OECD monitoring of non-member countries

A key objective of the OECD is to facilitate policy dialogue among policy makers with a view to identifying good practices across a wide range of economic and social policy areas. The OECD places a high priority on its dialogue with non-member economies (NMEs), recognising that such dialogue contributes to the quality and relevance of our work and helps us collectively to address global economic challenges. Effective dialogue depends on the wide dissemination of consistent and comparable information, analysis and evaluation of current policy developments.

This monitoring exercise documents and evaluates the latest agricultural policy developments in those NMEs for which the OECD has, in the past, undertaken full-fledged country reviews of agricultural policies. Eight countries: Brazil, Bulgaria, China, India, Romania, Russia, South Africa and Ukraine are included in this update. A review of support measurement issues and a comprehensive statistical annex, containing a wide range of comparable information for these countries, are also incorporated in this report.

This monitoring exercise mirrors that carried out each year for OECD countries and provides a common benchmark for international dialogue on agricultural policy reform. In particular, the calculation of support estimates, such as the producer support estimate (PSE), provide a much better understanding of the nature of government support to agriculture by:

- Quantifying and categorizing support policies.
- Comparing domestic to international commodity prices.
- Estimating taxpayer and consumer burdens.

The OECD approach to this policy monitoring process is unique. Local experts are engaged to provide background information while governments under review and OECD member countries actively participate in the review of draft reports. This process helps ensure accuracy of the results, awareness and “buy-in” by national policy makers and provides an important element of capacity building.

CHAPTER 1

OVERVIEW

1. This *Overview* is intended to first provide a general appreciation of the relative importance of the agriculture sector in the economies of eight non-OECD countries under review. These comprise three large developing countries (Brazil, India and South Africa), four formerly planned economies (Bulgaria, Romania, Russia and Ukraine) and China, which combines some features of both groups. Next, the policy context is explained in terms of the main driving forces for change. The political response to these forces in terms of policy reforms and new government initiatives is then evaluated, based on the OECD standard measures of support (*e.g.* PSEs/TSEs). Finally, some general policy observations and recommendations are offered. It is these last two elements that are generally of most interest to decision-makers – an assessment of different approaches to addressing what are often similar problems and economic circumstances. The OECD experience with policy reforms in OECD countries, and a growing number of NMEs, suggests that the effectiveness, efficiency and spill over effects of different agricultural policy measures vary a great deal.

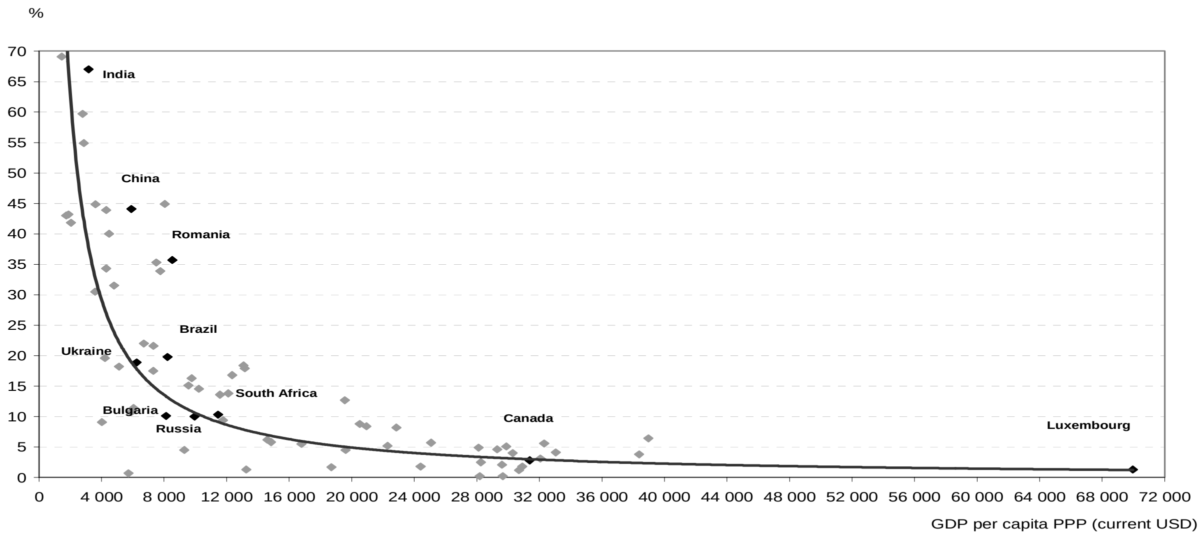
Agriculture in the economy

2. The relative importance of the agricultural sector in the overall economy is one of the critical factors in the ranking of agricultural policy reform on a government's political agenda. For the countries under review, the structure of the sector has changed enormously over the last couple of decades and continues to evolve at a rapid pace, compared with the majority of OECD countries. This makes the need to examine the performance of the sector and the effectiveness of associated policies on a regular basis all the more important.

3. With the two largest populations in the world from China and India, the eight countries under review account for 44% of world population and 30% of the agricultural output. They produce over 40 % of cereals and meat, and over one-half of all fruits and vegetables. Most production is consumed domestically with the group accounting for less than 10% of world agro-food trade. The following graphical highlights provide a brief overview of the relative importance of the respective agricultural sectors (see the Statistical Annex for more details).

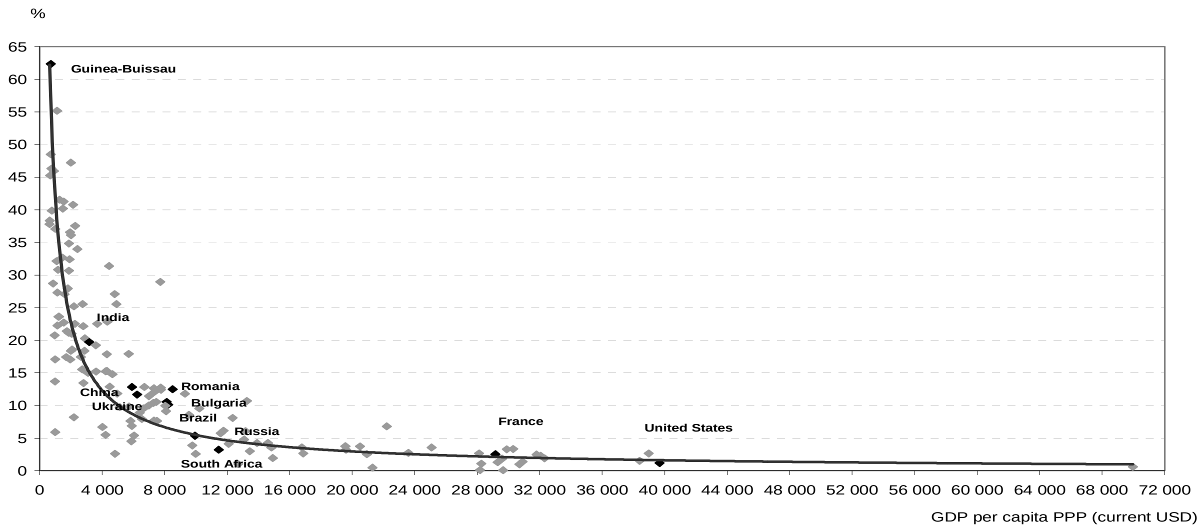
4. Comparing the share of agriculture in total employment and in GDP against GDP per capita across large number of countries provides a rough index of development (Figures 1.1 and 1.2). Generally, the more developed a country (higher GDP per capita), the lower the relative importance of agriculture. Typically, for the countries under review, agriculture has a disproportionate share of employment indicating low level of labour productivity and the buffer role of agriculture in labour markets. This reflects the dualistic nature of farming in all these countries, with a few large-scale operations and a large number of small, relatively unproductive producers.

