

**AGRICULTURAL PROTECTION IN RICH COUNTRIES:
HOW DID WE GET HERE?**

by Kimberly Ann Elliott

Abstract

After a half century of multilateral bargaining to reduce trade barriers, agriculture stands out for the degree of protection and government support that it still enjoys in most rich countries. This makes agricultural protection a natural focus of the current Doha Round of trade negotiations: in addition to offering the juiciest targets for liberalization, this round is supposed to address the needs of developing countries, where the vast majority of the world's farmers, most of them poor, reside. But is there any reason to think trade negotiations are more likely now than in the past to encourage substantial reform of rich countries' farm policies? This paper looks at the evolution of and current approaches to agricultural policies in rich countries to see if there are lessons from the past that might improve chances for reform this time around.

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**Center for Global Development and
Institute for International Economics**

After more than a half century of multilateral bargaining to reduce trade barriers, agriculture stands out for the degree of protection and government support that it still enjoys in most rich countries. The Uruguay Round of multilateral trade negotiations, launched in 1986 and completed in 1993, was the first under the General Agreement on Tariffs and Trade to try to address farm policies in a serious fashion, but protection in this sector is still an outlier.

Thus, agricultural protection is a natural focus of the current Doha Round of trade negotiations. In addition to offering the juiciest targets for liberalization, agriculture is important because this round is supposed to address the needs of developing countries, where the vast majority of the world's farmers, most of them poor, reside. William R. Cline (2004, p. 129) estimates that complete liberalization of agricultural barriers could lift as many as 200 million people out of poverty.

But is there any reason to think trade negotiations are more likely now than in the past to encourage substantial reform of rich countries' farm policies? This paper looks at the evolution of and current approaches to agricultural policies in rich countries to see if there are lessons from the past that might improve chances for reform this time around. The focus is on the United States and European Union because policies in these large markets have the most impact on global markets and they will be key to any agreement that is reached. Members of the "Group of 10" food-importing countries, led by Japan, Korea, Switzerland, and Norway, have the highest

levels of protection but are mentioned only in passing. They have undertaken little or no reform in recent years and their interests in the Doha Round are primarily defensive. The paper concludes by examining trends in both internal and external pressures that might make this a more favorable environment for reform than was possible a decade ago.

Colored Boxes and Cows versus Poor Farmers: What Does it All Mean?

The Oxfam “Make Trade Fair” campaign claims that, “rich countries spend \$1 billion a day on agricultural subsidies....”¹ Other development advocates use the metaphor of cows in rich countries living in luxury, supported by subsidies that exceed the incomes of more than a billion people living in extreme poverty on \$1 a day.² European Union Commissioner for Trade Pascal Lamy disputes these figures, arguing that the true figure for total subsidies is a third of what Oxfam claims. Who is right?

The Organization for Economic Cooperation and Development (OECD) estimates that member governments *and consumers* support farm incomes with average annual transfers of more than \$300 billion, and nearly \$350 billion in 2003, closer to Oxfam than to Lamy (OECD 2004a, p. 17). But Lamy is correct that OECD government *payments* to farmers are much lower. The difference lies in import restrictions and other government interventions that support farm incomes without budgetary outlay, or general government support for agriculture (for example, research and development) that is not tied to production levels. The OECD figure of \$300 billion-plus is the “total support estimate” of the value of all transfers from consumers and taxpayers resulting from policies in support of agriculture.

¹ See “The Issues: Hard Facts” at the Make Trade Fair Campaign website, www.maketradefair.com.

² Devinder Sharma, “Western Cow versus Eastern Farmer: The Absurdity of Inequality,” *Hunger Notes*, available at <http://www.worldhunger.org/articles/global/Sharma.htm>.

The figure that should be of concern in international trade negotiations is somewhere in between Lamy's \$100 billion and Oxfam's \$300 billion. On average in 2001-03, the OECD estimates the value of the most "trade-distorting" forms of support to farmers was \$180 billion. Most of this is in the form of "market price supports that create a gap between the price that producers receive and a market-oriented reference price. The principal mechanisms for this are import restrictions and other production controls. Other production-distorting interventions include payments that are linked to prices—where the government makes up the difference when target prices are above market prices—or subsidies for inputs that encourage production. Less-distorting support can be in the form of direct payments that are "decoupled" from current production or general support for agriculture that do not involve payments to farmers and are not expected to affect production decisions in the short run.

In order to compare some of the costs of agricultural support policies over time and across countries, Figure 1 shows OECD calculations of the "producer support estimate" (PSE) from 1986 to 2001 for key countries. The PSE is a calculation of "the annual monetary transfers to *farmers* from policy measures" (emphasis in original) that either maintain prices above market levels or provide government payments to farmers (OECD 2004c, p. 2). On average, OECD farmers receive transfers equal to roughly a third of farm receipts (valued at the gate). For most of this period, US producer support was below the OECD average, but it narrowed the gap in the late 1990s. The EU is close to the average while Japan and Korea are well above it.

Figure 2 shows how US and European support policies fluctuate counter-cyclically with global prices. A more direct indication of the degree to which producer supports distort international markets is in figure 3, which shows the OECD estimates of the most distorting forms of support, those directly linked to prices or production, as a percent of total producer

support. By this measure, policies in Japan and Korea have changed very little since the mid-1980s (when the OECD began trying to quantify them) and they remain both far more costly and more trade-distorting than those in the US or, in recent years, the EU (figures 1, 3).

Understanding the various forms of agricultural support is important because the distribution of the burden among consumers, taxpayers, and foreign exporters differs depending on whether import restrictions or government payments are used and whether or not subsidy payments are linked to production. Among developing country governments and development advocates, the principal concern is that poor farmers in poor countries, who have no say in the farm policies of rich countries, are paying part of the price for these policies.

Of most concern are OECD agricultural policies that support prices without controlling production, thereby increasing global supplies of supported commodities, lowering average world prices and increasing price volatility as world markets for many commodities become a residual market. The costs of rich-country agricultural interventions can be particularly severe for developing countries with large numbers of poor farmers who suffer from depressed prices and are forced to compete with subsidized imports in their home market.³ Developing country exporters obviously lose access in OECD markets protected by trade barriers, but they also suffer from production-related supports that increase volatility and lower average world prices in third-country markets. Subsidized exports add insult to injury by further distorting world markets. Figure 4 shows how industrialized countries increased their share of global agricultural exports in the 1970s and 1980s at the expense of low and middle-income developing countries.

Thus the objectives of international negotiations on agriculture are to increase market access, particularly for developing country exporters, by lowering trade barriers and “decoupling” subsidies. It is not necessary, as some critics demand, to completely eliminate

³ Of course, urban consumers in those countries benefit from lower food prices.

OECD agricultural subsidies, as long as they are decoupled from current production levels and prices. Such subsidies would likely discourage exit by some farmers and maintain production of subsidized commodities above the levels that would occur in a subsidy-free world. But removing import restrictions and export subsidies and allowing the market to set prices would substantially reduce the distorting effects of remaining subsidies.

Reflecting the interrelatedness of the various forms of support, trade negotiators in both the Uruguay and Doha rounds chose to address agricultural support policies under three headings: market access, export subsidies, and domestic subsidies. Recognizing that sharp reductions in the overall level of agricultural subsidies were unlikely to be politically viable in the short run, trade negotiators during the Uruguay Round also created separate “boxes” for different types of subsidies according to their impact on trade. More trade-distorting subsidies were placed in the “amber box” and subjected to nominal 20 percent cuts (from a high, nonbinding base). “Decoupled” subsidies, which separate income support from current production and prices, and payments for environmentally-motivated land set-asides can be allocated to a “green box” that has no cap. As an intermediate step, subsidies that are trade-distorting but where production is also controlled can be put in a “blue box” that, under the Uruguay Round agreement, is unlimited because it was intended as a temporary step on the way to decoupling. Since initial hopes of eliminating the blue box have apparently been dashed, debates over the definition of what can go in the blue box and whether to cap the value of subsidies eligible for it are likely to be among the more divisive issues in the current negotiations.

In mid-2004, however, the most difficult issue to resolve during discussions over the framework for negotiations was market access. The impasse on this issue emerged, in part,

because developing countries with large numbers of rural poor are uncertain as to how far and fast they want to commit to open up their agricultural sectors, especially as long as rich-country production and exports continue to be subsidized.

But these negotiations also pose difficult dilemmas for rich country policymakers because import restrictions allow them to support farm incomes while containing the budget costs. In places like the EU and, even more, Japan and Switzerland that rely heavily on import restrictions to support farm incomes, the budget impact of moving to a system of decoupled subsidies could be quite high. Still, it would at least cap outlays by basing them on past production or acreage rather than on current prices. And by making the subsidies more transparent, it increases the odds for reducing them over time, an outcome that farm groups fear and can be expected to oppose.

