

Agricultural Policy Reform in Brazil

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Introduction

Brazil is a major player in the global economy, one of the world's 10 largest economies, with a population of 180 million and vast natural resources. Brazil's agricultural land is exceeded only by China, Australia and the United States, and agriculture plays an important role in the country's economy. Primary agriculture accounts for 8% of GDP, while agricultural products account for about 30% of exports.

Over the past 15 years, Brazil's economy has undergone radical reforms that have provided a more stable investment climate and stimulated agricultural growth. Macroeconomic stability was achieved in the mid-1990s when the Real Plan invoked the budgetary restraint necessary to bring inflation under control. Structural reforms included the privatisation of state-owned enterprises, the deregulation of domestic markets, and the establishment of the Mercosur customs union with other South American countries. Policy changes included deep tariff cuts and the elimination of non-tariff barriers to trade.

Agriculture both contributed to these reforms and benefited from them. Through the 1990s, there was a scaling down of expenditures on price support and subsidised credit; the markets for wheat, sugar cane and coffee were deregulated; and trade was liberalised not just on the import side, but also for exports, notably with the elimination of export licenses, quotas and taxes. Agriculture benefited in overall terms from the change in development paradigm, as it removed the discrimination against the sector that was implicit in support for the manufacturing industry, and helped establish a more stable investment climate.

This *Policy Brief* provides an overview of the current agricultural policies in Brazil, the challenges facing the sector and the suggested directions for further policy reforms. ■

How has agriculture changed following reforms?

Brazil’s agriculture sector has grown rapidly since the government abandoned import substitution (policies designed to favour domestic production of an item over competing imports, for example high import tariffs), and the trend has accelerated in the last few years. This growth has been mostly attributable to improved productivity and lower prices for imported inputs, helped more recently by increases in agricultural area.

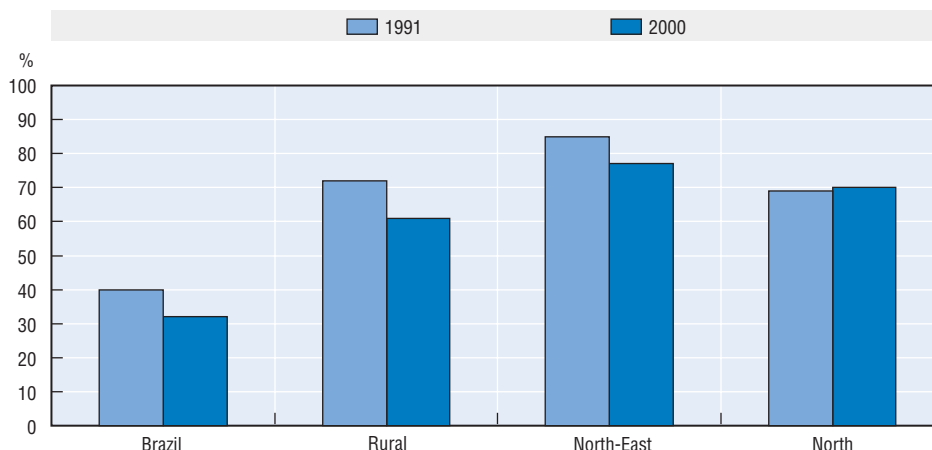
Agricultural exports have experienced a boom recently, with exports shifting away from traditional tropical products, such as coffee and orange juice, towards soybeans, sugar, and meat, notably poultry and pigmeat. Although OECD country markets are still very important, with more than 40% of agricultural exports destined for the European Union, and exports to most OECD countries increasing in absolute terms, the fastest export growth is with countries outside the OECD area, notably China and Russia.

Agricultural growth has exceeded that in the manufacturing sector and, with booming agro-food exports, has provided important benefits to the Brazilian economy. However, this growth alone has not been sufficient to resolve the problem of rural poverty and income inequality. It has also raised concerns about the associated environmental consequences, notably the implications for the Amazon rainforest.