Figure 1.1. Agriculture's share of total employment, 2003-05 average



Source: World Development Indicators, World Bank 2006.

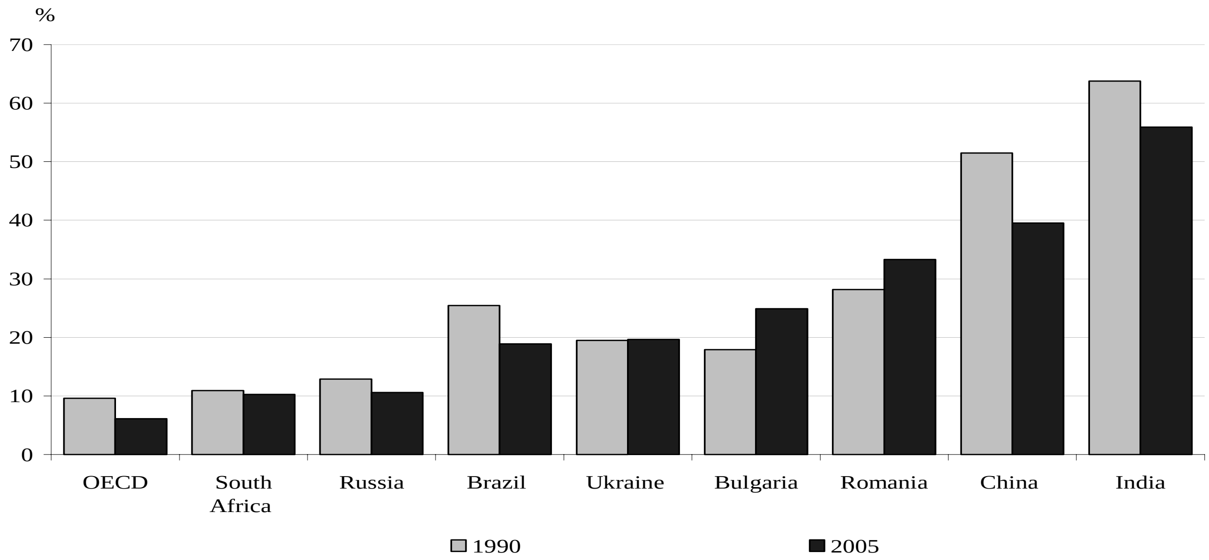
Figure 1.2. Agriculture's share of GDP, 2003-05 average



Source: World Development Indicators, World Bank 2006.

5. As a consequence, the countries under review contrast strongly with OECD members with a much higher share of agriculture in total employment, ranging from about 10% in South Africa to 55% in India (Figure 1.3). There has been, however, labour shedding from agriculture which has been particularly rapid in China and India, where strong economic growth and some labour market reforms have opened off-farm employment opportunities. Still, agriculture remains a much more important source of employment in all these countries. Contrary to the downward trend in most of these countries, increasing shares of agricultural employment in Bulgaria, Romania, and Ukraine reflect a slow economic readjustment process as well as specific government policies of land reform and small farm development.

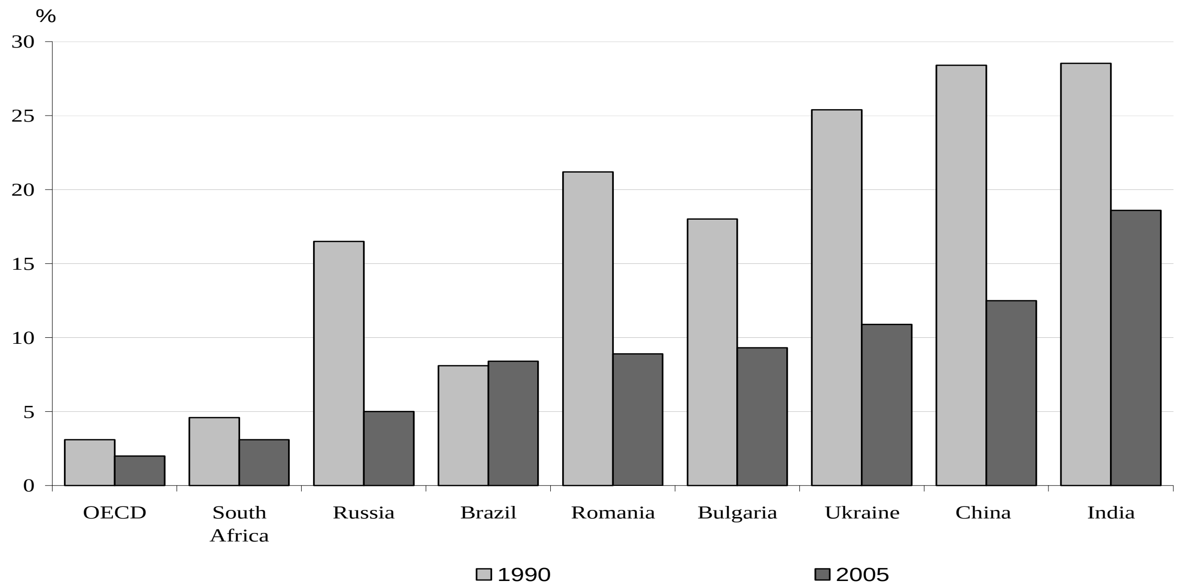
Figure 1.3. Share of agriculture in total employment



Source: OECD Secretariat; World Bank.

6. Agriculture is also a much more important component of Gross Domestic Output (GDP) in the countries under review than it is for OECD countries, with shares of total GDP three to five times higher than that for the OECD area (Figure 1.4). However, this share is rapidly declining as growth in the service and industry sectors outpaces that of agriculture. With the exception of Brazil and South Africa, the share of agriculture in GDP has virtually halved over the 1990-2005 period for the countries under review, suggesting that agriculture's traditional high priority in the policy agenda may diminish in coming years. Brazil is the only country in the group where agriculture has maintained its relative importance in the economy.

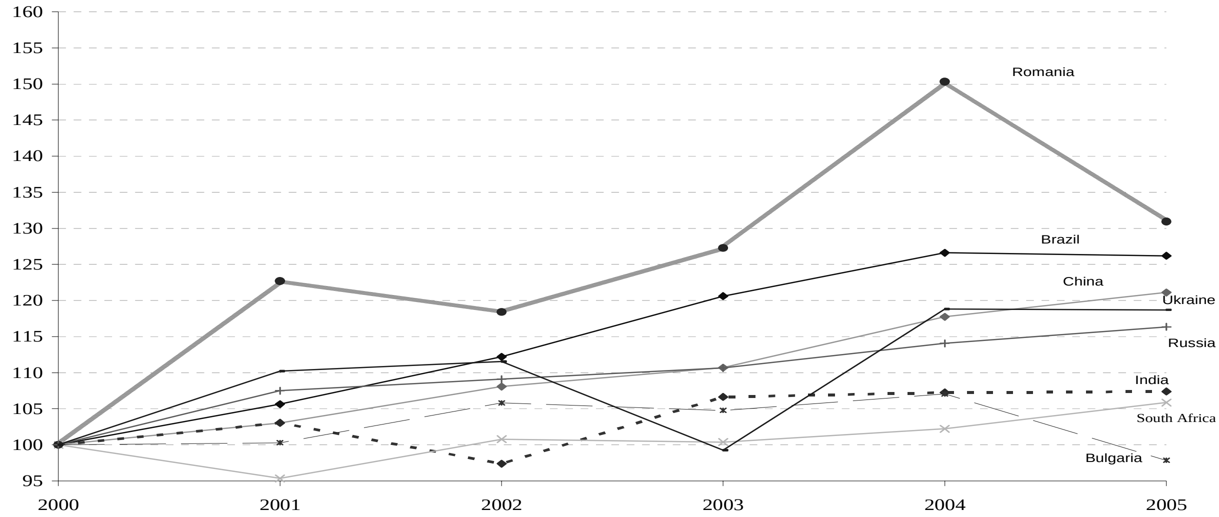
Figure 1.4. Share of agriculture in GDP



Source: OECD Secretariat; World Bank.

