

Agricultural Policies in Selected OECD Countries: Opportunities for Reform



.....

Ken Ash

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 (Ash, OECD 2002a).

AGRICULTURAL POLICY OBJECTIVES

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

in the NAFTA countries as well as in the EU. As stated in the Ministerial Communiqué, these goals were to ensure that the agrifood 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 socioeconomic development of rural areas;
- Contributes to food security at the national and global levels.

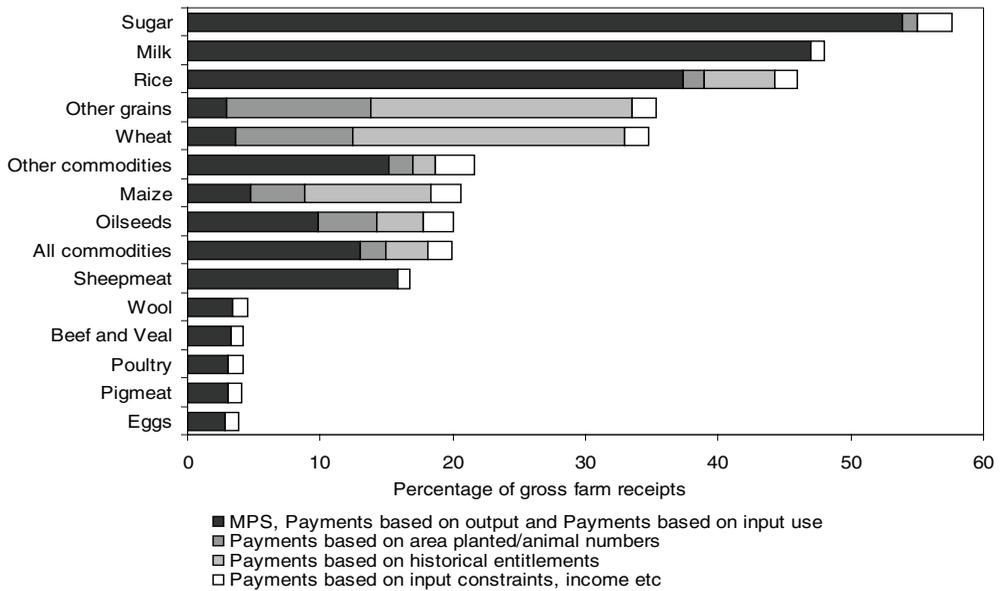
Farm Policy Goals

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 agrifood 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 (Agriculture and Agri-Food Canada).

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 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 (SAGARPA).

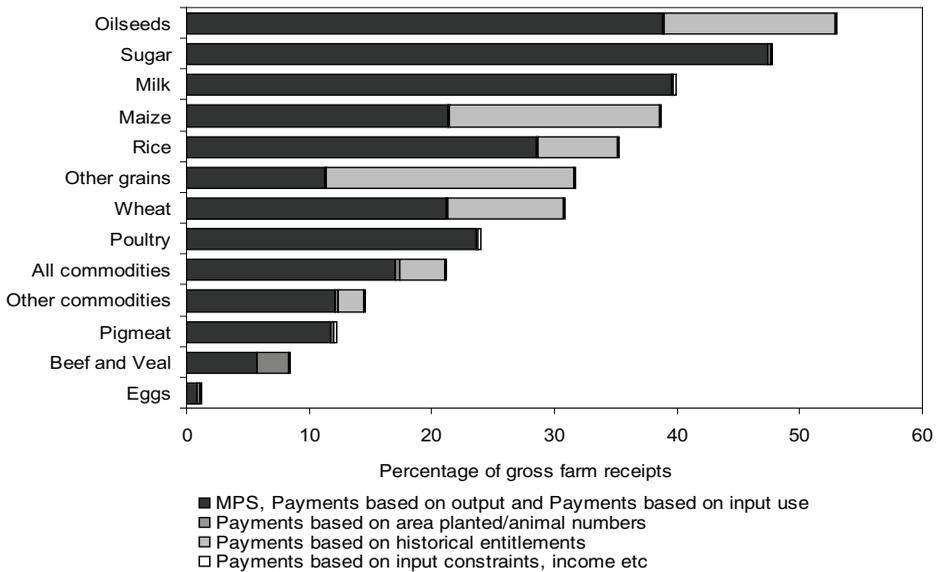
There are no specific objectives contained in the US *Farm Security and Rural Investment Act of 2002*, though the implicit objectives of the various Titles of the legislation seem evident. A number of US Department of Agriculture (USDA) publications can be drawn upon to specify American farm policy interests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

Figure 6.1: Percent PSE by commodity, 2001-03 average - Canada.