Farm Policy Goals and Options: The Evolution of US and European Agriculture

There are a variety of political economy theories to explain the origin and, especially, the persistence of agricultural subsidies but none of them are fully satisfying.⁴ Policymakers from different countries offer different justifications at different times for subsidizing agriculture, but most share the purported goal of supporting farm incomes while minimizing budget costs. Even without explaining the underlying motivations of policymakers, it is possible to find the logic behind particular forms of intervention chosen to achieve this goal under different structural conditions. What also seems obvious from a brief review of the past few decades is that policymakers have been more interested in containing the budget costs of agricultural support than in minimizing the negative spillovers for other countries. It also suggests that the the

⁴ See Moyer and Josling (1990) and Paarlberg (1989) for a review of some of the more prominent theories.

difficulties in reforming agricultural policy reflect primarily rent-seeking by farm interests rather than the oft-stated goals of protecting family farms or enhancing food security.

Figure 1 summarizes in broad terms the options available to policymakers in subsidizing agriculture and how they differ depending on the sector's relationship to international markets and on policymakers' willingness to bear the costs nationally. There are essentially three ways of supporting or raising farm incomes:

- provide direct payments
- manage supply to support market prices
- some combination of both.

As indicated in Table 1, decoupled subsidies are paid by taxpayers, are not linked to prices or production and impose no direct costs on consumers or foreign producers (though they likely would discourage exit). If policymakers wish to reduce the budget costs of a given level of agricultural support, they must somehow control supplies, which will shift some of the cost from taxpayers to consumers. In an autarkic economy, this can be achieved through direct production controls or acreage reductions that raise farm commodity prices. With trade, sectors that are globally uncompetitive will need import restrictions to contain budget costs. Countries with export potential face a dilemma if they want to support farm incomes above what the market provides. If they use supply controls to raise prices, they risk losing export share; but offsetting higher domestic prices with export subsidies raises budget costs, and costs to international competitors.

The European Economic Community (later the European Community, EC, and now the EU) launched the Common Agricultural Policy (CAP) in the early 1960s when memories of food shortages during and after World War II were still fresh and when the region was a large net

importer of most agricultural products. For more than two decades, EEC policymakers followed a policy of trying to insulate their import-competing farmers from global markets. But they were so generous that large surpluses developed that could only be exported with additional subsidies, thus roiling global markets. US policymakers first provided subsidies to American farmers during the Great Depression when they were not much concerned about trade and US policies subsequently fluctuated more than in Europe, depending on the degree of engagement with global export markets and conditions in those markets.

European policies: from net importer to net exporter

As of the mid-1980s, the countries of the Europe Community had only a quarter the arable land of the United States, but three times as many farms that were, and are, much smaller (Newman, Fulton, and Glaser). When the CAP was created, European production costs were so far above world prices that supporting farm incomes at an acceptable budget cost necessarily meant insulating domestic production from international markets. At this early stage, the Community was a common market, without the tax power of a state, and this also tilted the CAP in the direction of placing the financial burden of subsidies on consumers and foreign producers rather than taxpayers.

The principal tool developed for this was the “variable levy,” which the EC imposed on imports to ensure they would not undercut domestic price targets for agricultural products. Over time, because of high target prices and technological progress, production increased, consumption was dampened, and surpluses began to accumulate. As a result, EC expenditures for storage costs and export subsidies to dispose of surpluses increased sharply. Trade conflicts also multiplied as the EC moved from being a large net importer to a net exporter of sugar, beef,

butter, and wheat in the 1970s and 1980s (ibid.). As shown in figure 5, EC imports have fluctuated, but exports have grown steadily and, by the early 1990s, the EC had essentially closed its agricultural trade deficit.⁵ By this time, the EC was under intense pressure, both from the budget and from its trading partners to find a way to reduce the internal and external costs of supporting its farmers.

Fluctuating US policies

The United States, with its abundant endowment of land, emerged in the 19th century as a net exporter of bulk commodities, such as feed grains, oilseeds, and cotton, and into the early 20th century policymakers protected manufacturing at the expense of agriculture. After World War I, global markets for US farm products shrank markedly and pressures for subsidies or protection began to grow. Those pressures were resisted until the Great Depression of the 1930s when the collapse of global markets and the drought that created the “dust bowl” threatened farmers’ livelihood and few alternative jobs were available.

Since global markets had collapsed, agricultural policy, including for traditional export crops, was developed with little regard to international market effects. The Agricultural Adjustment Act of 1933 sought to reduce supplies and raise prices by paying farmers to reduce the acreage planted in most major commodities.⁶ Section 22 of the Act authorized the use of tariffs and quotas if imports threatened to undermine domestic supply control programs. Dairy was protected from the beginning, and beef (at relatively low levels of protection), sugar, peanuts, and tobacco (at much higher levels) were added to the list later.

⁵ Note that the data underlying the charts are denominated in nominal dollars, which accounts for some of the fluctuation.

⁶ This discussion of the history draws on Orden, Paarlberg, and Roe (1999, pp. 18-24).

As a temporary measure, to support farm incomes until supply controls took effect, the government introduced commodity loans. Farmers could take out loans using stored crops as collateral and then they could either sell the crops to repay the loans if prices rose or forfeit them to the government as payment in full if prices dropped below the loan rate. But like so much else in agricultural policy, commodity loans did not remain temporary and they eventually became another mechanism for supporting prices when Congress took over the setting of loan rates.

Though there were a few fluctuations related to changes in control of Congress, with Republicans generally favoring lower target prices and Democrats favoring higher ones, the policies forged in the 1930s remained more or less intact until the 1960s. During the recovery following World War II, US farm exports were mostly in the form of food aid. But as global commercial markets revived, high target prices and supply controls were increasingly seen as an impediment to US exports (Gardner 1990). At this point, US policy moved toward what Orden, Paarlberg, and Roe (1999, pp. 61-67) call a “partial cash-out,” which introduced a two-tier price system that allowed exports at world market prices, and introduced direct “deficiency payments” to compensate farmers for domestic sales below the target price. From this time on, US farmers were relatively more exposed to global market conditions and American policy fluctuated in response to those conditions and to associated budget costs.

High prices during the 1970s commodities boom could have been used to ease farmers off of government subsidies. Instead, the low immediate budget impact lulled policymakers in both the US and EC into excessive generosity in raising nominal support prices to make up for inflation and helped to set the stage for the US farm crisis and proliferating trade conflicts in the 1980s. High target prices increased production and exports but the US trade balance turned sharply downward in the early 1980s because of a confluence of events—the overvaluation of

the dollar, declining demand in developing countries because of the debt crisis, and increasing competition in export markets from the EC and emerging exporters such as Brazil and Argentina (figure 6). The US responded to the subsidized export competition from Europe by adopting its own export subsidies, further disrupting global markets and generating yet more trade conflict. Thus the stage was set to finally address agricultural policies in multilateral trade negotiations.

Recent Reforms and the Current Status of Agricultural Policies in Rich Countries

As often happens, rising prices in the latter half of the 1980s released some of the pressures for reform. But they could not wholly dissipate them because the distortions, and the associated costs had become too great. Although there were efforts to reduce the global spillovers from farm policies through trade negotiations, agricultural reforms in the United States and European Union have continued to be driven primarily by budget pressures. The Uruguay Round of trade negotiations, the completion of which was delayed three years largely over agriculture, played little role in these reforms, though it probably has helped to lock them in and constrain backsliding. In the 1996 farm bill, there was a seemingly substantial shift in the direction of US policy toward decoupling. But the speed with which those reforms were undone when prices declined underscores the difficulties involved in significant agricultural reform.

EU reforms: slow and incremental but in the right direction

Up to the mid-1980s, the EC controlled agricultural supplies only on the import side and it was not until chronic surpluses threatened to break the CAP budget that policymakers resorted to modest production controls for dairy in 1984. At the same time, they modestly lowered intervention prices for cereals and began to consider acreage set-asides as a means of reducing

surpluses, with the first payments for this being made in 1988. These limited reforms did little to rein in surpluses or budget outlays, however, which hit record levels in 1987-88 (Moyer and Josling 1990, chapter 4). In addition, subsidized wheat exports and conflicts over oilseeds, beef, and other imports were roiling trade relations with the United States. Finally, the United States and the Cairns Group of agricultural exporters (including Australia, New Zealand, Canada, Argentina, Brazil, and several others) insisted that the new round of trade negotiations, launched in Punta del Este, Uruguay, in September 1986, address domestic subsidies to agriculture because of their links to trade distortions.

The EC's inability to agree internally on further reforms, however, resulted in the failure to end the Uruguay Round as scheduled in 1990. After another 3 years of negotiation, EC policymakers agreed among themselves on reforms to the CAP that modestly lowered levels of support, continued the move toward setasides and direct payments, and introduced the idea of decoupling some payments from current production, though this provision was weakened in the end (Swinbank and Tanner 1996, chapter 5). Once this was accomplished, EC negotiators concluded a deal with the United States to resolve an escalating bilateral conflict over oilseeds and, at the same time, to set the parameters for a multilateral agreement that would essentially ratify reforms that each had undertaken unilaterally. This agreement was then presented to other GATT members essentially as a fait accompli. A key result was the selection of the high-subsidy years 1986-88 as the base period from which reductions would be calculated, thereby ensuring that few reductions beyond those already adopted would be required.