Rural poverty has fallen considerably in Brazil, but was still more than 60% in 2000, double the country’s overall poverty rate (Figure 1). Furthermore, the situation for the bottom 20% of rural households, who are well below the extreme poverty line, has actually deteriorated. A trebling of government transfers between 1991 and 2000 helped poor households in general, but many of the poorest missed out because they fell outside the remit of the formal economy and were thus not covered by pensions and other programmes. Rural poverty is increasingly located in the North and North East regions – indeed, the percentage of the northern population living below the poverty line increased, albeit only slightly, between 1991 and 2000.

There has also been growing concern about the environmental consequences of the rapid agricultural growth. Since 1990, Brazil has

Figure 1.
POVERTY IN BRAZIL,
1991 AND 2000
Per cent of population below the poverty line



Source: Helfand and Levine (2004) based on the Demographic Census.

lost an area of forest equal to the size of the United Kingdom. Large-scale commercial ranching is responsible for the majority of this deforestation, ahead of logging and the migratory slash and burn practises of many subsistence farmers. Some argue that soybean farming has also contributed indirectly, by causing displaced cattle ranchers and subsistence farmers to migrate to the forest frontier. The trade-off between the economic benefits of agricultural expansion and the environmental benefits of forest preservation is a difficult domestic policy decision facing Brazil. ■

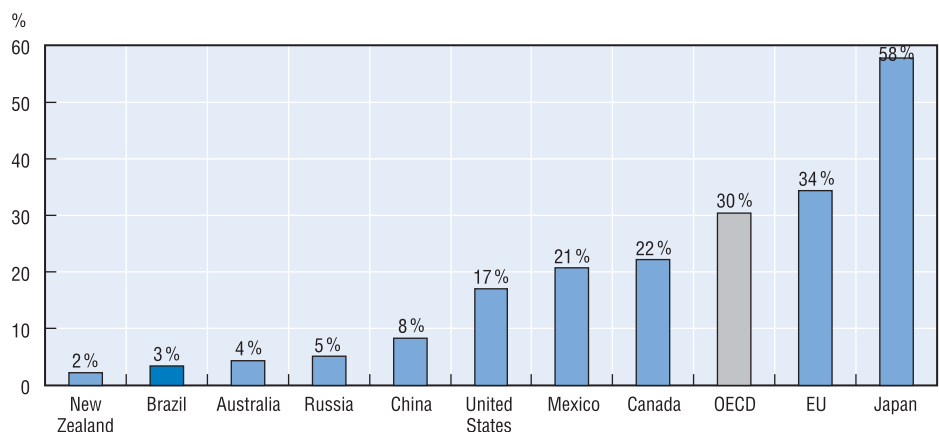
Are current agricultural policies effective?

Brazil provides a relatively low level of support to its agricultural sector. Total support to the sector, which includes support to producers and the financing of general services to agriculture, such as agricultural research, education, infrastructure, averaged BRL 8.2 billion (USD 2.7 billion) per year in 2002-04, or 0.5% of GDP. The cost of support to the overall economy is low relative to most OECD countries, and is roughly comparable to that in Australia (0.3%) and New Zealand (0.4%). About three-quarters of this support are delivered to producers, as opposed to general services to the sector.

Producer support in Brazil accounted for an average of 3% of the value of gross farm receipts between 2002 and 2004 – a rate of support that is comparable with that of New Zealand (2%) and Australia (4%), and far below the OECD average of 30% (Figure 2). The highest support levels are for staple crops that are competing with imports (wheat, maize and rice) and cotton (Figure 3).

Producer support is provided mostly through preferential credit to the sector. This system has been justified on the grounds that it offsets high market interest rates that are a legacy of macroeconomic instability (from which agriculture suffered disproportionately). A further rationale for special treatment of the sector emanates from social goals, where affordability of production credit is seen as a crucial element of supporting income generation among the rural poor.

Figure 2.
PRODUCER SUPPORT ESTIMATE IN BRAZIL AND SELECTED COUNTRIES, 2002-2004 AVERAGE
As per cent of gross farm receipts



Note: 2002-2003 average for China and Russia.

Source: OECD PSE/CSE database.