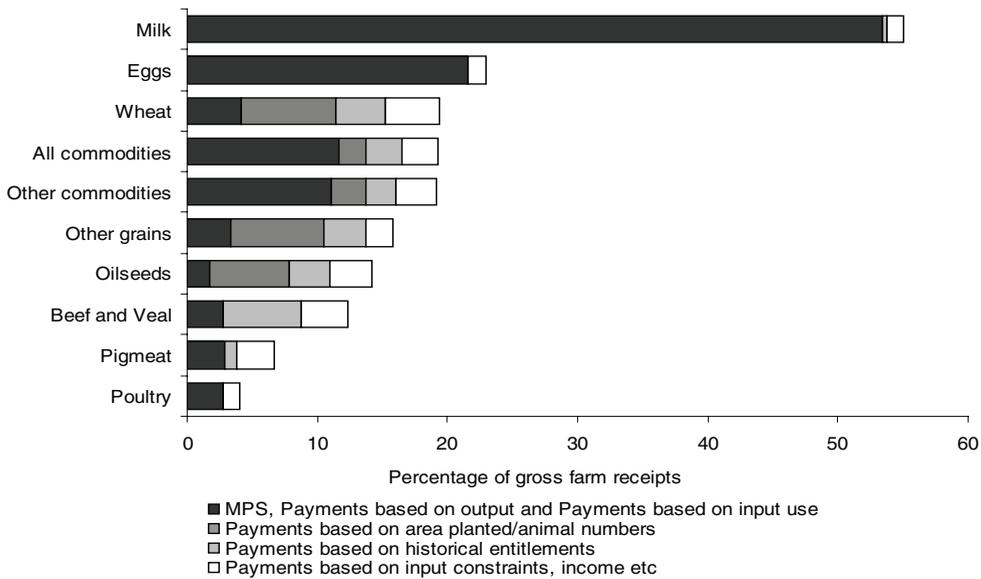
Source: OECD 2004.

Figure 6.2: Percent PSE by commodity, 2001-03 average - Mexico.



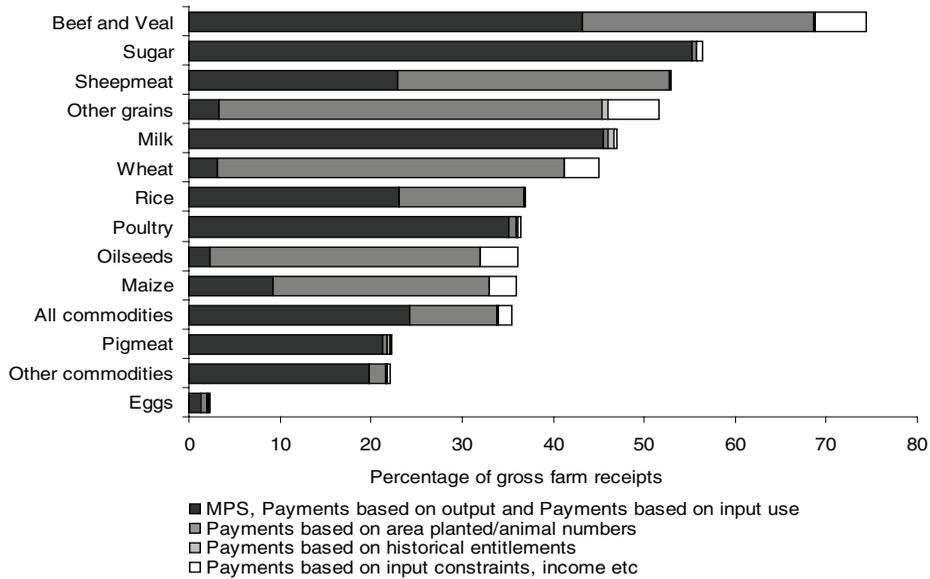
Source: OECD 2004.

Figure 6.3: Percent PSE by commodity, 2001-03 average - United States.



Source: OECD 2004.

Figure 6.4: Percent PSE by commodity, 2001-03 average - European Union.



Source: OECD 2004.

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 (CEC).

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 tradeoffs 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 (OECD 2004).