Since the end of the Uruguay Round, ongoing budget pressures, and the prospect of those growing sharply with the accession of 10 Eastern European countries in 2004, have continued nudging the EU in the direction of gradual and incremental reform. According to OECD figures,

the overall level of EU producer support has declined little since 1986-88, but the most trade-distorting elements of that support have declined from nearly 100 percent of the total to 68 percent in 2003 (figure 3).

In preparation for the accession of 10 new members and to determine the parameters for negotiations in the Doha Round, EU policymakers undertook another reform in 2003, including introduction of a “single farm payment,” which is based on historical payments and is non-commodity specific (OECD 2004b, p. 7). The EU Commission’s proposal to convert most payments to the decoupled single payment was watered down to allow countries flexibility in how soon they had to adopt the single payment and in the share of payments for various commodities that can remain “coupled.” Other payments are excluded from the single payment scheme entirely.

OECD projections of the effects of the 2003 CAP reform suggest a continuation of recent trends, with little change in the overall level of support and a modest further reduction in the trade-distorting elements to 62 percent by 2008 (OECD 2004a). One problem for the EU is that, because of its relatively heavy reliance on off-budget trade measures, further moves toward decoupled subsidies could require additional budget resources in the short run that can only be lowered by further lowering levels of support.⁷

US reforms: continued fluctuation with no clear trend

US policymakers also initially responded to the farm crisis of the mid-1980s with modest, incremental changes. The 1985 farm bill used paid acreage set-asides to bolster prices but also modestly lowered some target prices in order to encourage exports and, in response to increasing

⁷ The budgetary consequences of moving to decoupled subsidies will be even greater in countries like Korea, Japan, Norway, and Switzerland that rely even more heavily on import restrictions to maintain prices and farm incomes.

EC wheat export subsidies, adopted the Export Enhancement Program to “level the playing field.” In a potentially positive innovation, Congress introduced environmental concerns into farm policy with a “conservation reserve” acreage setaside program to take particularly vulnerable land—prone to erosion or in wetland areas—out of production for long periods, if not permanently.⁸

On the less positive side from a global perspective was a decision to shift from “nonrecourse” loans to marketing loans in certain sectors to promote exports and reduce the government’s storage costs. Nonrecourse loans were called that because the government had no recourse but to accept commodities held by farmers as collateral when prices dropped below the “loan rate.” With forfeitures and storage costs escalating rapidly in the first half of the 1980s, Congress shifted to marketing loans under which farmers could export stored commodities even when world prices were below the loan rate and the government would make up the difference.

After pursuing this gradual, incremental reform path for a decade, US policy took a sudden and dramatic turn in 1996 at a time of high commodity prices and with Republicans in control of the House of Representatives for the first time in 50 years. Orden, Paarlberg, and Roe (1999) argue that these two factors were both necessary and, together, sufficient to trigger a major shift in US farm policies. The shift was always less radical than it appeared on the surface, however, and important elements were reversed within two years when prices declined sharply. While some elements of the reform were retained when a new farm bill was written in 2002, important reversals, including a move back toward linking some payments to prices, were institutionalized.

⁸ I say potentially positive because not all land put in the “conservation reserve” is permanently retired and that undercuts both the environmental and decoupling goals.

The chief innovation of the 1996 farm bill, initially called the “freedom to farm act,” was to free farmers from having to produce particular crops and manipulate the acreage planted in order to receive payments. Instead, farmers would sign “production flexibility contracts” that would allow them to plant whatever they wanted in response to market signals (with a few exceptions) and they would no longer be guaranteed a minimum price. Rather, payments would be based on historical acreage enrolled in subsidy programs and they would be reduced over time. Marketing loans and other subsidies were not totally eliminated, but they were intended to become much less important forms of support. Note, however, that even this relatively radical reform, trumpeted in some press stories as “ending farm subsidies,” made minimal changes to the more heavily-protected import-competing sectors—sugar, dairy, peanuts, and tobacco.

The shift to Republican control of the Congress made “freedom to farm” possible because they were more ideologically opposed to market interventions in general and in particular to mechanisms like production controls. Although there were regional differences, many Republicans also represented areas dominated by the larger-scale, more commercially-oriented and competitive sectors that chafed at supply controls and would suffer relatively less from a reduction in target prices. Democratic concerns focused on smaller-scale farmers, many of whom would not survive without supply controls (Orden, Paarlberg, and Roe 1999).

But the Republican takeover likely would not have been sufficient had there not also been a surge in agricultural commodity prices in 1996-97. Some skeptical farmers were sold on the radical shift to decoupled payments because sticking with the old system of deficiency payments and commodity loans linked to target prices would have meant that farmers received *less* from the government than under freedom to farm’s historically-based payments (ibid.). In other words, decoupled payments at a time of high market prices offered the opportunity for a windfall

for farmers in affected sectors, including wheat, corn, and cotton. Congressional Democrats argued against the reform bill on the basis that farmers would be trading away their permanent safety net for this short-term windfall. In fact, when prices collapsed following the Asian financial crisis and farmers in some regions were hit by severe flooding and others by drought, Congress quickly intervened to restore the safety net with emergency payments that were, in effect, deficiency payments linked to prices.

While the next farm bill was being written in 2002, Democrats regained control of the Senate, though by the slimmest of margins. Prices had recovered a bit but were still well below mid-1990s levels and the appetite for radical farm policy reform had waned. Congress retained some decoupled payments, renaming them “direct payments” and ditching “production flexibility contracts,” but they undermined the reform element of these nominally decoupled payments by allowing farmers to update the acreage that would be eligible and by adding new commodities. Although the payments remain nominally non-commodity-specific, and therefore less distorting than otherwise, the expectation of similar changes in future farm bills is likely to encourage farmers to produce at higher levels than they otherwise would.⁹

In addition to that relatively small step back, Congress took a much larger step back from decoupling by reintroducing counter-cyclical payments that compensate farmers when prices for particular commodities drop below target levels. This change is believed to be behind the US effort to change the definition of the so-called “blue box” for subsidies in the current WTO negotiations on agriculture. Without such a change, these subsidies would have to be placed in the most trade-distorting “amber box” and the United States might have problems staying under its cap if this box is targeted for deep cuts in the Doha Round.

⁹ A WTO dispute settlement panel ruled in summer 2004 that restrictions in the law that bar farmers who receive direct payments from planting (unsubsidized) fruits and vegetables means these payments are commodity-specific, which makes them trade-distorting and, therefore, ineligible for the green box.

The net result of these policy changes over the past decade is that the overall level of US support for agriculture, as measured by the OECD's "producer support estimate," was down by a fifth in 2001-03 from its peak in 1986-88 (20 percent of the value of farm production versus 25 percent earlier). But, as shown in figure 3, while it started from a lower level, the share of trade-distorting payments in overall producer support has declined less than the EU's and the shares are now similar, though the overall level of European support remains higher (figure 1). In Japan and Korea, almost no decoupling has occurred.

Prospects for Reform

The Uruguay Round of multilateral trade negotiations contributed relatively little to agricultural reform in the OECD countries in the 1980s and 1990s. But there are changes since then that might make prospects for the ongoing Doha Round brighter. The number of farmers in the industrialized countries continues to decline while their average age continues to increase, as does the concentration of payments to larger, richer farmers. Both the US and EU are facing growing budget pressures that will highlight anew the costs of farm subsidies. And, perhaps most important, developing countries that are competitive agricultural exporters are demonstrating themselves to be more organized and more effective than they were during the Uruguay Round. This, combined with the mobilization of development-oriented NGOs on behalf of poor developing countries, is contributing to a different dynamic in this round that could produce a more positive outcome. This section first reviews the environment for further reform within key countries and then reviews the achievements and failures of the Uruguay Round Agreement on Agriculture (URAA) and the prospects for further liberalization in the Doha Round.

Internal Pressures for Reform

Of the various potential sources of reform pressure, structural economic change—the declining importance of agriculture in economies as they industrialize—has long seemed the most likely to have an impact. But the question remains, when? Over the past two decades, at least, the most effective pressure for reducing farm subsidies has instead been budgetary, especially when markets turned down and the costs of support prices set in good times soar. But, of course, it is also politically difficult to cut subsidies when farmers are suffering losses so most reforms have tended to be modest and incremental. Is there hope for anything more?

Nearly twenty years ago, Honma and Hayami (1986) hypothesized that government support for agriculture would begin to decline once the share of farmers in the total population dropped below 5 percent. But figure 8 shows no consistent pattern in key countries. The farm share of the US population dropped below the 5 percent threshold 30 years ago but subsidies have fluctuated with world prices and the value of the dollar and have shown no consistent decline (figures 1 and 2). The farm population share in the EU dropped below 5 percent much more recently but budget pressures to reduce subsidy levels began before that. Japan also just recently dropped below the 5 percent threshold and, thus far, shows no sign of significantly reducing support for its farmers. Moreover, the fact that farmers in the United States and Europe are getting older—roughly half of them are 55 or beyond—and that 50 percent or more are only part-time farmers, earning significant shares of household income from off-farm sources, has had little impact thus far on policy (table 1).