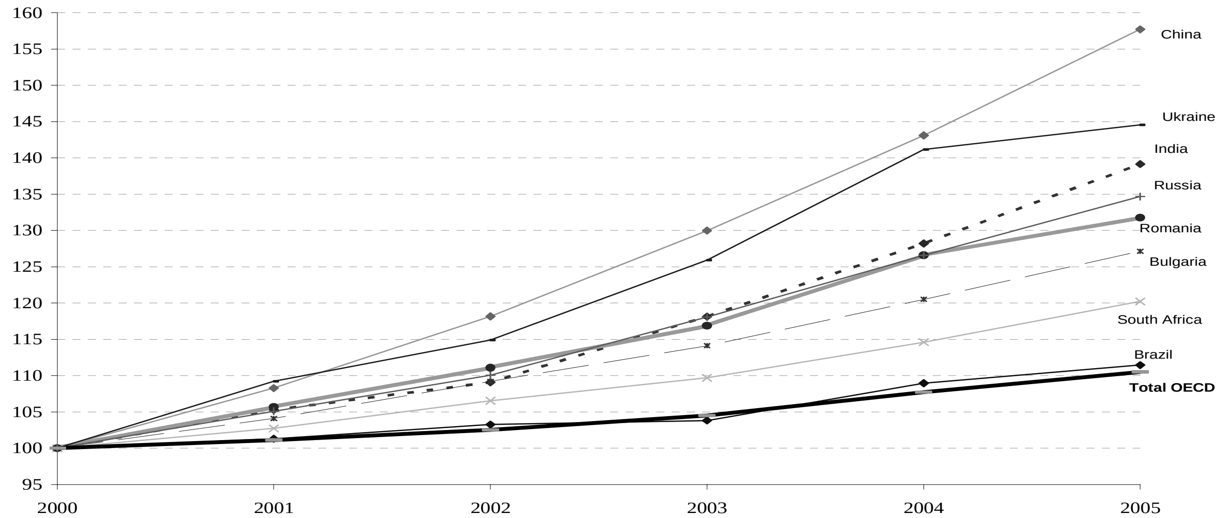
7. Gross agricultural output has increased steadily since 2000 but generally not kept pace with the rate of growth in the overall economies (Figures 1.5 and 1.6). The long-term upward trends are the result of more input-intensive production, improved technology, and increased livestock production. With the exception of Brazil, the land area used for agriculture has remained stable or declined. Large year-to-year variations tend to reflect extreme weather conditions which affect production. Crop yields, for example, have been highly variable over the last 5 years in Romania, Russia and Ukraine. This has led to some short-term policy responses intended to counterbalance volatile market conditions. In contrast, Brazil and China have managed steady annual gains in agricultural output since 2000.

Figure 1.5. Gross Agricultural Output, index 2000=100



Source: OECD Secretariat; FAO.

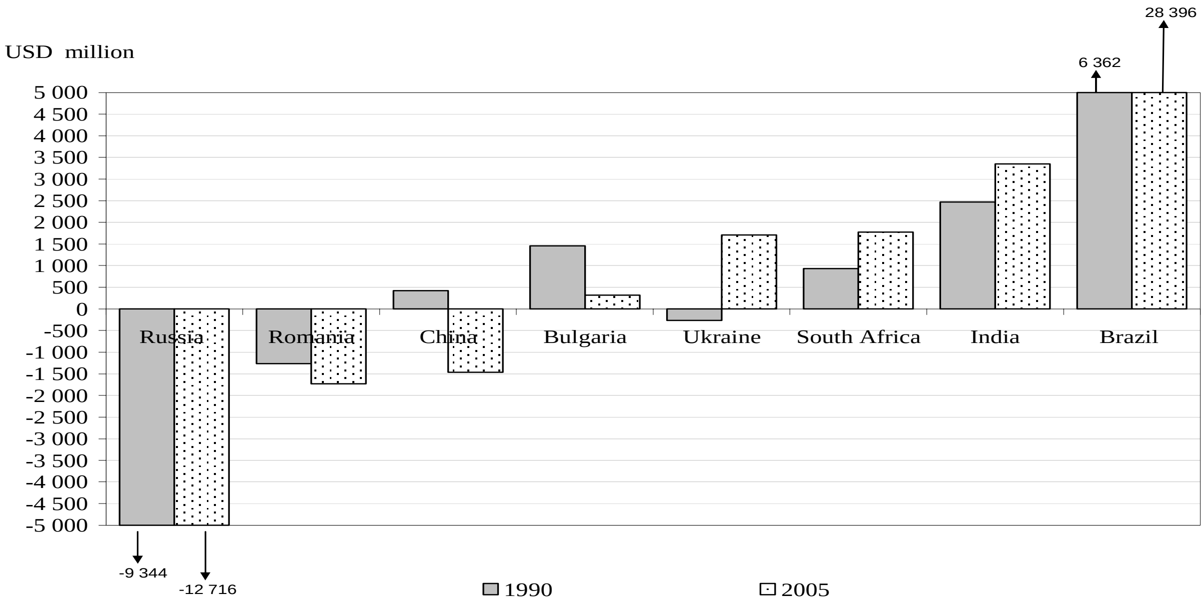
Figure 1.6. Evolution of GDP, index 2000=100



Source : OECD Secretariat; World Bank.

8. In terms of trade balances, Romania, Russia and China are net agriculture and food importers with a growing food trade deficit as rising incomes and currency appreciation reduce the cost of imports and consumer demand outpaces growth in domestic food production (Figure 1.7). For the first time since the late 1970s, China's agro-food balance changed from a net export to net import position in 2004 as the government purchased 7 million tonnes of wheat to replenish stocks and imports of soybeans and cotton increased sharply. Except for Bulgaria, exports are expanding for the other net exporting countries in this group with Brazil far and away the most significant and fastest growing exporter of agriculture and food products (13.5% growth in 2005).

Figure 1.7. Agricultural and food trade balance

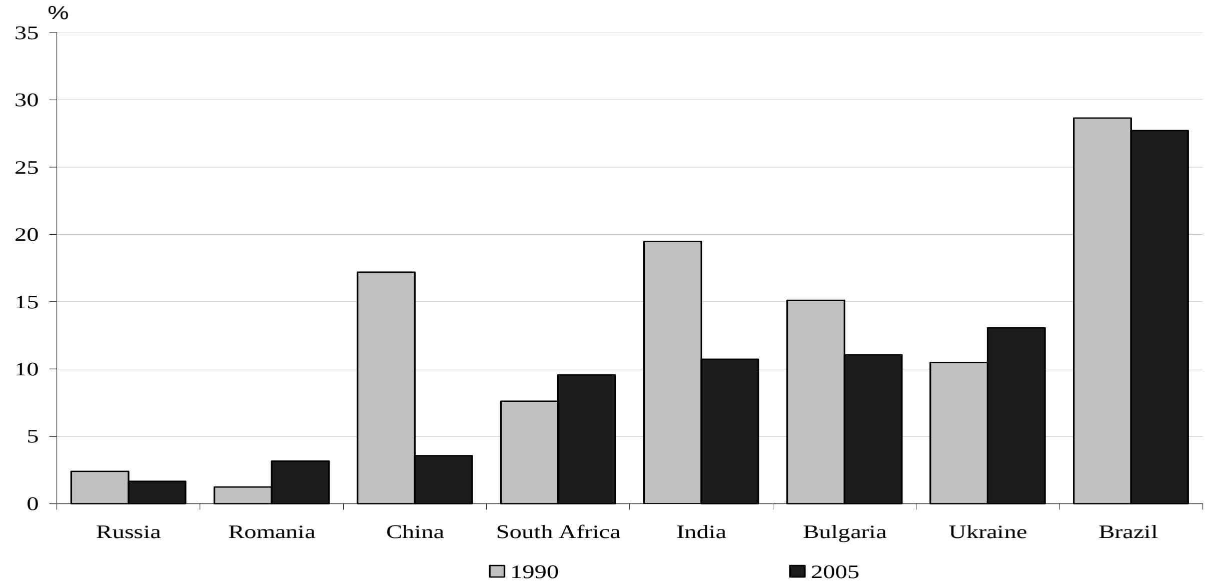


Source: OECD Secretariat; UN Comtrade.

