

VIEWPOINT : DECOUPLING OF AGRICULTURAL SUPPORT PROGRAMS: APPROPRIATE ACTION FOR SOUTH AFRICA, THE CAIRNS GROUP AND DEVELOPING COUNTRIES

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Protectionist agricultural support policies became progressively more distortionist, expensive and ineffective. The 1994 GATT agreement is intended to reduce this. However, particularly the U.S.A., E.U. and Japan are likely to continue supporting their farmers. Decoupled payments have been proposed to substitute for production and price related programs. Decoupling will undoubtedly be much less trade distorting. Its advantages should outweigh side effects involving farmers' capital position, possible managerial effects, land price effects and environmental aspects; some of these may, in any event, be positive. CAIRNS group and developing countries should insist on accompaniment of decoupled payments by reduced total AMS support expenditure.

ONTKOPPELING VAN LANDBOU-ONDERSTEUNINGSPROGRAMME : TOEPAS-LIKE OPTREDE VIR SUID-AFRIKA, DIE CAIRNS GROEP EN ONTWIKKELENDE LANDE

Proteksionistiese landbou-ondersteuningsprogramme het toenemend meer ontwrigtend, duur en oneffektief geraak. Die 1994 AOTH ooreenkoms is aanvaar om dit te verminder. Veral die V.S.A., E.U. en Japan sal egter waarskynlik voortgaan om boere te ondersteun. Ontkoppelde betalings is voorgestel om produksie- en prysverwante programme te vervang. Ontkoppeling sal gewis minder handelontwrigtend wees. Die voordele daarvan behoort nuwe-effekte t.o.v. boere se kapitaalposisie, moontlike bestuurseffekte, grondpryseffekte en omgewingsaspekte te oorskadu; sommige hiervan mag in elk geval positief wees. CAIRNS-groep en ontwikkelende lande behoort daarop aan te dring dat ontkoppelde oordragte gepaard gaan met verlaagde totale AMS ondersteuningsuitgawe.

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1. INTRODUCTION

The GATT Agreement on Agriculture of 1994 has as its main aim the improvement of international trade in agricultural products through the reduction of trade distorting domestic agricultural policies.

In some regions of the world, for example most of Western Europe presently forming the EU, a desire to be self sufficient in food (a reaction to hardships during World War II) was a driving force for protectionist policies. In some other regions, including South Africa, the USA, Canada and Australia it stemmed from a desire to support commercial farmers' income position. According to Paarlberg (1988) there were well established premises in the USA which included, among others, the following: (1) That a low level of income of the farmer and not an inability of the consumer to pay for it, is a major problem; (2) That farm programs that limit food production and/or increase its price are in the public interest. Similar premises undoubtedly underscored the decision in South Africa to pass the Marketing Act in 1937 and tightening up its procedures in subsequent amendments to the Act.

Eventually, domestic agricultural policies of many countries and blocks such as the E.U. became increasingly protectionist, particularly in cases of farming industries which already had been or were becoming internationally uncompetitive but could claim, particularly through lobbies, that they were subject to 'unfair' competition (Petit, 1989).

In this process, exports from other countries suffered through various kinds of discrimination; some policies of particularly industrial countries eroded markets for other countries in terms of reduced earnings. These policies harmed the economies of particularly those countries that depend heavily on exports of raw materials and agricultural products - thus the less developed countries. In 1986 - 1988, the extent of domestic support to agriculture in industrial countries amounted to \$173 billion compared to \$24 billion in developing countries (GATT, 1994). In industrial countries, an average of \$14 400 was transferred to each full time farmer in 1993 (OECD, 1994 Quoted by World Bank, 1995).

Hillman (1994), quotes the OECD (1993): "by 1992, net transfer from consumers and taxpayers in the world associated with agricultural policies amounted to \$354 billion with the EC having a share of 45.2 per cent (\$160 billion), the U.S.A. 25.7 per cent (\$91 billion) and Japan 20.9 per cent (\$74 billion)". These three

entities' combined share of these transfers was 91.8 per cent. Total transfers per full time farmer equivalent in 1992 were \$17 700 in the EC, \$36 100 in the USA and \$24 000 in Japan. In addition, enormous bureaucracies developed to execute these programs (Hillman, 1994).

The efficiency of these programs became progressively less over time, stemming from a world-wide increase in dependence on trade, the emergence of a well integrated international capital market, the almost universal adoption of flexible or floating exchange rates and significant international monetary instability since 1986. Thus, policy efforts aimed at increasing exports (e.g. by subsidies) cause a strengthening of the exchange rate, eroding the effects desired. The same happens to import controls and tariffs. In addition, changes in monetary policy can cause movements opposing those desired in farm programs (Schuh, 1974 1976, 1989).

