

# Regulatory Reform in the Agro-food Sector

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*Regulatory reform in the agro-food sector is a two-edged sword. Reform of traditional agricultural support policies is reducing economic regulation. But emerging public concerns, not least in environmental protection and food safety, are creating pressures for new regulatory measures.<sup>1</sup>*

The agro-food sector in the OECD area is characterised by a high degree of state support and protection, with wide variations in its volume and composition both among countries and across commodities. The OECD countries are committed to the reform of agricultural policy, and some progress has been made in recent years in reducing support, improving market orientation and liberalising trade. This trend is continuing, although government intervention is still pervasive (Figure 1). Economic regulations (price administration, supply controls and border measures among others) form an integral part of policies that support and protect the agro-food sector. Deregulation is therefore an essential part of the reform process.

The forms of assistance to the agricultural sector have gradually become more numerous and complex. Governments traditionally protected the sector through market-price support (MPS) by means of border measures (tariffs and quotas) – most often in response to low prices in world markets – and by guaranteeing minimum prices for farmers. This kind of support has been widely applied, not least because (initially) it was effective in protecting producers, neutral in its direct effects upon national budgets and does not require much central

administration. Agricultural support policies usually mean higher prices for producers than would exist in the market and consequently higher prices to consumers. This implicit tax on consumers has been declining over time but varies considerably across OECD countries (Figure 2).

Regulations imposed by agricultural policies often inhibit the ability of the agro-food sector to exploit opportunities created by evolving consumer demands and new technologies. Price support may be tied to narrow rules on product specifications, and regulations intended to maintain quality tend to limit products to a few common grades. Both types of regulations can inhibit market responsiveness; indeed, representatives for the industry often argue that this ‘one-size-fits-all’ approach ties their hands. In many OECD countries, for example, dairy producers were slow in responding to the shift in demand towards low-fat dairy products in part because support prices were based on the fat content of milk.

## Improving Economic Efficiency

To maintain an MPS system that brings with it high domestic prices, considerable intervention is required – not least the fixing of prices and restriction of supply, which can substantially affect the efficiency of the agro-food sector as a whole. Other forms of support to farmers, such as direct payments de-linked from pro-

duction, are held to be more efficient in making transfers. The proportion of direct payments in total transfers to farmers has been increasing gradually in OECD countries, notwithstanding their administrative cost.

Structural adjustment, developments in international and domestic markets, new technologies have so altered the agro-food industry that governments are rethinking traditional approaches to agricultural policy. Budgetary pressures have also forced them to seek new, less expensive, methods of intervention and to introduce cost-recovery programmes, where the beneficiaries pay for services rendered. There is still a role for regulation and economic instruments such as direct payments – but other, more market-oriented approaches ought to make the farming industry more self-reliant and achieve policy objectives with less distortion.

## Liberalising Trade

The Uruguay Round Agreement on Agriculture (URAA) was an important step forward in strengthening multilateral disciplines for trade in agricultural products. The main achievement was the replacement of non-tariff trade barriers (NTBs) with ordinary customs duties, increasing transparency immensely.<sup>2</sup> Commitments to lower

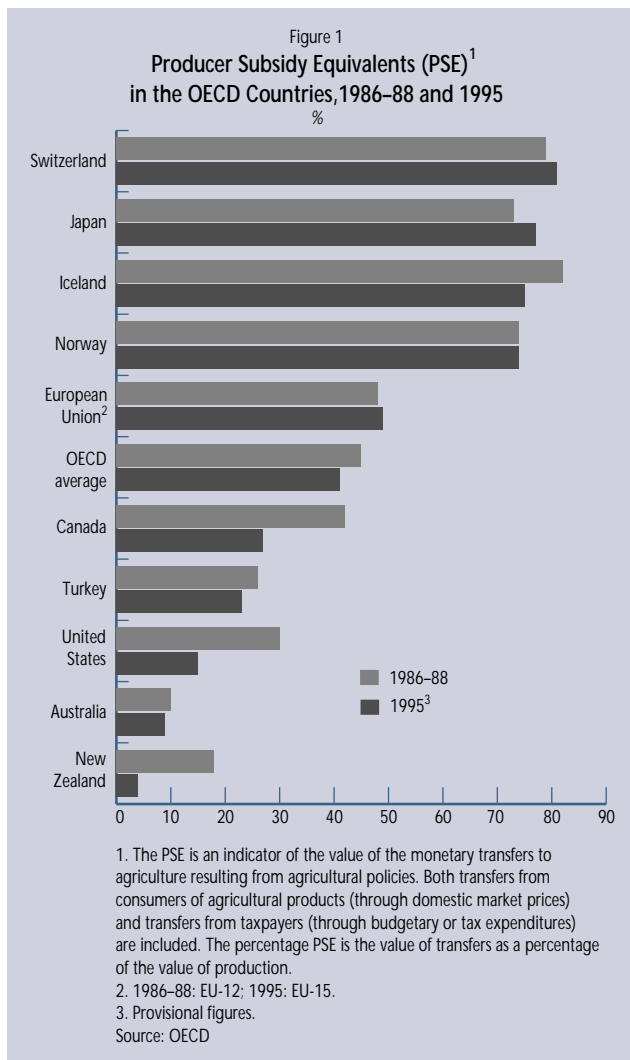
1. *Regulatory Reform and the Agro-Food Sector*. OECD Publications, Paris, 1997.