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

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 6.1-6.4). In Canada, milk stands out as the commodity that receives a very high level of support (55 percent), while most other commodities receive much lower levels of support (less than 20 percent). For Mexico, oilseeds (53 percent), sugar (48 percent), milk (40 percent), maize (39 percent), rice (35 percent), other grains (32 percent) and wheat (31 percent) receive very high levels of support. In the US, commodities receiving very high levels of support include sugar (58 percent), milk (48 percent), rice (46 percent), and wheat and other grains (each 35 percent). Other commodities receive support at much lower levels (generally 20 percent and less). Commodities receiving very high levels of support in the EU include beef and veal (74 percent), sugar (56 percent), sheepmeat (53 percent), other grains (52 percent), milk (47 percent), wheat (45 percent), rice and poultry (37 percent), and oilseeds and maize (36 percent).

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 categorized, as described, in the following paragraphs.

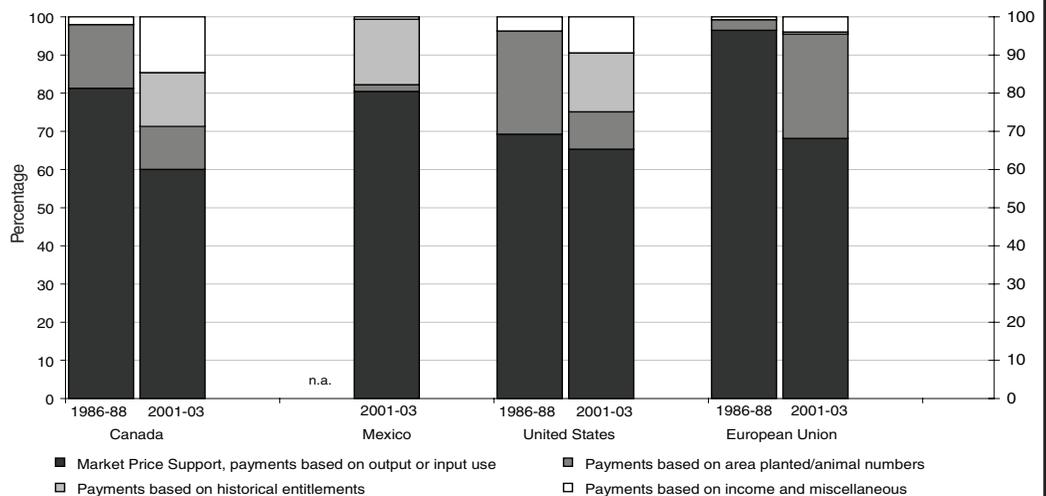
Market price support (MPS) measures the gap between higher domestic prices received by producers and paid by consumers, relative to prices on world markets. These higher prices are regulated (or administered) by governments, and maintained via border protection. This type of support distorts production, 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 percent of support to farmers across the OECD area, and by 2003 this had declined to 75 percent. Within these aggregates, significant differences are evident in the pace of reform across countries (Figure 6.5). 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 countries continues to be dominated by production linked measures. And as shown in Figures 6.1-6.4, 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?

Figure 6.5: Composition of Producer Support Estimate by country, 1986-88 and 2001-03 (percentage share in PSE).



Note: n.a. = not available.

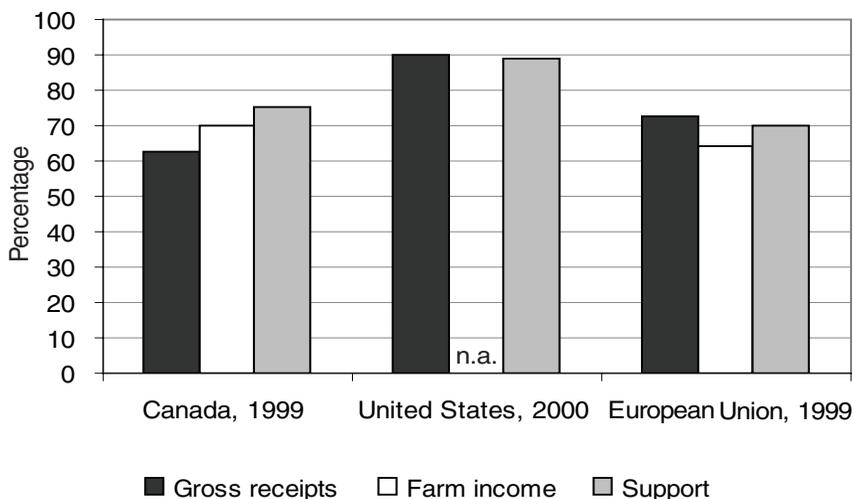
Source: OECD 2004.