Approximately one half of the overall benefit from credit support stems from the restructuring of large farm debt accumulated over the period of macroeconomic instability in the late 1980s to mid 1990s. Debt rescheduling was unavoidable, given the need to renew the flow of liquidity into the sector. However, successive rescheduling has led to defaults on rescheduled debt that are likely to continue in anticipation of further concessions. This may impede fresh lending. Also, to the extent that debt rescheduling involves budgetary support, it may crowd out more productive public spending in areas such as infrastructure development.

Aside from preferential credit, Brazil employs several mechanisms to support producer prices, such as commodity loans or intervention purchases, where the government intervenes in the market to buy and store produce if the market price falls below a fixed target price. However, these do not result in broad, sector-wide price distortions. Indeed, market price support has tended to be close to zero in recent years.

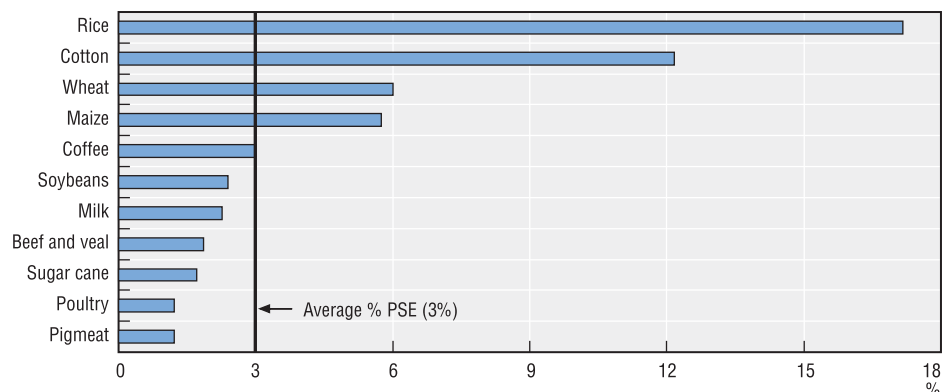
Although support to the agricultural sector in Brazil is low, the structure of that support is becoming less conducive to long-term development. A large and growing share of total support is used to subsidise producers, with expenditure in crucial areas such as research and extension, training, and the development of rural infrastructure becoming less important. ■

How would more open world trade benefit Brazil?

The benefits to Brazil from a multilateral agreement on more open world trade would come mainly from global reforms of agricultural policies. Given that Brazil has broadly liberalised its own agricultural policies, most of those benefits are expected to come from reforms to agricultural policies in other countries, with access to OECD country markets the most important issue. At present, Brazilian agricultural exporters face a number of barriers to selling their produce in OECD markets. These include:

- High tariffs in key markets (notably sugar, poultry, orange juice, beef and pigmeat, and tobacco).
- Tariff escalation according to degree of processing (notably in the soybean sector, and for processed food products and coffee).

Figure 3.
BRAZIL'S PRODUCER SUPPORT ESTIMATE BY COMMODITY, 2002-2004 AVERAGE
As per cent of gross farm receipts



Source: OECD PSE/CSE database.

- Discriminatory import regimes, such as country-specific tariff-rate quotas (TRQ) and preference schemes, which typically do not favour Brazil. These mechanisms for controlling imports tend to be relatively important in the sugar, beef and cotton sectors and are applied most by those countries which represent Brazil's biggest overall markets, i.e. the European Union, the United States, China and Russia.
- Non-tariff measures, such as sanitary and phyto-sanitary regulations, which, irrespective of their legitimacy, impede market access. These are a particular problem for meat products, where several countries do not accept Brazil's contention that specific regions should be considered as free from foot-and-mouth disease, even if this is not the case for the country as a whole.

Brazil is expected to be one of the biggest external beneficiaries from reforms in OECD countries and elsewhere. It is estimated that a 50% cut in tariffs and export subsidies globally and for all sectors, together with a 50% reduction of domestic support to agriculture in OECD countries, would provide a welfare gain to Brazil of USD 1.7 billion, or equivalent to about 0.3% of GDP. Of these gains, 59% would come from tariff reductions on agricultural products by OECD members. The gains to Brazil from agricultural policy reforms in OECD countries account for more than half of all the gains to developing countries.

