCUSSION POINTS

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.

1. **What may be the forms of non-distorting support to farmers, in both the developing and the developed countries? What types of support measures can be used to ensure that farmers remain in rural activities and boost their agricultural productivity and production to meet future food economy challenges? Do smallholder farmers in developing countries require specific support in the short, medium and long run to become more productive and competitive?**
2. **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 "reserve" in high income countries?**
3. **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? One option could be that a certain percentage of farm subsidies in OECD countries be put into some development funds to be utilized for investments that would benefit eligible developing country (especially LDC) farmers.**
4. **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?**
5. **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?**

incomplete or non-existent markets, and may necessitate complementary investment policies. As input subsidies in the past have suffered from weaknesses in design and implementation in some regions, greater emphasis may need to be placed on developing the infrastructure for input (seeds, fertilizer) supply and accessibility, and when necessary, promoting effectively targeted input subsidies, especially to rural smallholders.

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. Market-based safety nets, including index 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.

Also there is a need for the establishment of a safety mechanism against food crises emanating from economic shocks. This could take the form of 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.

For further information

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