9. In five of the eight countries reviewed, the share of agriculture and food exports in total commodity exports declined (Figure 1.8). Conversely, the share of agriculture and food exports increased in Romania, South Africa and Ukraine. Romania's agro-food exports grew by 2.5 fold between 2000 and 2005. South Africa is one of the world's leading exporters of wine, fresh fruits and sugar and a major trader in the African region. Agro-food exports for Ukraine reached a record level of USD 1.7 billion in 2005. Agro-food exports remain particularly important for Brazil, where they accounted for over one-quarter of all exports in 2005.

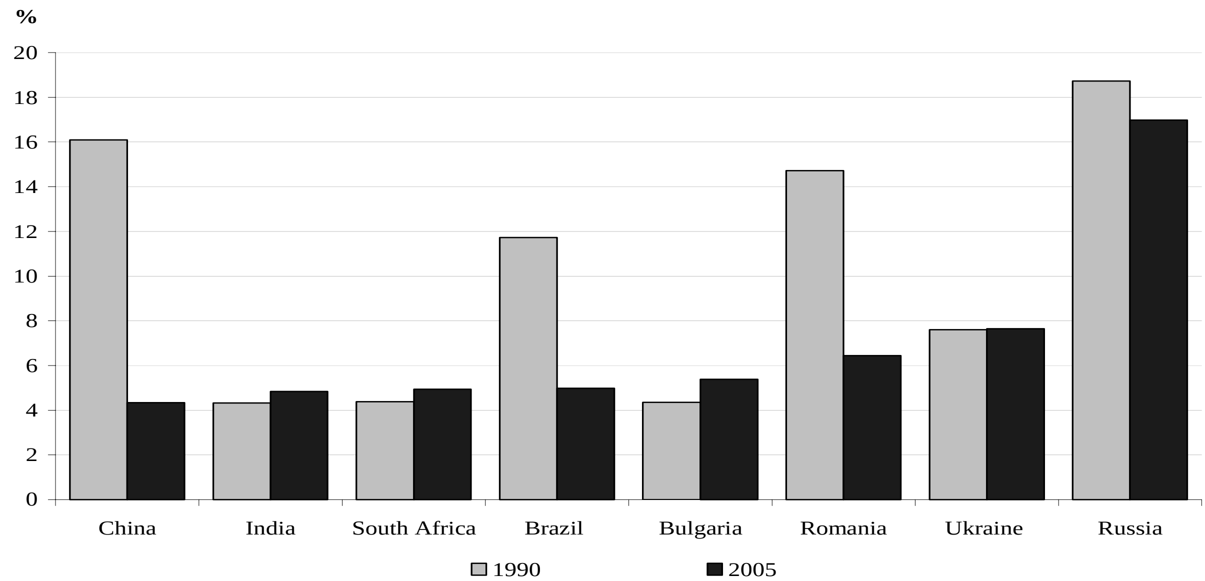
10. There was little change in the share of agriculture and food in commodity imports over the 1990-2005 period at about 5-7% for India, South Africa, Bulgaria and Ukraine (Figure 1.9). The large declines in the share of agriculture and food imports for China, Brazil, Romania and, to a lesser extent Russia, reflect the rapid growth in non-food imports associated with rising consumer incomes. In the case of Romania, currency appreciation, higher wage rates and reduced unemployment since 2004 combined to increase consumer expenditures on non-food imports.

Figure 1.8. Share of agriculture and food exports in total exports



Source: OECD Secretariat; UN Comtrade.

Figure 1.9. Share of agriculture and food imports in total imports



Source: OECD Secretariat; UN Comtrade.

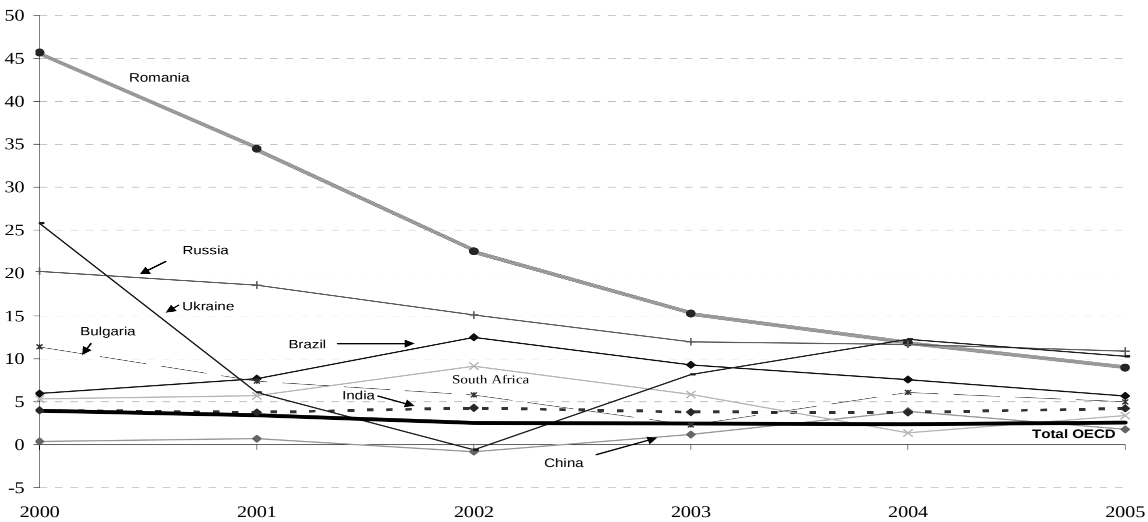
The policy context

11. This section examines some of the driving forces for change in the agricultural policies of the countries under review. With agriculture occupying a prominent role in each of these economies, and closely linked to such concerns as rural development, poverty alleviation and resource sustainability, decision-makers often seek at least partial solutions to broader social and economic problems through agriculture. There are many similarities but also several important differences in the pressures faced, and objectives pursued by the governments of these eight countries.

12. These countries have benefited from sound macroeconomic policies throughout the 2000s, which have resulted in improved fundamentals, including lower levels of public debt, budget surpluses or modest deficits and, in most cases, positive current account balances. Much of the economic growth has come from services and industry rather than agriculture. Recent economic growth in these countries has often outpaced that for OECD countries as a whole, with China and Ukraine the strongest performers (Figure 1.6). Both China and Russia posted record high current account surpluses in 2005, driven largely by positive trade balances. High oil prices caused a downturn in economic growth for most countries in 2005-06, although as an energy exporter Russia also benefited to some extent from higher oil prices. Growth slowed in Brazil where investment and consumption were dampened by high real interest rates, while in Bulgaria and Romania deteriorating foreign trade balances led to sharp increases in current account deficits.