One consequence of declining numbers of farmers has been consolidation of farm operations and subsidy payments. Because coupled subsidies tend to be based on levels of

production and decoupled subsidies on historical payments or acreage, most subsidies go to the largest operations. In the United States, according to a database of payments maintained by the Environmental Working Group (www.ewg.org), the top 5 percent of recipients in 1995-2002 got 53 percent of total subsidy payments, an average of more than \$400,000 per recipient, while the bottom 80 percent got only 14 percent of the total and an average payment of under \$7,000 (table 2). According to the US Department of Agriculture (2000), 64 percent of farms receive no subsidies at all and only 40 percent of those that do have sales under \$50,000 annually.

While one might think that outrage over the inequitable distribution of subsidies would lead to calls for reform, basic political economy theories of rent-seeking tell us that smaller groups with concentrated gains or losses find it easier to organize and engage in collective action (Paarlberg 1999, Moyer and Josling 1990, chapter 1). Much larger groups with more diffuse costs or benefits arising from government policy—in this case consumers and taxpayers—care less intensely and typically fail to organize to protect their interests. In this case, food is also a small and declining share of the consumption basket in rich countries and farm subsidies are a relatively small share of overall government budgets.

So, even though Americans tell pollsters that they do not favor subsidies to large operations and do not favor subsidies at all except in “bad years,” very few of them vote on this issue or bother to lobby their representatives. In contrast, US farm interests lobby vociferously and, in the 2001-02 election cycle, contributed more than \$50 million to political campaigns (Center for Responsive Politics database at www.opensecrets.org). And, unfortunately for the NGOs lobbying for reductions in OECD farm support on grounds of *international* equity, Americans appear to be unconvinced by these arguments. A recent poll on globalization by the Program on International Policy Attitudes (www.pipa.org) shows that a slim majority (53-56

percent, depending on the question), think that US subsidies to farmers were justified to compete with farmers in poor countries with lower returns and that it is “not our responsibility to take care of farmers in other countries”.

For at least two decades, the strongest source of pressure for reform has been fiscal. In the EU, budgetary pressure is a long-standing problem that has been exacerbated by the accession of 10 Eastern European countries and the prospect for more in the future. Absorbing all of the farmers in these countries, and they are relatively more numerous than in the current 15 EU countries, confronts the EU with a stark choice of either large increases in the CAP budget or lower levels of support. The EU is dealing with this in the short run by phasing in the proportion of direct payments for which farmers in the accession countries are available, starting at 25 percent and rising to 100 percent only in 2013. But they are immediately eligible for export subsidies and other “intervention mechanisms.” As all these costs rise, pressures to lower the level of support that farmers receive will also increase.

In the United States, a sharply deteriorating fiscal picture resulting from recession, tax cuts, and increased military spending, has also revived the debate over budget deficits and this will contribute to the pressure to reduce the level of agricultural support when the next farm bill is debated in 2006-07. But if agricultural prices were to continue to rise, as they have over the past year, this could relieve pressures for reform, as occurred in 1996 when budget constraints were tight but prices were also high.

So if equity concerns and consumer or taxpayer outrage seem unlikely to force changes in farm policy any time soon, and if budget constraints depend on global market conditions that cannot be predicted, can international trade negotiations exert pressure on legislators in rich

countries more than in the past? Alternatively, can the Doha Round succeed without internal pressures for reform that force concessions in the international negotiation?

External pressures for reform: Trade negotiations and the URAA framework¹⁰

When the General Agreement on Tariffs and Trade (GATT) was created after World War II, the rules negotiated to discipline quantitative restrictions and export subsidies were weaker for agriculture than for manufacturing. The United States further weakened the GATT's role in 1954 when it requested a waiver for import quotas on dairy and other products that were not in compliance with already lax standards for agriculture. The EEC went further when it developed the Common Agricultural Policy in the early 1960s and implemented the variable levy, which was totally outside the international trade rules and which effectively insulated European farmers from world markets.

As US exports increased in the 1960s, American policymakers came to regret their role in weakening the international rules, but efforts by them and others to undo some of the damage proved largely unsuccessful. Moreover, as noted, the US government still protects a few sensitive sectors of its own and provides generous subsidies to others. Despite strong free-market rhetoric, US trade negotiators, like those from other countries, typically try to preserve their own government's policy autonomy while constraining that of others.

Given this history, it is not surprising that the Uruguay Round largely failed to liberalize agricultural trade and succeeded mainly in creating a framework in which further reforms might be encouraged. It reduced export subsidies, capped the level of trade-distorting domestic subsidies (albeit at high, mostly nonbinding levels), encouraged decoupling by leaving those

¹⁰ For a more detailed evaluation of the URAA results and analysis of current proposals in the Doha round, see Hathaway and Josling (2004).

subsidies largely unconstrained, and made the costs of trade restrictions more transparent by requiring that quotas be converted to tariffs.¹¹ The current Doha round of negotiations is trying to build on this framework with further reductions under the three broad headings of domestic subsidies, export subsidies, and market access.

Logically, a trade negotiation should focus on the use of trade measures to support the agricultural sector and leave the appropriate level of “domestic subsidies” to national governments to decide. The decision during the Uruguay Round to address domestic policies as well resulted from recognition that, in practice, different forms of support are intertwined—reducing import restrictions raises the on-budget costs of high support prices and creates political problems at home. Indeed, the pattern to date has been that OECD governments modestly reduce domestic support for farmers and shift some direct payments to farmers from forms that encourage production to others that are less distorting, but they have also kept budget costs down, in part, by doing little to reduce the costs imposed on the rest of the world by trade barriers.

There has been relatively more progress on export subsidies, which are the most obvious “beggar-thy-neighbor” policy and which entail budget gains when cut. These subsidies have gone down substantially since the end of the Uruguay Round and from the beginning of the Doha Round it has been obvious that the eventual elimination of export subsidies would be a prerequisite for successful completion of the negotiations. It also appears that the EU, the major user of export subsidies, has grudgingly accepted this reality, though the negotiations will not be easy. One means by which the EU is trying to preserve some flexibility is by insisting that the

¹¹ Rather than adopting straight “tariffication” for heavily-protected products, most countries resorted to tariff-rate quotas that used prohibitively-high tariffs to prevent imports above a certain level. For a few of the most heavily-protected products—for example, rice in Japan and Korea—countries also had to make “minimum access” commitments to guarantee at least a small market share for imports.

negotiations address other forms of export subsidies, including the subsidy element of export credits and food aid, used primarily by the United States, and state trading companies used by Canada and Australia. Such concessions would not be easy for these countries either.

Recent WTO panel decisions could affect these negotiations but in very different ways. In a potential boost to the EU position on “parallel” forms of export subsidies, the panel appointed to review US cotton subsidies, in a case brought by Brazil, ruled that US government export credits are export subsidies and that the US exceeded the limits on export subsidies that it negotiated in the Uruguay Round. US negotiators strongly dispute this conclusion and they are appealing. Cutting against the EU (and US) position on state trading companies, a panel in a case filed by the United States recently ruled that the Canadian Wheat Board does not per se violate WTO rules, though it did recommend some changes in how it operates to ensure that it is in compliance.

The panel ruling in the Brazil versus US cotton case could also affect the negotiations over domestic subsidies. Prior to the announcement of that decision, there seemed to be broad agreement on preserving the basic framework of the URAA in the area of domestic subsidies, meaning encouraging further cuts in the so-called “amber box” containing the most trade-distorting subsidies and retaining the “green box” for decoupled payments and non-commodity specific subsidies, for example to preserve environmentally-sensitive land (see Hathaway and Josling 2004). But the cotton panel overruled the allocation of some subsidies to the green box, concluding that they were effectively product-specific and trade-distorting. If upheld, a debate between developed and developing countries over whether there should be a cap on or more clarity in the definition of green box subsidies could heat up.

The final element of the subsidies negotiations is the disagreement over how to treat the “blue box,” which covers trade-distorting subsidies as long as they are linked to production controls. Developing countries favoring elimination of the blue box were initially supported by the United States, but the American position shifted in 2003 and US negotiators are now pushing to retain the blue box and redefine it to cover the counter-cyclical payments included in the 2002 farm act. These payments are capped because they are based on historical acreage but they are also linked to current prices and, therefore, encourage production.

But the sharpest disagreements in the run-up to the end-July 2004 General Council meeting in Geneva were over market access. This is in part because developing countries with large numbers of rural poor are uncertain how far they feel comfortable going in opening their own markets and they are, not surprisingly, reluctant to do so *before* rich countries eliminate subsidized production. But rich countries are also resisting deep cuts in import barriers for “sensitive sectors” because their farmers could not survive without them and large increases in farm budgets would be necessary to compensate them.