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 capitalized 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 (OECD 2002b). The same applies, of course, to land costs for alternative, nonfarm 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 6.6). In Canada, the largest 25 percent of farms have average gross farm receipts of C\$300,000. They produce 63 percent of farm output and receive 75 percent of support. In the US, the largest 25 percent of farms have average gross farm receipts of over \$275,000 and average farm net worth of over \$780,000. They produce 90 percent of

Figure 6.6: Share of the 25 percent largest farms.



Note: n.a. = not available.

Source: OECD 2004.

farm output and receive 89 percent of support. In the EU, the largest 25 percent 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 percent of farm output and receive 70 percent of support. In all cases, the remaining 75 percent of farms, produce relatively little, receive little support, but often have a sizeable average farm net worth (OECD 2003).¹

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 sized 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. 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 four percent 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 realized 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 four percent 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.

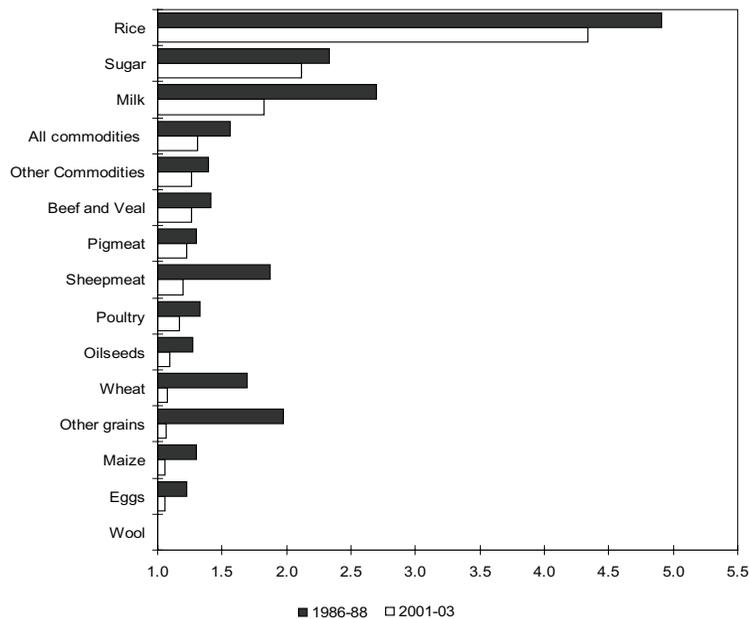
Production linked policies also have important international spillovers. Existing policies provide significant incentives to produce, thereby increasing global supplies and lowering world prices, to the detriment of competitive suppliers elsewhere. Market interventions, which dominate current policies, 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 byproduct of domestic policies.

¹ Note, corresponding data on Mexico is not available.

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 to 100 percent 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 6.7). Clearly, the link between domestic and trade policies is highly dependent 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

Figure 6.7: Producer nominal protection coefficient by commodity, OECD average.



Source: OECD 2004.

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 spillover effects on global markets, and other countries, are large and are negative. Are there more effective alternatives?

How Large Are the Gains from Trade Liberalization?

A standard tool used by economists to estimate the income gains generated by trade liberalization, 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 specialization and trade (OECD 2002a). National governments, international organizations, 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 (Hertel).

A study undertaken by the Economic Research Service of the USDA (Burfisher) using a modified version of GTAP finds that a full elimination of all agricultural policy distortions would yield long-term global welfare gains of \$56 billion a year. The Australian Bureau of Agriculture and Resource Economics (ABARE), using its own CGE model (based partly on GTAP) finds larger benefits, estimating that a 50 percent cut in agricultural protection between 2005 and 2010 would lead to total welfare gains of \$53 billion a year by 2010 (Freeman *et al.*). If a 50 percent cut were also applied to protection of textiles, motor vehicles, and other manufactures, the welfare gains would increase to \$94 billion by 2010. A more general study published by the European Commission 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 percent global cut in protection, accompanied by a modest amount of trade facilitation (reducing transactions costs by one percent), would yield annual welfare gains of \$220 billion. These gains jump to \$400 billion a year in the case of a 50 percent cut. The results are similar to those of the World Bank, which finds gains of \$260 billion a year from the liberalization of all goods markets (Anderson, Hoekman, and Strutt).

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 ten percent reduction in support to crop producers in Canada, the EU, Japan, Mexico, Switzerland, and the US. The PEM model estimates that such a modest reform package would produce annual welfare gains of \$2.6 billion.

The above model estimates are difficult to compare. Even when the same CGE model is used, different liberalization 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 liberalization package. Fourth, developing countries would be major beneficiaries, although a small number of net-importers and highly specialized 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 materialize. 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 realized, 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 specialization 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 (OECD 2002a), 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 underprovide (such as a pleasing countryside).