13. A common characteristic of the countries under review is the impressive progress made in bringing inflation under control since 2000 (Figure 1.10). Still, the generally strong economic performances over this period continue to exert inflationary pressures and exchange rate appreciation. Russia and Ukraine saw double digit inflation rates in 2004-05 with a more moderate 5-6% in Brazil and South Africa. In 2005, China adopted a new exchange rate regime to moderate appreciation of the Yuan, concerned that cheaper agricultural imports would adversely affect farmers. Despite the overall positive economic situation, unemployment rates remained very high in Bulgaria (18%) and South Africa (26%), with large regional disparities and hidden unemployment, particularly in agriculture, common to all these countries.

Figure 1.10. Inflation, end year changes in consumer price for 8 countries and OECD, per cent



Source : OECD Secretariat; World Bank.

14. With improved budget situations, governments are tempted to address social and economic problems with increased spending on agricultural programmes. In Brazil, policy initiatives in 2005-06 were designed to mitigate a price-cost squeeze in agriculture and transfer cash to poor families. Alleviating poverty, combined with food security, is the main priority of India’s current five-year plan. China’s government has been allocating more budgetary resources to rural areas, while increased budgetary support to agriculture is provided for in a new Ukraine law introduced in 2005. South Africa increased spending on programmes to reduce poverty and unemployment. Russia introduced a two-year National Project stepping up support to the agro-food sector. Land reforms are another common policy focus (Box 1.1).

Box 1.1. Land reforms

Land reforms in the countries under review have been undertaken within very different economic and social contexts and are guided by varying objectives. Constraints – historical, economic, political, social and institutional – vary from one country to the next. However, a common feature of land reforms in all countries is an initial attempt to transfer rights to all or part of the agricultural land from large scale private or collective units to smallholders. In the developing countries (Brazil, South Africa and India) such transfers were put forward as a means of improving social equity and alleviating poverty, in the formerly planned economies (China, Russia, Ukraine, Bulgaria and Romania) these transfers were part of a broader transition to a market economy.

While in all formerly planned economies expected efficiency gains from a better designation of land rights played an important role, each country differed in the manner by which it implemented land reforms. In China, reforms were based on equal distribution of land use rights to all rural families, in Bulgaria and Romania on the restitution of land ownership rights to former owners, and in Russia and Ukraine on equal distribution of land ownership rights to rural workers and retirees, with large scale farms preserved via the renting of land from new landowners. In some cases – India, China, Romania and to some extent Bulgaria – reforms resulted in a fragmentation of agricultural holdings, leading governments to consider measures encouraging consolidation of farms into more viable economic enterprises. Below is a brief synopsis of the record of land reforms in the countries under review with the special focus on Brazil and South Africa, where land reform initiatives have been undertaken most recently.

Brazil has one of the world's most unequal land distributions. Towards the mid-1990s the issue assumed increased prominence, as the pressure from landless peasants mounted. Brazil is currently implementing its second National Agrarian Reform Plan, the broad objective of which is to integrate the poorest households into the general process of economic development. The main actions include settlement of landless peasants on lands confiscated, purchased or reclaimed by the government; provision of low-interest loans to acquire land; and funding community and infrastructure-related investments. A related activity is the Programme for Strengthening of Family Farming (PRONAF), targeted to small landed farmers and providing varied support for agricultural activities, such as a large number of preferential credit lines for investments and working capital, processing and marketing. This programme also incorporates education and extension components. Expenditures on land reform and the support of family farming have increased since 2003 when the newly elected government declared eradication of poverty its main political priority.

Land Reform in **South Africa** foresees the restitution of land to people dispossessed in the past by discriminatory legislation. The restitution is done either in the form of physical land allotments, financial compensation, or through alternative remedies. Over 600 000 land claims had been made by 2004, of which more than one half concerned rural land. Another component of the Land Reform is land redistribution, aiming in particular to settle small and emerging black farmers on viable farming operations in the commercial farming areas. It is planned to redistribute around 25 million hectares by 2015. Different modalities are foreseen under the redistribution programme, including the acquisition of part of equity in existing agricultural enterprises, and the purchase of farms using capital grants. There also exists a Comprehensive Agricultural Support Programme (CASP), providing investment grants to farmers settled through the land reform, as well as Micro-Agricultural Finance Schemes providing micro-credit for agriculture on communal lands. In addition to these activities, other programmes targeted to address social disparities are implemented. For example, Agricultural Black Economic Empowerment is a comprehensive programme for skills development of the black rural population and their integration into mainstream economic activity.

The current farm structure in **India**, dominated by small-scale farming, is inherited from post-independence land reform originally aimed at distributing land to the poor and limiting the size of land ownership. A stated objective of Indian land policy is the consolidation of farms into larger, more viable units. Yet, the fragmentation of agricultural holdings becomes more acute with each succeeding generation, due to customs and inheritance laws under which a holding is divided among family members. Local initiatives have met with some success in the northern states, notably Punjab, Haryana, and Western Uttar Pradesh.

In **China**, while past reforms shifted agricultural production from collectives to a family-based farming system, farmland is owned by village collectives and leased under contract to individual households. Farmers' land rights have been formally strengthened with the extension of land lease contracts up to 30 years, but in practice remain weak. In particular, as urbanisation and industrialisation advance, low compensation for lost access to land has become one of the main reasons for peasants' discontent. The government has tried to tighten control over the conversion of farmland to non-agricultural uses and several legislative initiatives have been undertaken to protect farmers' economic rights, but their implementation remains weak.

In **Russia** and **Ukraine**, the early process of decollectivisation based on equal distribution of land ownership rights among rural workers and retirees has been completed. Eligible citizens received land share certificates and vast majority of them obtained state acts confirming their land property rights. However, while in Ukraine the process of physical delimitation of specific land plots has almost been finished, in Russia such delimitation is envisaged only in cases when a land owner wants to create a separate family-run farm. Land market transactions are to a varying degree limited by existing legislation. Although the sale of agricultural land in Russia is permitted, the regulations and procedures are complicated, lack clarity and are constantly amended, while in Ukraine, agricultural land sales are subject to a moratorium, now extended until the end of 2006. There are also upper limitations on land ownership by individuals or legal entities both in Russia and Ukraine.

Land reforms in **Bulgaria** and **Romania** involved two different processes: decollectivisation, mainly through the restitution of land used by cooperatives to previous owners; and privatisation of state owned land through sales, lease and concessions. While in Bulgaria the two processes are completed, in Romania legislative gaps led to procedural delays and the finalizing of land reform is one of the government's primary objectives. In particular, land market legislation has been changed to accelerate legal actions in court on land restitution. SAPARD, the pre-accession EU-funded programme, and EU structural policies within the EU Common Agricultural Policy are expected to help stronger farm units emerge in the two countries.

15. In all countries under review, the governments are committed to increasing the welfare of large numbers of small farmers. The policy objectives go far beyond raising farm incomes and poverty reduction to the development of commercially viable operations, and include the need to integrate small farms into rapidly changing domestic supply chains and expand rural non-farm opportunities.

16. There are several driving forces for change that are particular to certain countries. The main developments in Bulgaria's and Romania's agricultural policy, for example, are related to preparation for accession to the European Union in January 2007, and to emergency measures related to weather disasters and animal disease outbreaks. Russia and Ukraine are entering the final stages of WTO accession, requiring harmonisation of their legislative frameworks with WTO rules and standards. Accession in 2007 is anticipated but some agricultural issues related to domestic support, export subsidies and border protection remain unsettled. In the interest of expanding trade and with the absence of substantive progress in WTO negotiations, all the countries under review have continued to pursue a range of bilateral and regional trade agreements.