Thus, while decoupling subsidies from production is the ultimate solution, it is only a partial solution in the short run because either the budget costs of maintaining completely decoupled subsidies at current levels of support or the political costs of cutting levels sharply will be unacceptable to many governments. These political dynamics push in the direction of continued incremental reform.

Pushing in the opposite direction is the formation of the G-20 group of developing countries that joined together in the run-up to Cancun to demand significant liberalization of rich country farm policies. Agriculture is one of the few remaining sectors where they can expect large gains from developed-country liberalization (Cline 2004, chapters 3 and 4). But in order to

mobilize manufacturing and services interests in the rich countries to lobby in favor of agricultural reforms, the larger and more advanced developing countries will also have to agree to liberalize their markets. Whether the necessary compromises can be made on all sides remains to be seen.

But what we know is that the Doha Round will not end with the elimination of all trade-distorting subsidies or with complete liberalization of agricultural trade barriers. So what should the broad priorities be in tackling OECD support for agriculture? First, export subsidies, whatever form they take, add insult to injury in distorting global markets and should be eliminated as quickly as possible. Second, trade-distorting domestic subsidies should be reduced on a product-specific basis so that averaging does not allow some products to escape cuts. Third, whatever happens with the definitions of the various boxes, the ultimate goal should be a reduction in the sum of all trade-distorting subsidies in the amber and blue boxes and in the de minimis category (which allows trade-distorting subsidies up to a capped percentage of production, currently 5 percent). Fourth, while tariffs cuts for sensitive products will be less than for others, they should not be allowed to escape entirely and tariff-rate quotas should be subject to at least some expansion. Achieving even such relatively modest goals will not be easy but anything less would be a farce.

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TABLE 1 OPTIONS FOR ACHIEVING FARM POLICY GOALS

	<u>Subsidies Linked to Prices/Production</u>			<u>Decoupled Subsidies</u>
Relationship to global markets	Import sectors	Export sectors	Autarkic	Not applicable.
Intermediate goals of interventions	Prevent imports undercutting target price.	Stabilize and support incomes.	Control domestic supplies as necessary to maintain prices.	Maintain incomes
Mechanisms	Import tariffs, quotas, or variable levies (used by the EC) high enough to maintain target price.	Direct payments or commodity loans to make up difference when prices drop below target.	Direct payments or commodity loans, often with supply controls to support target price at acceptable budget cost. Tools include production quotas or acreage reductions, including for environmental purposes.	<p>“Buy-out:” payment(s) equal to discounted present value of subsidies.</p> <p>“Cash-out:” smaller, ongoing payments based on historical payments or acreage, not linked to prices or current production decisions.</p> <p>Increased transparency of cash-out may allow eventual “squeeze-out,” ending all farm payments.^a</p>
Effects of target prices well above world prices	Could lead to chronic surpluses requiring storage costs or export subsidies to manage.	Could price goods out of world market and require either supply controls to prevent or export subsidies to dispose of surpluses.	Not applicable.	Not applicable.

National costs	Borne principally by consumers, taxpayers if surpluses develop that must be stored or disposed of.	Shared by consumers, who pay higher prices from supply controls, and taxpayers who pay for direct payments, storage costs.	Shared by consumers, who pay higher prices from supply controls, and taxpayers who pay for direct payments, storage costs.	Transparent and borne by taxpayers.
International costs	Foreign exporters: <ul style="list-style-type: none"> • lose market access in protected market, • if export subsidies used, also lose market share in third markets, • suffer lower world prices, • increased volatility. 	World prices decline and foreign exporters lose market share in third markets when competing with subsidized production.	Not applicable.	Not applicable.
Bottom line: coupled subsidies are a means of forcing the rest of the world to share the costs of supporting farmers inside a country's borders.				

a. These terms are from Orden, Paarlberg, and Roe (1999, chapter ??).

Table 2 The Aging and Part-time Farm Population in the US and EU		
	EU	US
Percent of farmers that are (1997):		
Over 55	<input type="checkbox"/> > 50 percent	<input type="checkbox"/> > 45 percent ^a
Part-time	<input type="checkbox"/> > 70 percent	<input type="checkbox"/> 50 percent

(a) According to the latest USDA Census of Agriculture (table 60), 50 percent of farmers in the US were 55 or older in 2002.

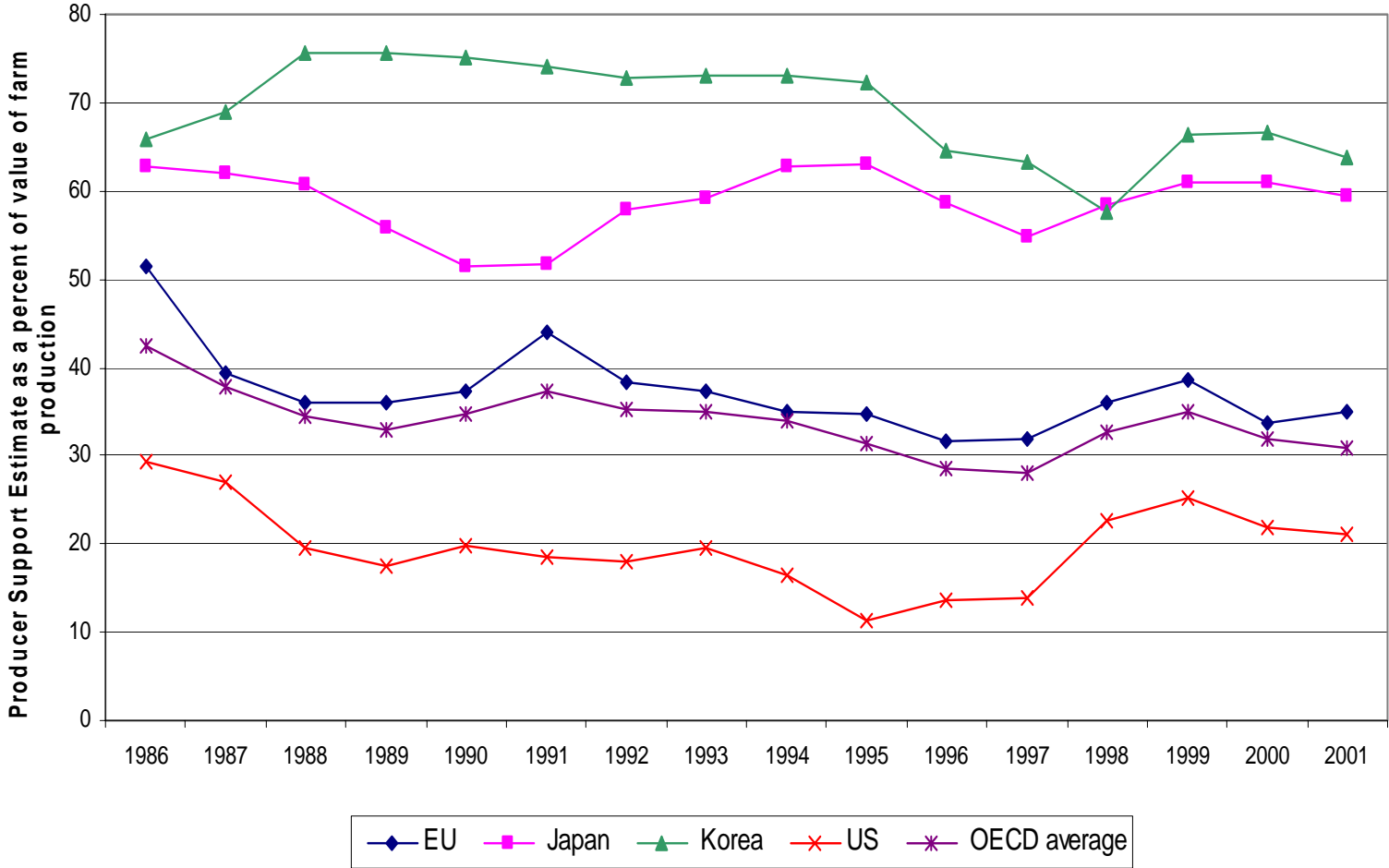
(b)

Source: US Department of Agriculture, Economic Research Service. 2004. *U.S.-EU Food and Agriculture Comparisons*. Washington.