2. Carmel Cahill, ‘OECD Agriculture after Uruguay’, *The OECD Observer*, No. 196, October/November 1995.

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export subsidies and domestic support will reduce distortions. Tariff rate quotas (TRQs) ensure that market access obtained before the Round is maintained and in some cases increased. Other trade-related issues affecting agriculture, such as sanitary and phytosanitary regulations and technical barriers to trade, as well as the dispute-settlement procedure itself, are addressed in specific Agreements under the auspices of the World Trade Organization (WTO).

Export subsidies (restitution payments) for processed products before the Uruguay Round were often based on the difference in price of agricultural raw material on the world market

and those available domestically to the food-processing industry. When these export subsidies were reduced, exporting companies found themselves at a disadvantage compared with their competitors in less distorted agricultural markets. Predictably, there were then demands for compensation and/or exemptions from tariffs. In Norway and Switzerland, where prices of agricultural commodities are very high, the food industry is now allowed to import raw material for further processing at zero or low tariffs on condition that the finished product be re-exported.

3. See pp. 14-18.

4. Wilfrid Legg and Luis Portugal, 'How Agriculture Benefits the Environment', *The OECD Observer*, No. 205, April/May 1997.

A large number of methods have been used to allocate import licences under TRQs. There is still some uncertainty about which mechanisms are allowed under the WTO; and there is no agreement on their distortionary and discriminatory impacts. Under some allocation mechanisms, there is a danger that the benefits of cheaper imports may be captured by those with import licences rather than by consumers or taxpayers. In some cases single entities - including producer and processor organisations - have been assigned the import licence. This move could reduce the competitive pressure exerted by foreign products and result in higher prices. For reasons of equity and administrative ease, some governments auction import licences (Iceland, Korea, Norway and Switzerland, for example), although traditional exporters such as New Zealand and Australia suggest this process may introduce a



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'tax' on imports over and above the tariff rates stipulated by the quota.

## Ensuring Effective Competition

The intent (or effect) of agricultural policies is often to limit competition so as to increase returns or reduce risk to primary producers. As a result, there are many partial exemptions and special rules from competition laws for the agro-



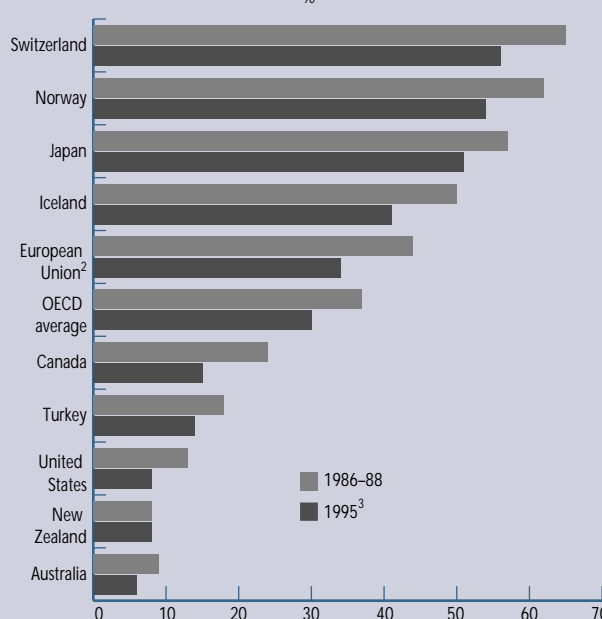
Border measures are among the economic regulations that support and protect the agro-food sector.

food sector, mainly affecting production agriculture (price-support schemes, supply management) and in some cases primary processing (farmer co-operatives, marketing boards). But such restrictions on competition can have an impact on other parts of the food chain by affecting the quality, cost and availability of inputs, insulating inefficient operations from market forces, restricting innovation and hindering the development of value-added.

A number of OECD countries have addressed these concerns. Recent rulings by the French Competition Council, for example, clarified the application of EU legislation, which forbids price-fixing, controls on production that are intended to influence prices, and restrictions on new entrants to the market. Indeed, the Council imposed sanctions on some firms which were controlling supply and affecting prices of cheese and veal. And in the United Kingdom the Milk Marketing Board system, which was the sole buyer of milk from producers and the sole seller of milk for processing, was abolished in 1994. With its demise, a number of companies were bidding for milk for the first time in 60 years, resulting in higher prices to farmers.