These phenomena gave rise, firstly to initiatives to reduce trade-restricting practices and eventually the Uruguay Round Negotiations, and secondly to proposals for decoupled agricultural support, i.e. farmer support decoupled from product prices and movements. This would involve a separation between government payments to farmers and production, thus lump sum payments irrespective of the volume of production (Pasour, 1990). This would therefore take the form of a welfare payment - a phenomenon resisted and feared by farmers in the USA (and probably Europe) (Hillman, 1994).

However, Hillman (1994) observes that U.S. taxpayers "are concerned as much or more with who gets payments - a distributional question - as they are with what payments are for".

2. THE NATURE OF PAST AND PRESENT AGRICULTURAL SUPPORT

Price support programs, which have for long dominated, and still dominate agricultural support in (amongst others) the USA, EU and Japan, have traditionally hinged on a few interrelated mechanisms:

- (1) Price guarantees which almost invariably caused domestic prices to be at levels higher than what equilibrium market prices would be; these guarantees inevitably caused farmers to increase production.

- (2) Efforts - e.g. by land diversion programs and payments- to entice farmers to produce less. These efforts tended to have limited success; farmers set aside mostly marginal land and substituted other inputs for land.
- (3) Import tariffs to restrict or eliminate cheaper imports.
- (4) Quantitative import restrictions.
- (5) Subsidization of exports, either on a widespread basis or of a targeted nature.

When support prices in either the USA or EU or other potential surplus producers exceed prices elsewhere, domestic policy cannot be implemented without restricting imports and/or subsidizing exports. "The widespread use of domestic policies that attempt to manipulate prices and the dominance of domestic policy over foreign policy have been the main barriers to liberalization of agricultural trade" (Grennes, 1988).

Basically, agricultural policies as described above involve a transfer of wealth or revenue to domestic farmers from domestic taxpayers, domestic consumers and foreign farmers. The goal has certainly not over the last couple of decades been to support impoverished farmers; the programs were instituted on a political basis, stimulated by powerful lobbies in for example, France, Italy and the U.S.A. (Tweeten, 1986; Gardner, 1995). The programs have had the effect of making wealthy farmers even wealthier (in the U.S.A., average farm household income has exceeded the national average since 1967 (Gardner, 1995). At present, E.U. farmers receive half their annual income in subsidies, while those in the U.S.A. have dropped to an average of 3.6 per cent (Bloomberg, 1998).

3. THE GATT AGREEMENT

The long term objective of the agreement is to "provide for substantial progressive reductions in agricultural support and protection sustained over an agreed period of time, resulting in correcting and preventing restrictions and distortions in world agricultural markets" (GATT, 1992). The aim with the agreement was specific binding commitments regarding market access, domestic support and export competition, as well as sanitary and phytosanitary issues, while making some special concessions for developing countries.

The mechanics involve the calculation of a total Aggregate Measurement of Support (Total AMS) for countries, which means the sum of all domestic support provided to farmers; some types of support are however exempt, for example general services (research, quarantine services, training, extension, marketing and promotion, etc), public stockholding for food security purposes, domestic food aid, disaster aid, direct non-production based payments, decoupled income support, etc.

Member countries are bound to convert various types of quantitative import restrictions and some other discriminatory rules on importation into ordinary customs duties.

With the exception of special safeguard provisions against abnormal import situations, all members of the World Trade Organization (WTO) – the successor to the GATT – are committed to reduce over time the total AMS provided to their producers. This will include border protection by tariffs, domestic price support that does not comply with the exemption rates mentioned earlier and export subsidization.

4. DECOUPLING: THE CONCEPT

Given that under the present WTO regimes there is a drive to reduce trade distortive agricultural policies and that wealthy countries will for domestic political reasons continue to support their farmers financially, the search is on for a non-trade distorting method of doing so. The challenge is to have programs that will not involve income or wealth transfers from farmers in other countries to domestic farmers (mostly in the USA, EU and Japan).

This is where decoupling has entered the international debate. In October 1997, the U.S.A. submitted a special paper advocating the use of decoupled farm income support to the W.T.O. "Decoupling" is really a fairly recent name for an application of the older public finance concept of a lump sum payment. The basic idea is rather simple: The government of a country (or the EU Commission) determines the total sum to be paid out in lieu of subsidies to farmers and establishes the rules as to how this will be distributed among farmers. The most important feature is that it should not be related to current (or past) production levels (Grennes, 1988).