Table 3 Concentration of US Farm Subsidy Payments, 1995-2002				
Percent of recipients	Percent of payments	Number of recipients	Total payments, 1995-2002 (billion dollars)	Payment per recipient
Top 1%	22	28,890	24.9	\$861,983
Top 5%	53	144,454	60.4	\$418,345
Top 20%	86	577,816	98.4	\$170,255
Bottom 80%	14	2,311,267	15.6	\$6,770

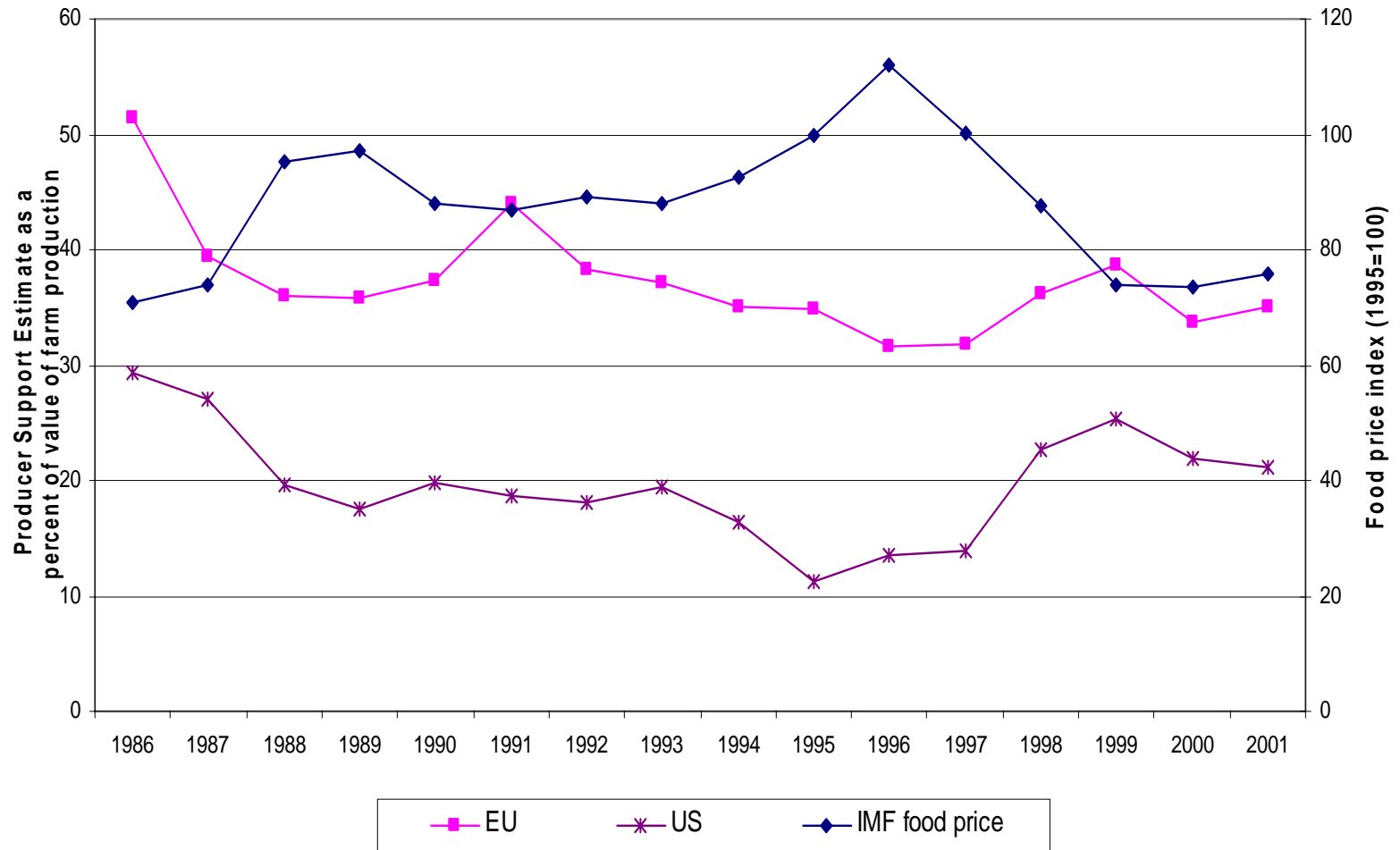
Source: Environmental Working Group, Farm Subsidy Database (www.ewg.org).