There are two reasons why OECD reforms matter most: first, a large share of Brazil's agricultural exports go to OECD countries (notably the European Union), and protection in these markets is relatively high; second, OECD countries account for the majority of support that undermines Brazil's competitiveness in third country markets. That said, a rising proportion of Brazil's exports is going to non-OECD country destinations, notably China and Russia, which makes policies in these countries of increasing importance. ■

What are the main challenges for agricultural policies?

Despite agriculture's rapid growth in recent years, Brazilian producers still face a number of further constraints. Weak infrastructure is emerging as the most significant bottleneck to agricultural development. Producers in Brazil are typically a long distance from their principal markets, and face internal logistics systems that are relatively underdeveloped. For example, only 10% of all highways in Brazil are paved, compared with 29% in neighbouring Argentina. Moreover, transport costs are important for Brazilian exporters, as a relatively large share of the country's agro-food exports is in the form of bulk commodities.

The upgrading of rural infrastructure need not be detrimental to the environment, but nor is it likely that an unregulated expansion of agricultural area will provide sufficient protection to environmentally important areas. Brazil's policies need to take account of the implicit trade-off between the economic benefits and environmental costs of agricultural growth in the Amazon region, while their design needs to reflect the difficulties of policing such a vast area.

For many agricultural producers, the terms and availability of credit are also a major constraint. The greatest difficulties arise for businesses that are obliged to borrow on the domestic market. Although the economy has stabilised in recent years, macroeconomic uncertainty still has a disproportionate effect on less well-established companies without easy access to overseas lenders. High real interest rates mean that access to credit from banks is almost prohibitive, but for government subsidies. General credit subsidies risk crowding out non-agricultural investment more than targeted subsidies to land reform recipients and smallholders.

Tax policies also have an important effect on producers' opportunities. Under Brazil's ICMS (value added) tax system, each of the country's 26 states imposes its own taxes and exemptions. This distorts producers' incentives, while the system's complexity places an additional burden on taxpayers.

In addition to the need to continue improvements in agricultural competitiveness, Brazil also faces a number of social challenges associated with agricultural development. Agricultural growth has made little impact on the problem of rural poverty. More than 60% of the rural population has an income below an absolute poverty line of half the minimum wage, while income inequality in rural areas has gone up over the last decade and the poorest have become poorer. Migration from rural areas may have helped reduce rural poverty, but to a large extent this has shifted the burden to urban areas. Rural poverty is increasingly concentrated in the North and North East, where there is a heightened need for effective development policies and social safety nets.

The key need is for targeted adjustment policies. For some households, extension programmes to upgrade farming skills may enable them to become competitive within the sector. At the same time, it is important to recognise that the long-term (inter-generational) future for most semi-subsistence farm households lies outside agriculture, so there is a parallel need for measures that facilitate income diversification and the exploitation of non-farm opportunities. Investments at the individual level, for example through education and health expenditures, are important here, as are policies that foster rural development, such as infrastructure development.

In overall terms, Brazil has pursued essential policy reforms that have benefited the agricultural sector and helped raise incomes and reduce poverty. A shift of support towards longer term investments in areas such as infrastructure, and research and extension should further enhance competitiveness, while better targeting of agricultural and economy-wide social policies could enable agricultural development to be more fully inclusive than it has so far been. ■

For further information

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For further reading

OECD, 2005, OECD Review of Agricultural Policies: Brazil,
ISBN 92-64-01254-0, 50.00 €, 218 pages.

OECD, 2005, OECD Economic Surveys: Brazil,
ISBN 92-64-00747-4, 42.00 €, 160 pages.

OECD, 2005, Trade and Competitiveness in Argentina, Brazil and Chile: Not as Easy as A-B-C,
ISBN 92-64-10871-8, 35.00 €, 236 pages.

OECD, 2005, OECD Review of Agricultural Policies: China,
ISBN 9264012605, 50.00 €, 303 pages

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