Such a refocusing 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 (e.g., venture capital schemes or business training and advisory services) might be helpful. Overall, local multisector initiatives, rather than traditional farm commodity programs, 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 liberalization, at least in the short run. Some countries (notably some low income developing countries) may lose from agricultural trade liberalization, 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 multisector 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 recognized 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 labor market policies. Finally, reform can be facilitated with the backing of economy-wide social programs.

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 realized 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 REFORM²

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.

² While this section draws on insights gained from analysis of farm policies in OECD countries, the 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.

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 Uruguay Round Agreement on Agriculture (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 sectors.

During the 1990s 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 (Ejidos 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 also has signed a number of regional free trade agreements, though none would lead to completely free trade in agriculture. Recently, a new 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 realized, domestic policy reforms will also be required. The prospects for reform in the coming US farm bill is discussed in detail in the chapter by Robert L. Thompson.

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 ongoing 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 labor 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 realized, 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.

CONCLUSIONS

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 nonsectoral 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 redistribute 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 nonfarm employment and income opportunities. Many rural amenities can be supplied by various individuals and enterprises, and not just by farmers. Nonsectoral 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). 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 organizations – 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 focusing 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. Ongoing 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.

BIBLIOGRAPHY

- Agriculture and Agri-food Canada. 2003. “Federal-Provincial-Territorial Framework Agreement on Agricultural and Agri-Food Policy for the Twenty-First Century.” Available at <http://www.agr.gc.ca/cb/apf/index_e.php?section=info&group=accord&page=accord>. Accessed 12 September 2005.
- Ash, K. 2001. “EU and US Agriculture Policies: More Similarities than Differences?” Unpublished, OECD presentation given to the Société Française d’Economie Rurale.
- Anderson, K., B. Hoekman and A. Strutt. 1999. “Agriculture and WTO: Next Steps.” Version of *World Bank Paper* presented at the second annual conference on global economic analysis, Helnaes, Denmark, June 20-22.
- Burfisher, M.E., ed. 2001. *The Road Ahead: Agricultural Policy Reform in the WTO*. Washington, DC: USDA Economic Research Service, Agricultural Economic Report No. 797.
- CEC. 2002. *Mid-Term Review of the Common Agricultural Policy*. Brussels: Communication from the Commission to the Council and the European Parliament. 10 July.
- European Commission. 1999. *The Millennium Round: An Economic Appraisal*. European Commission Directorate General for Economic and Financial Affairs No. 139.

- Freeman, F., J. Melanie, I. Roberts, D. Vanzetti, A Tielu and B. Beutre. 2000. *The Impact of Agricultural Trade Liberalization on Developing Countries*. Canberra: ABARE Research Report 2000:6.
- Gundersen, C., M. Morehart, L. Whitener, L. Ghelfi, J. Johnson, K. Kassel, B. Kuhn, A. Mishra, S. Offutt, and L. Tiehen. 2002. *A Safety Net for Farm Households*. Washington, DC: USDA Economic Research Service, Agricultural Economic Report No. 788.
- Hertel, T.W., ed. 1997. *Global Trade Analysis*. Cambridge: Cambridge University Press.
- Organization for Economic Cooperation and Development (OECD). 2001. *Market Effects of Crop Support Measures*, Paris, France.
- . 2002a. *Agricultural Policies in OECD Countries: A Positive Reform Agenda*, Paris, France.
- . 2002b. *The Incidence and Income Transfer Efficiency of Farm Support Measures*, Paris, France.
- . 2003. *Farm Household Incomes: Issues and Policy Responses*, Paris, France.
- . 2004. *Agricultural Policies in OECD Countries: Monitoring and Evaluation*, Paris, France.
- Secretaría de Agricultura, Ganadería, Desarrollo Rural, Pesca y Alimentación (SAGARPA). 2003. *Acuerdo Nacional para el Campo*. Available at <<http://www.sagarpa.gob.mx/cgcs/acuerdo/acuerdo.doc>>. Accessed 28 September 2005.
- Thompson, R. 2006. "The Next Farm Bill." In K.M. Huff, K.D. Meilke, R.D. Knutson, R.F. Ochoa, and J. Rude, eds. *Agri-food Regulatory and Policy Integration Under Stress*. Texas A&M University, University of Guelph, and Inter-American Institute for Cooperation in Agriculture-Mexico. Available at <http://naamic.tamu.edu/sanantonio/thompson.pdf>
- USDA. 2001. *Food and Agricultural Policy: Taking Stock for the New Century*. Washington, DC.