Several bases for distribution have been proposed. These include variations on area used for crop production in the recent past. Decoupling proposals for livestock production are less clear. Not all movements to lump sum payments can be regarded as fully decoupled - for example, per hectare payments in the EU. Although current yields do not play any role in the determination, the payments remain tied to an obligation to produce certain crops, it requires some land to be set aside, and is based on current area declaration (Moschini & Sckokai, 1994).

In a completely decoupled system, financial transfers to farmers should not affect prices or production. The question remains under which conditions complete decoupling can be achieved and whether the countries in question will ever implement such a completely decoupled system.

In production theory, a producer will try to maximize his profits, and this is achieved when Marginal Value Product (MVP) = Marginal Cost (MC). Marginal Value Product is a function of physical marginal physical product and product price. If subsidy or program payments to farmers are completely decoupled from price and production, MVP with wealth transfers will be equal to MVP without any income or wealth transfers.

Marginal cost, in its turn, is a function of prices per unit of variable inputs and marginal physical product. Any subsidy that will lower MC - e.g. subsidies on fertilizer - will lead to expansion in production, while taxation of variable inputs - e.g. fuel - has a production reducing effect. In the absence of such subsidies of taxes, government action will be price, production and trade neutral.

However, if lump sum payments to farmers are tied to a certain use or application of any resource - be it land, livestock, labour, capital equipment or any short term variable input, then these payments will have some effect on production, prices and eventually also trade. Since many "decoupled" programs are still tied to land or to production levels in a certain base period, decoupled program will therefore still have an effect on production and thus also trade.

5. SIDE EFFECTS OF DECOUPLED PAYMENTS

No interference in economic life occurs without side effects. In other words it is hard to find a neutral policy. Some of these side effects may have some influence

on agricultural trade over the long run and indirect effects on developing countries.

By placing increased funds in the hands of farmers, decoupled lump sum payments strengthen the funds available to the present farming population, thereby increasing their ability to afford capital items and also their ability to adopt new, capital intensive technology, which has been the main vehicle for expansion of agricultural production in most high income countries, including the U.S.A. and Western Europe. Development of such technology has for long been the main thrust of agricultural research in high income countries. Thus decoupling may indirectly enable high income countries to enhance their competitive position vis-a-vis developing countries. In addition it can also be argued that decoupled lump-sum payments are used by farmers to purchase lumpy inputs which in a way lowers fixed costs at improves the financial position of these farmers.

This possibility will be influenced either negatively or positively thereby that decoupled lump sum payments will enable less inefficient producers - who generally are also the less astute managers - to remain in farming. These farmers can not be expected to be a major force in enhancing their respective countries' competitive advantage. However, poor management may be a retarding factor in a move towards sustainable agriculture, (Helmert & Hoag, 1993) thereby affecting the environment negatively and inducing potential costly externalities. Sustainable agriculture involves crop rotations and more organic methods of fertilization and of management. It is not certain to what extent such environmental effects become international externalities; it varies from case to case.

In the main, decoupling should however contribute to the move towards sustainable agriculture. In the United States, for example, target prices have been available only for specific crops. This inevitably encouraged the use of land and other inputs for those crops, leading both to monocropping, heavy use of chemical inputs and eventually surplus problems that could not be handled other than by export subsidies. Decoupling can be expected to reduce production of these crops and perhaps, the use of (particularly) chemical yield enhancing inputs.

Another side effect that may emanate from decoupled lump sum payments, if these are (as appears likely) tied to land area, is that it will inevitably be

capitalised into higher land prices. This will encourage particularly new producers to substitute capital and other inputs for land in efforts to obtain higher per hectare yields. Thus, some side effects may well also have effects on production, prices and world trade. This can however be insignificantly small compared to the disruptions caused by those support programs that become tradition during the 20th century.

6. CONCLUSION

It appears that decoupling will, on the balance, be associated with high significant reductions in distortions to production levels, prices and trade. However, there are side effects, which may somewhat, reduce the advantages that agricultural trading nations outside the USA and EU will derive from decoupling in the USA, EU and Japan. Decoupling will if correctly instituted, remove many more distortions than can indirectly emanate from its side effects.

South Africa, other countries in the CAIRNS Group and developing countries should however insist on measures, which will ensure the realisation of the benefits of decoupling. The practice, as in the E.U. to still couple lump sum payments to an obligation to produce certain crops, should be discouraged - and perhaps not officially be accepted as being decoupling.

CAIRNS Group and developing countries should insist on accompaniment of decoupled payments by equivalent reductions in Total AMS expenditure. Although this may require changes in the rules, it may be necessary to forestall a long-run situation that side effects of decoupling become sufficiently large to significantly nullify gains obtained by reduced protectionism.

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