17. Not surprisingly with over one-third of the world's population, food security is a major policy challenge in China and India. Grain security has been a top priority in China in recent years with the emphasis on increasing production capacity. Specific targets of 103 million hectares and 500 million tonnes of grains (including soybeans) have been set for 2010. India's primary agricultural policy objectives are food self-sufficiency and poverty reduction (to improve access to food). The Green Revolution brought about large gains in production but, in recent years, food crops in particular have reached a plateau with deteriorating land quality and water shortages posing serious problems for future increases in output.

18. Finally, agro-environmental issues are a growing policy concern in Brazil, China and India. Policymakers in Brazil confront a difficult trade-off between the economic benefits from agricultural expansion and the environmental benefits from forest preservation. But the fate of the Amazon rainforest is just one environmental issue linked to agriculture, albeit the one that attracts the greatest international interest. The impact of agricultural water use on resource levels and pesticide use on water quality are other concerns raised by farming systems in Brazil.

19. China is searching for ways and means of better aligning resource use with societal interests and environmental sustainability. China's endowment of water resources is extremely low and badly distributed while input-intensive agronomic practices are taking their toll in land degradation. Agro-environmental issues with a special focus on water, as identified in the 2005 OECD *Review of Agricultural Policies in China*, were seen as an urgent priority of the Ministry of Agriculture; and will be a central issue in the on-going OECD *Environmental Review of China*.

20. Similarly, in India the sustainable management of water and land resources are two of the most important agro-environmental issues. India has only 4% of world water resources and 16% of the population, and the lack of water is a serious issue in many parts of the country. Moreover, the demand for water is rising rapidly for both non-agricultural and agricultural uses. Several serious conflicts have arisen between states over water use in agriculture and the development of irrigation through multi-purpose hydroelectric dams. Land degradation is a widespread problem from direct erosion due to flooding and surface run-off as well as from the excessive use of water, resulting in salinity and/or alkality.

Evaluation of support

21. Support estimates are presented here for seven of the eight countries covered in this *Review* (India is excluded). These estimates form the basis for a comparative evaluation of policy developments in each country, the foundations of which are discussed in Box 1.2.

Producer support is relatively low but has risen in several countries…

22. In all cases, producer support as a share of farm receipts (the %PSE) is lower than the OECD average of 30% in 2003-05 (Figure 1.11) – only in Romania and Russia is the %PSE more than half the OECD average. There is a natural tendency for net agricultural exporters (Bulgaria, Brazil, Ukraine) to have lower rates of support than net importers, but there is pressure for protection in all cases, as each country has significant numbers of import-competing producers who are not competitive at world market prices. In the majority of cases, support has increased from the mid-1990s, the exceptions being Russia and South Africa, where support was already significant and has fallen modestly. In the cases of Brazil and Ukraine, there was a switch from a significant taxation of producers (implying a negative PSE) to positive support. The evolution of support thus contrasts with the slight decline in producer support across the OECD area as a whole. A stronger macroeconomic environment explains this general trend, as food price increases are more easily withstood by consumers when their incomes are higher, and budgetary transfers are more affordable when public finances are under reduced strain. A specific factor in the case of Bulgaria and Romania has been the need for policy convergence with the European Union.

Market price support dominates…

23. As in most OECD countries, market price support (MPS) is the dominant way in which support is provided to producers. This form of support is provided via domestic price interventions and border measures that create a wedge between domestic and world prices. MPS is a relatively inefficient way of delivering support to producers (see Box 1.2), but is often attractive in countries with lower incomes, as it does not require the use of scarce budgetary funds. The use of MPS and output subsidies in OECD countries has been declining in both absolute terms and as a proportion of producer support (Figure 1.11). In the seven countries for which PSE results are presented, the pattern is almost the opposite. Brazil and Ukraine both had significantly negative MPS in the 1995-97 period; this discrimination against agriculture had been essentially removed by 2003-05 and in the case of Brazil replaced by modest support. In Bulgaria and Romania MPS was close to zero in 1995-97, but had increased sharply by 2003-05. In China, there was a rise in MPS which mirrored the increase in the PSE, while in South Africa there was a decline which reflected the drop in producer support. MPS rose in Russia at the same time that the PSE fell, indicating an increased reliance on this instrument as other subsidies (notably those linked to debt restructuring) have become less important.

Box 1.2. Evaluating policies in non OECD member countries

The OECD has undertaken a wide range of analysis which considers the effectiveness of alternative agricultural policy instruments in addressing their objectives. These objectives fall within two broad categories: raising the incomes of agricultural households, and correcting market failures of various kinds (for example by providing a cleaner environment than would occur otherwise). A general finding is that the policies which work best are those that address their objectives directly, and disrupt the functioning of markets as little as possible. Such policies are described as "market oriented". Thus targeted payments not linked to production and consumption decisions can deliver support to farm households much more effectively than sectoral solutions such as price supports and credit subsidies, and they enable support to be linked to a clear rationale, be that facilitating adjustment or providing income safety nets for farmers who face major difficulties in adapting to competitive markets. Similarly, market failures are generally 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 under provide, such as a well maintained countryside.

The principles of market orientation have been affirmed on several occasions by OECD member countries. In 1987 OECD Ministers recognised the need for a reduction in agricultural support, and for a restructuring of support in favour of measures that were less market distorting. In 1998, they agreed on a set of principles for agricultural policy reform and a set of operational criteria for putting those principles into practice. In 2002 a *Positive Reform Agenda* for agricultural policies in OECD countries was agreed, conforming to the principles of market orientation, and linking those principles to a range of supporting analytical work. Most recently, in 2005, member governments acknowledged that the policies which help countries to achieve their domestic objectives are fully reconcilable with a commitment to facilitating agricultural trade.

The principle of market orientation is reflected in the way in which agricultural support is measured and classified by the OECD. The breakdown of the PSE according to the criteria of policy implementation corresponds to different levels of distortiveness (divergence from market orientation). The most distorting producer support policies are input subsidies and price supports, which directly stimulate production; while other forms of support cause fewer distortions according to the extent to which they are "decoupled" from production decisions. Thus payments linked to current area or animal numbers are less distorting that price support, but more distorting than payments based on some fixed historically established entitlement. Support for the agricultural sector that is not provided to producers appears in the General Services Support Estimate (GSSE), and includes many expenditures that can be considered as public goods (such as spending on rural infrastructure). The PSE and the GSSE, together with transfers to consumers from taxpayers, sum to the Total Support Estimate (TSE). Market orientation is associated with a low PSE, a composition on the PSE that is oriented towards decoupled payments, and a GSSE that contains legitimate expenditures on public goods.

The PSE and related indicators were originally developed for OECD countries. The methodology and analysis based on this system of measurement, has been accepted by OECD countries. However, there is no similar formal process of recognition by countries outside the OECD area, and some arguments have been advanced suggesting that the conclusions of OECD analysis may be less valid for poorer developing countries. So how useful a tool are PSEs for the analysis of agricultural policies in non OECD member economies?