Figure 1 OECD Producer Support Estimates



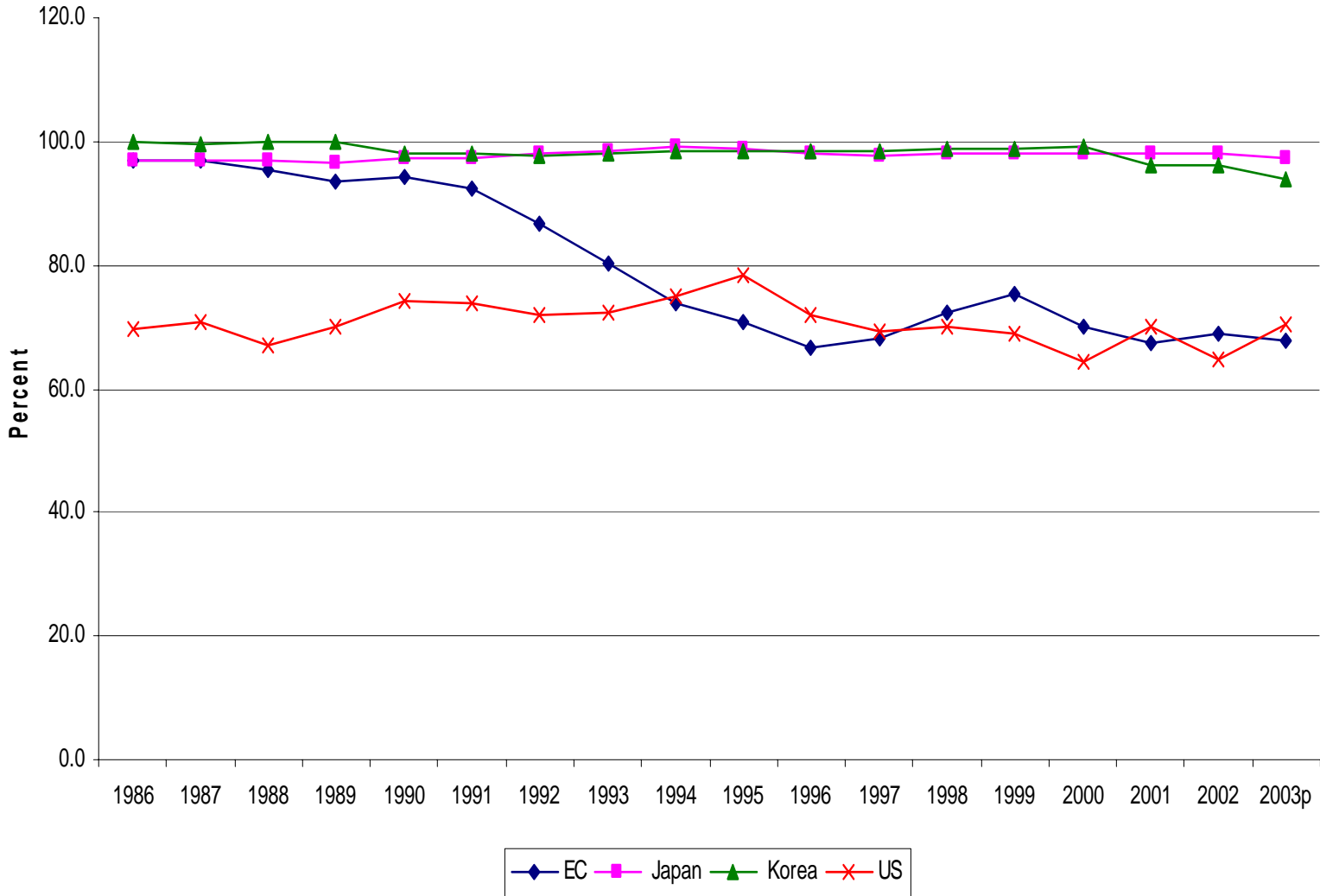
Source: OECD

Figure 2 Subsidies and prices



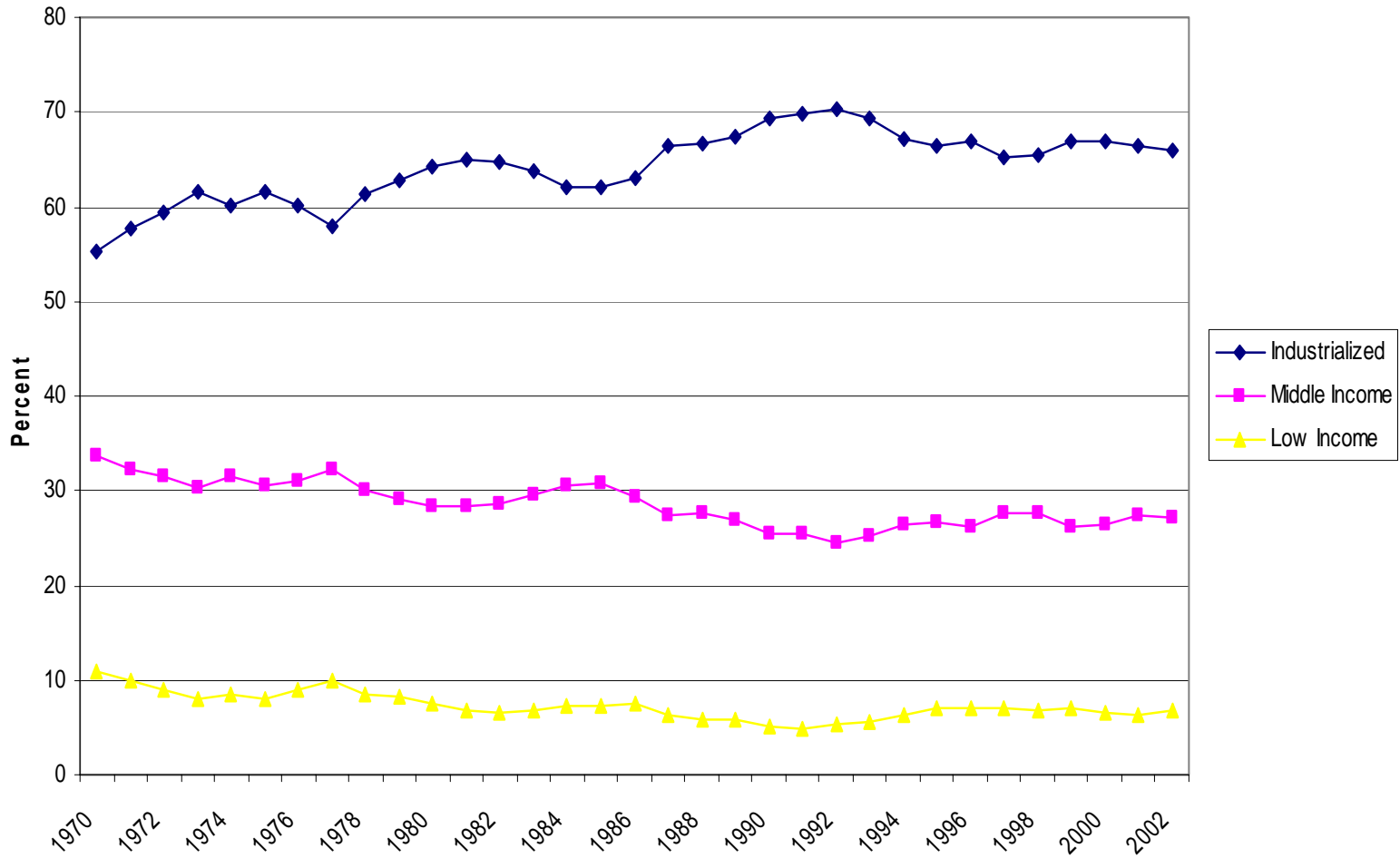
Source: OECD; International Monetary Fund

Figure 3 Trade-distorting support as percentage of total producer support



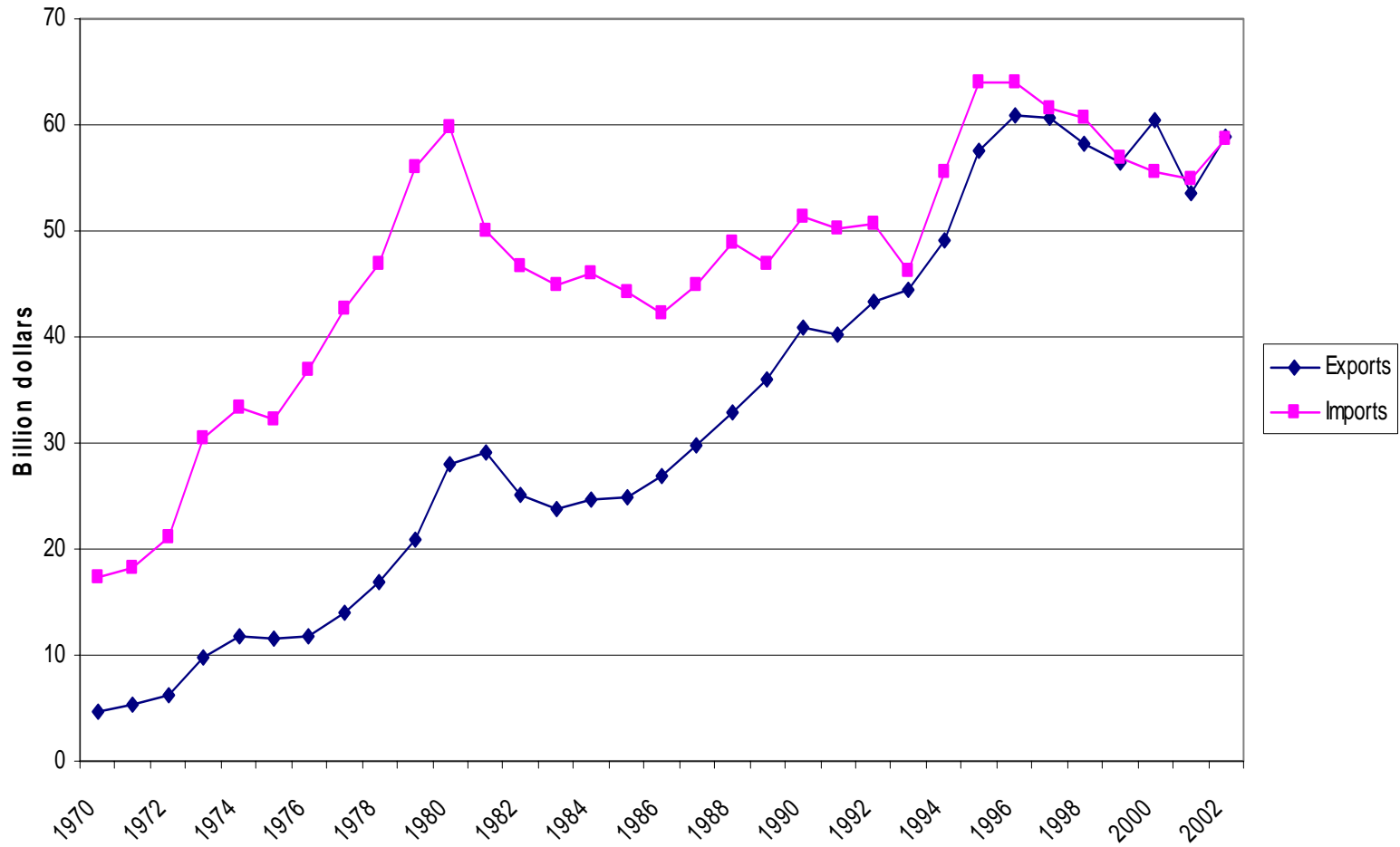
Source: OECD

Figure 4 Shares of global agricultural exports



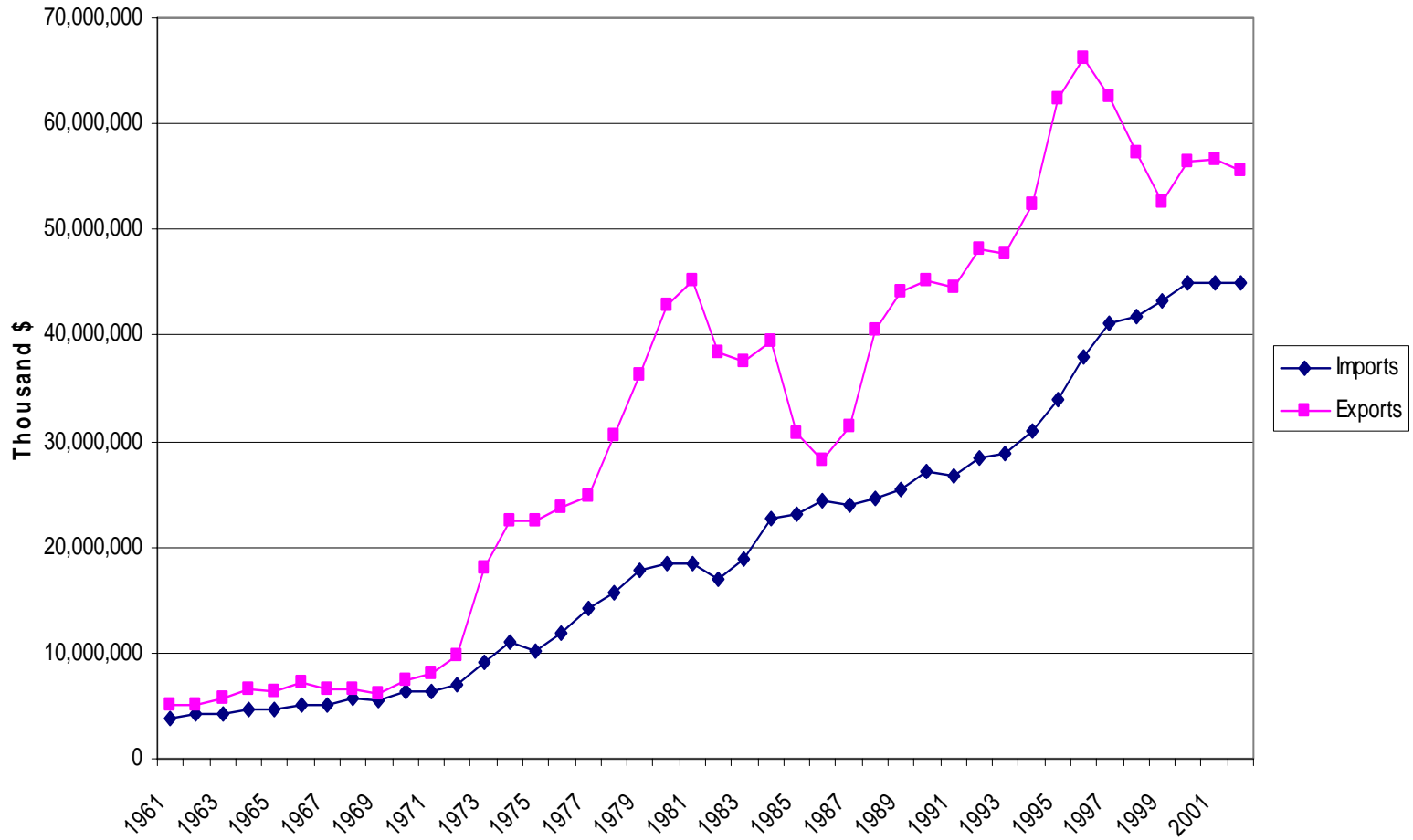
Source: UN FAO.