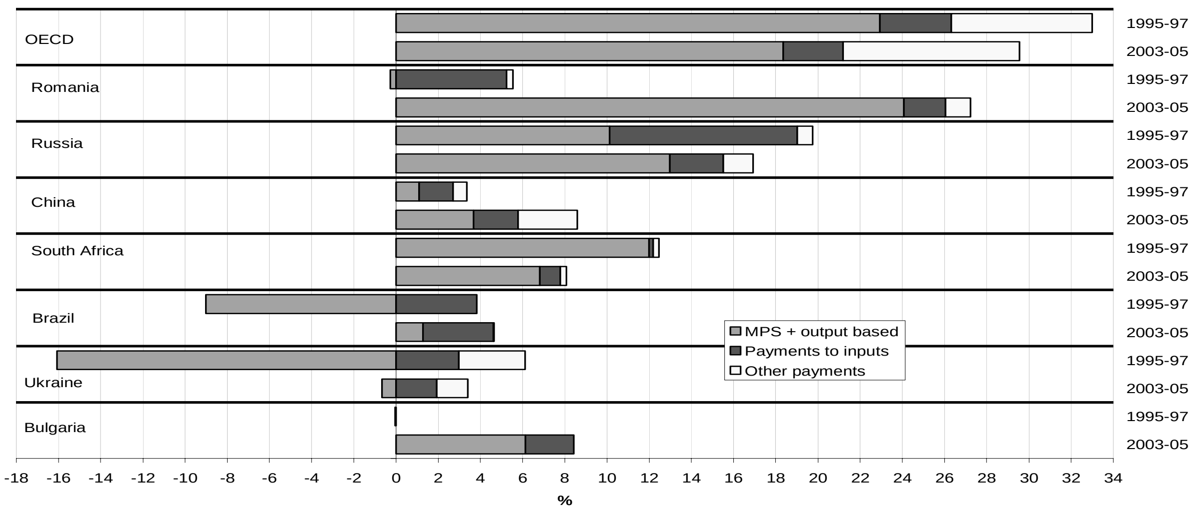
The first point to note is that the core economic analysis of how agricultural policies operate (in particular the identification of inefficiencies associated with distorting policies) remains valid for *all* countries, irrespective of their level of development. This has enabled OECD analysis to be applied successfully to a heterogeneous range of countries, including both the countries covered in this monitoring report, formerly planned economies that have joined the OECD and three countries with developing country status at the WTO (Korea, Mexico and Turkey).

Second, the distinction between supporting agriculture through investments in public goods versus supporting farmers' incomes inefficiently through instruments such as price supports and input subsidies is very important. Indeed, this distinction is possibly even more important in developing countries, where often there is an under-provision of public goods that support the functioning of the market system.

Nevertheless, a range of arguments have been advanced that apply specifically to developing countries, and which are purported to qualify the policy prescription in favour of market orientation. These include the impracticality of providing fully decoupled support in poor countries, and the suggestion that market interventions may provide a legitimate way of stimulating agriculture to develop beyond a low level equilibrium of subsistence farming. Such issues are the subject of much debate in development circles; a debate that has had implications for WTO discussions, as developing countries have sought reduced obligations, longer implementation periods, special safeguards to protect producers, and a recognition that some policies are different in a development context (e.g. providing subsidised inputs for low income and resource poor farmers). None of these arguments repudiates the findings of OECD analysis, but they do suggest possible circumstances under which "second best" solutions are necessary.

Recognising that some of the economic arguments may differ, and that non-OECD countries have not signed up to the results of OECD analysis in the same way as OECD member countries, there are some cases where the PSEs and related measures need to be interpreted more cautiously, and where the associated policy evaluation needs to be more circumspect. These needs are reflected in the analysis contained in this monitoring report.

Figure 1.11.Composition of Producer Support Estimates



Source: OECD, PSE/CSE Database, 2006

Complemented with input subsidies…

24. Payments based on input use tend to account for a smaller share of producer support than MPS, but are the next most important category of support, and in fact dominate in Brazil and Ukraine. In the case of Brazil, subsidised credit to farmers includes the deferral of debt repayments and additional credit to compensate producers for the effects of drought. In Ukraine, these payments have been more or less constant in recent years. For individual years, a negative MPS has in fact been the dominant component, but the switch from a negative to positive value in 2005 means that the average for 2003-05 has been low and input subsidies have been on balance more important. Input subsidies are typically even less efficient than market price support, as they encourage production (to an even greater extent) and a substantial share of support is captured by input suppliers. They are also often associated with negative environmental consequences, as they encourage the over-use of inputs. On the other hand, for agricultural sectors that are relatively under-developed, interventions in input markets can compensate for market failures (such as a sub-optimal provision of credit) and provide a way of supporting the transition to more efficient technologies and production methods. While this provides a possible rationale for some targeted support in the countries covered in this *Review*, the overall scale and structure of support for inputs does not correspond to this justification.

More targeted and decoupled forms of support are emerging…

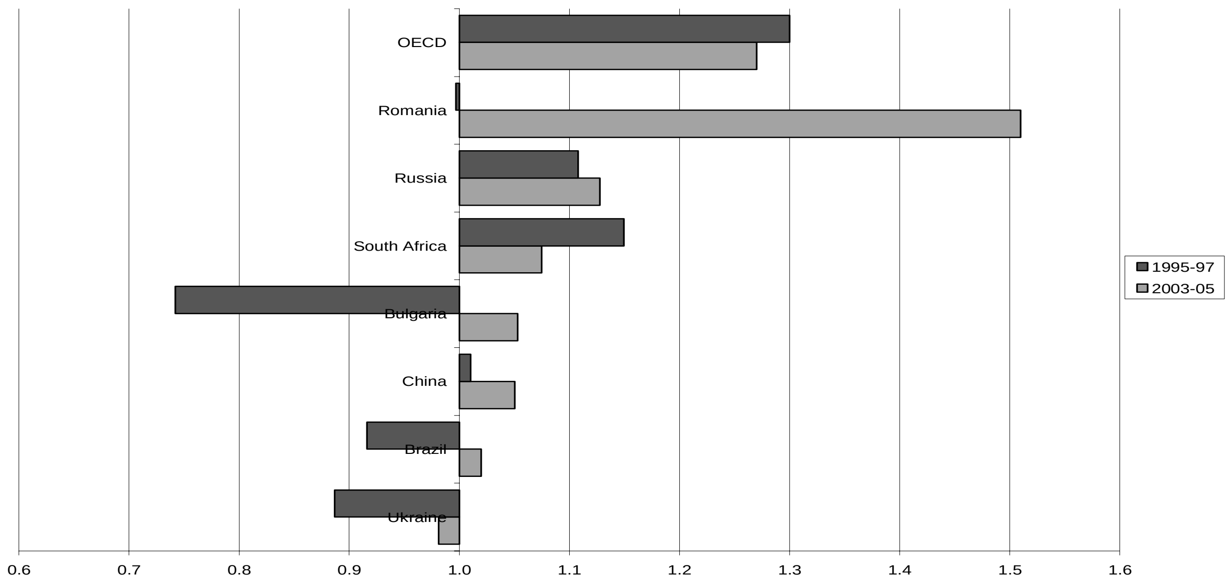
25. Despite the dominance of market price support and output and input payments, other more targeted and decoupled forms of support are emerging. In China payments based on area, input constraints and farm income are now collectively more important than payments based on input use, in Romania payments based on area and numbers of animals have increased, while in South Africa and Ukraine there has been an increase in the use of payments based on overall income, compared with the 1990s.

Average market protection is low, but sensitive commodities keep protection…

26. The producer Nominal Protection Coefficient (NPC), which shows the ratio of prices received by farmers to world prices, is below the OECD average in all countries under review except Romania (Figure 1.12). The NPC has risen in all cases except South Africa, where support declined. In countries

where the NPC was already greater than one (China, Romania, Russia), this implies an increase in the misalignment of domestic prices vis-à-vis world market levels, but in other cases (Bulgaria, Brazil, Ukraine) it implies a closer correspondence between domestic and international prices. The tendency of all countries to now provide price support to farmers is reflected in negative CSEs for all countries (in Ukraine the CSE only became negative in 2005), but consumers are on average taxed much less than in OECD countries. In some countries, the relatively low NPCs mask significant variations among commodities. This is for instance the case in South Africa where the average NPC is below 1.1 but the NPC for sugar exceeds 1.5, in Ukraine where an overall NPC implies implicit taxation of producers but the poultry NPC is 1.8, and Brazil where with an average NPC just above 1, the rice NPC is close to 1.3.