Figure 5 EC-10 Agricultural Trade
(excluding intra-EC trade)



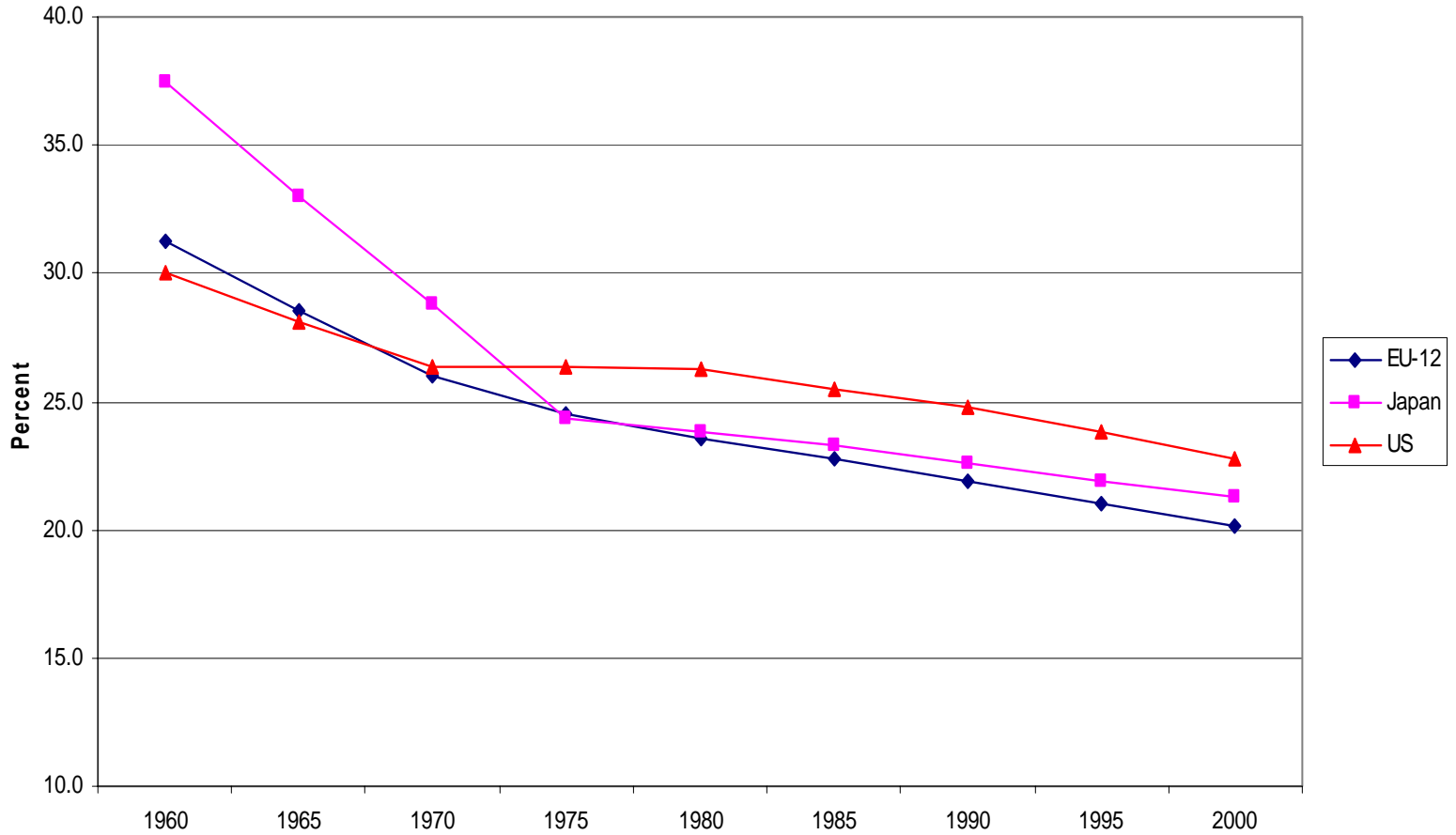
Source: UN FAO.

Figure 6 US Agricultural Exports and Imports



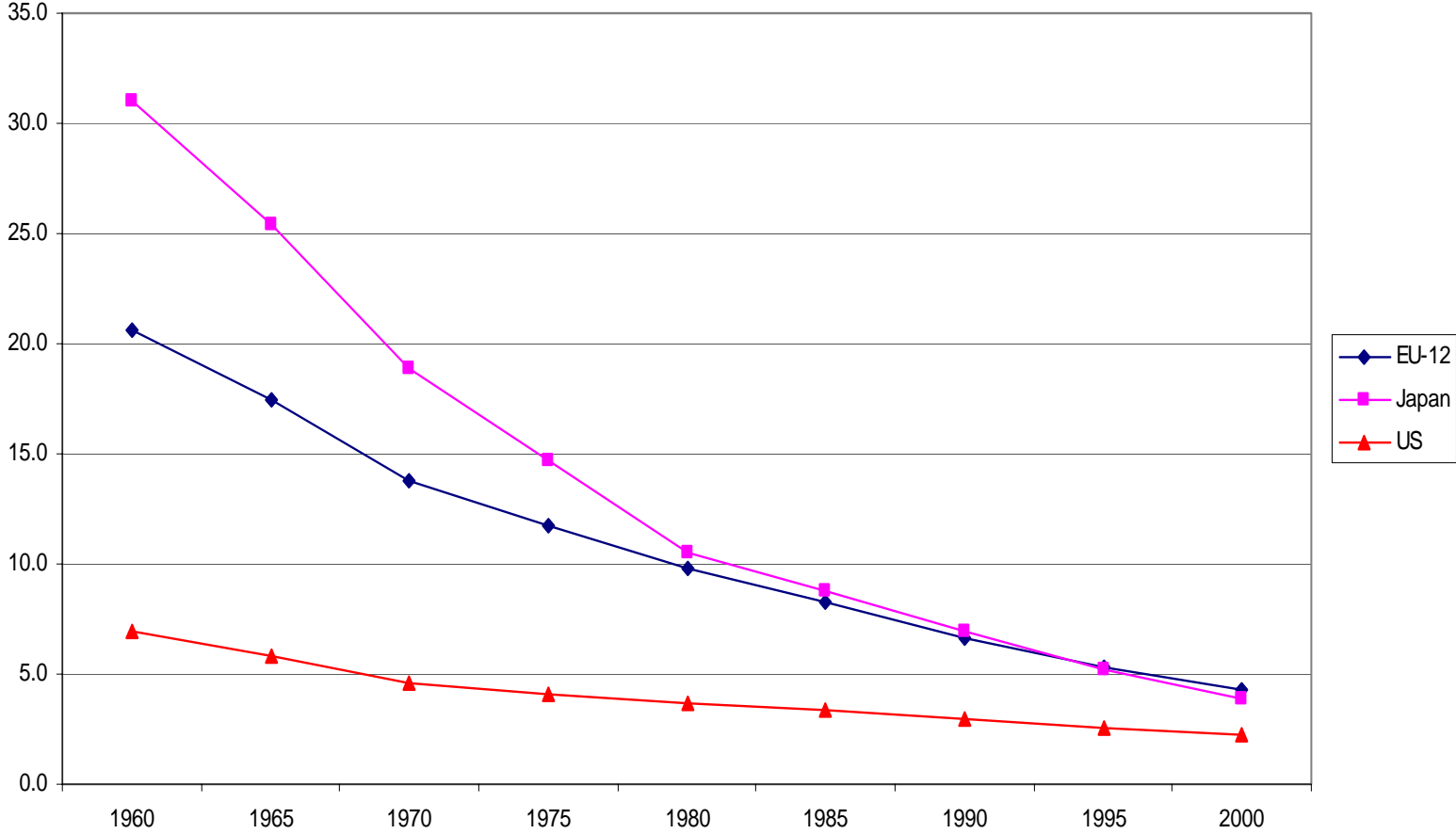
Source: UN FAO.

Figure 7 Rural population as a share of total



Source: UN FAO.

Figure 8 Share of population dependent on agriculture



Source: UN FAO.