Figure 1.12. Producer Nominal Protection Coefficients

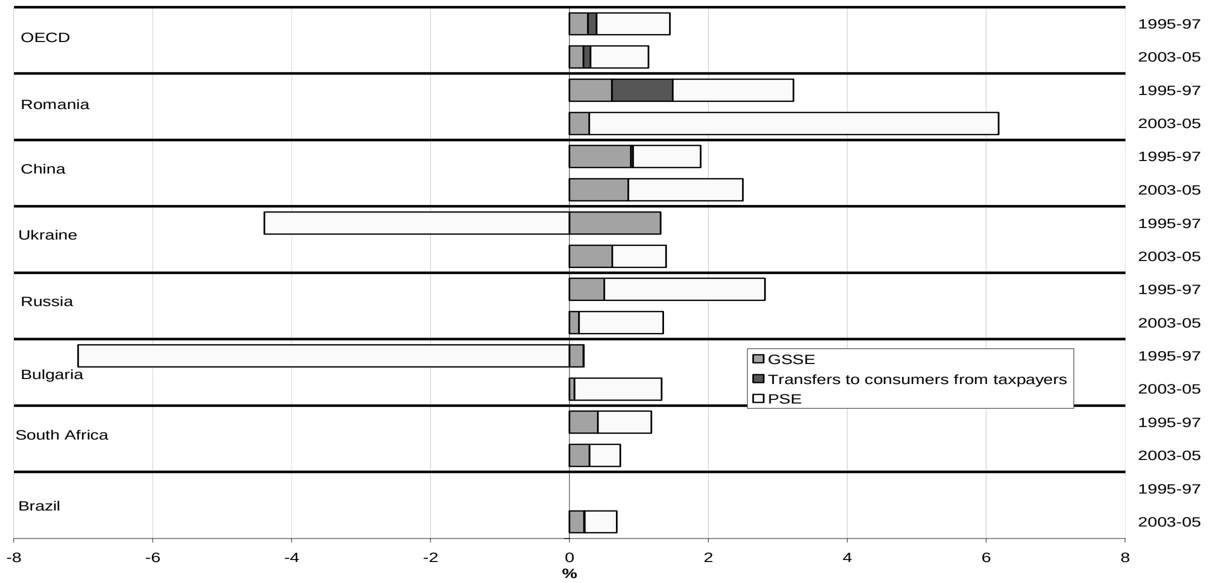


Source: OECD, PSE/CSE Database, 2006

The money spent on producer support could be more productively allocated to public investments…

27. In addition to support to individual producers, countries provide services to the agricultural sector as a whole. This support is captured by the General Services Support Estimate (GSSE), which includes expenditures on research and development, extension, inspection, marketing and infrastructure. Expenditures on general services account for a minority of support in all seven countries for which support is calculated, yet this category includes potentially important areas of public investment. A somewhat worrying development is that the share of the GSSE in total support has been declining in several countries, as producer support has risen (Figure 1.13).

Figure 1.13.Composition of Total Support Estimate (% of GDP)



Notes: Data for 1995-97 for Brazil are not available
Source : OECD, PSE/CSE Database, 2006.

28. The total value of support to the agricultural sector is measured by the TSE, which includes the PSE, the GSSE and transfers from taxpayers to consumers. A given rate of agricultural support to producers imposes a larger burden on countries with lower incomes and a higher share of agriculture in GDP. Thus, the burden of that support is extremely high in Romania, at 6% of GDP (Figure 1.13). In China, total support is low relative to the OECD average, but imposes a greater burden on the economy (more than 2% of GDP). In other countries, the ratio of the TSE to GDP is less than 2%, i.e. of a similar order to the average ratio in OECD countries, indicating that countries tend to provide support to their agricultural sectors to the extent that they can afford it.

Policy observations and recommendations

29. All of the countries under review in this monitoring report have demonstrated that profound agricultural policy reform is both possible and beneficial, given sufficient economic pressures and political will. The breadth, extent and, in some cases, speed of reform has been remarkable. This is true for the developing countries and the formerly planned economies under review. These reforms have permitted the agricultural sector to both benefit from, and contribute to, broader economic growth.

30. A key policy lesson from past reforms in these eight countries is the importance of getting the fundamentals right. Macro-economic stability has been the cornerstone of economic growth. Tight fiscal and monetary policies combined with an opening of the economy provided the necessary conditions for private sector development, but substantive improvements in human capital, regulatory systems and infrastructure have been required to capitalise on these reforms. Given the appropriate economic environment, private economic agents, including commercial farmers, have responded rapidly to market forces. Agricultural policy reforms over the medium-term have resulted in relatively low levels of government support and greater market orientation.

31. Less positive is the somewhat *ad hoc* nature of recent policy developments which does not provide the sector with the predictable policy environment that is essential for sound business decisions.

There are several examples in this report of *ad hoc* agricultural expenditures to build up stocks or regulate prices, only for governments to introduce countervailing measures the following year.

32. Even more disconcerting is the fact that support to agriculture in the countries under review is still dominated by market price support and input subsidies, the least efficient and most trade distorting ways of providing agricultural assistance. Moreover, the share of MPS and input subsidies in total support has been growing. Such measures generally misallocate resources and are not well targeted to specific desired outcomes. While there is a strong case for the increased public investment in support of the agricultural sector, scarce budgetary resources have often been used in inefficient ways to support producer incomes.

33. However, as the economic situation and sectoral performance have improved, there has been a noticeable shift in government priorities for agriculture from increasing production to providing income support and promoting rural development. This shift come from the realisation that economic growth alone does not solve, and can sometimes exacerbate, economic and social divisions. Current policies are correctly being focused on such objectives as:

- Closing the income gap between rural and urban populations.
- Integrating small-scale farmers into markets.
- Stimulating the reallocation of resources to create more efficient farm structures.
- Increasing the competitiveness of agri-food products on domestic and international markets.
- Improving the governance of institutions in designing and implementing agricultural policies.
- Sustainable management of water and land resources.

34. There have been policy developments in these directions. This report documents ongoing programmes to improve agricultural structures and equity through land and credit reforms, the development of infrastructure and information services and the improvement of regulatory systems. There have been attempts to better target farm income support to those most in need and to diversify the rural economy. Unfortunately, little analytical information is available on the effectiveness and efficiency of these new initiatives and internal monitoring is weak in most cases.

35. In terms of policy design, advisors and decision-makers in the countries under review would do well to consider the operational criteria agreed by OECD Agriculture Ministers in 1998, which state that policy measures should be:

- ***Transparent:*** having easily identifiable policy objectives, costs, benefits and beneficiaries.
- ***Targeted:*** to specific outcomes and as far as possible decoupled.
- ***Tailored:*** providing transfers no greater than necessary to achieve clearly identified outcomes.
- ***Flexible:*** reflecting the diversity of agricultural situations, be able to respond to changing objectives and priorities, and applicable to the time period needed for the specific outcome to be achieved.

- ***Equitable:*** taking into account the effects of the distribution of support between sectors, farmers and regions.

36. In terms of policy direction, priorities need to maintain the focus on economy-wide measures such as improved access to education in rural areas, better health care, pension and other social security services, enhanced land property rights and rural tax reforms. In agriculture, the emphasis should be on continued improvements in competitiveness and targeted adjustment assistance. It is important to recognise that the long-term future for most semi-subsistence farm households lies outside agriculture, so there is a need for measures that facilitate income diversification and the exploitation of non-farm activities.