In some cases, government intervention in the agro-food sector was originally a response to a perceived lack of competition (where a large number of small farmers had to negotiate with a highly concentrated processing sector, for example). When such agricultural policies are removed or reformed, complementary measures may be required to maintain effective competition. In Sweden, for example, producer co-operatives dominated primary processing and were obtaining control of markets downstream. Many markets outside the co-operative sphere were dominated by one or two major firms and there was concern that downstream processors, wholesalers and retailers might capture the benefits of reform. A new Competition Act in 1993 extended coverage to the agro-food sector, although special rules remain. A 1996 report recommended additional measures to increase competition in the food industry.

Figure 2  
Consumer Subsidy Equivalents (CSE)<sup>1</sup>  
in the OECD Countries, 1986-88 and 1995  
%



1. The CSE is an indicator of the value of monetary transfers to consumers resulting from agricultural policies. Normally, these transfers are negative and the CSE can be thought of as the implicit tax imposed on consumers by agricultural policies. The percentage CSE is the value of transfers as a percentage of the value of consumption (valued at producer prices).

2. 1986-88: EU-12; 1995: EU-15.

3. Provisional figures.

Source: OECD

## Environmental Pressure

Environmental concerns are on the rise with, for example, demands to reduce the use of harmful chemicals and to maintain resource sustainability. As with nutrition, biotechnology, animal rights and other areas where governments are being pressured to intervene, the issue is less one of deregulation and more one of how best to ensure that regulations are effective and efficient with a minimum of adverse secondary effects.<sup>3</sup>

Where agricultural and environmental policies meet,<sup>4</sup> the general thrust has been to pay farmers for the provision of environmental benefits or to alleviate damage, although environment-

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Where the environment is concerned, the issue is less one of deregulation than re-regulation, to ensure that rules are efficient and have a minimum of secondary effects.

al regulations are having an increasing impact on farming. But the benefits of such measures have been offset at least partially by continued high support linked to agricultural production. Further reform of support policies would contribute to improving environmental quality.

A major difficulty in implementing regulations has been how to address diversity. Regulations tend to be rigid and generate economic distortions by neglecting differences across farms in the costs of reducing environmental harm. One way of tackling the 'negative externalities' caused by farming is by imposing economic penalties or requiring farmers to assume the costs of an activity that damages the environment (by applying the OECD 'Polluter-Pays' Principle). But much more work is necessary before harmful external effects can be identified, attributed and measured, and their costs assigned appropriately.

There is a growing number of regulations on land use and management in OECD countries. These regulations can require temporary or permanent changes in how land is used, as in land-diversion programmes (by afforestation, for example), modifications in farm-management practices, not least the disposal of animal wastes, and specific feeding and grazing practices or livestock densities. In some countries, farmers receive financial incentives to keep agricultural land out of production.<sup>5</sup> Often, short-term land diversion schemes are primarily intended to control the supply of a particular commodity, and in such cases environmental benefits may be temporary.

In other cases, regulations have been developed where conflicting land-use pressures arise,

5. Leo Maier, 'Letting the Land Rest' *The OECD Observer*, No. 203, December 1996/January 1997.

generally in densely populated regions. Protecting farmland from urban encroachment (maintaining traditional landscapes, natural habitats, bio-diversity, soil and water resources) is a common policy goal across OECD countries. In response, zoning and physical planning legislation has been widely adopted to curtail urban sprawl by designating rural areas as agricultural and sometimes by imposing regulations which severely restrict non-agricultural development.

## Improving Food Safety

As consumers become increasingly aware about the safety and quality of food products, concern about increased regulation and stricter enforcement in the agro-food sector has grown.

Recent outbreaks of food-borne diseases (BSE, *E. coli*, salmonella, listeria) have intensified these pressures. There is disagreement about what degree of safety should be pursued, which regulatory instruments ought to be used and who should bear the cost. There are also concerns about administrative and compliance burdens for industry, particularly for smaller firms.

Government intervention in food supply has been substantial, especially in designing and monitoring/enforcing minimum standards of safety, quality assurance and labelling. The role of the state in this area is being re-examined. Increasingly, a distinction is made between the regulations that provide a public 'good' (not least health and safety) and those conferring private benefits (quality assurance, for example), which are in most cases better left to industry – which has superior knowledge of market requirements and consumer preferences. In Canada, for example, the food industry has been given more discretion to grade products according to the demands of both international and domestic consumers. Governments have to ensure that the definition of responsibilities within the regulatory framework is clear to all and continuously updated.

Food-safety standards restrict the freedom of suppliers to differing degrees. As a general principle, suppliers should be as free as possible to choose the manner in which they meet a specified regulatory requirement. They will then be able to minimise the costs of compliance by choosing the most efficient method of doing so. This will promote innovation in compliance technology. Interestingly, the trend in recent years has been for public regulation to follow *de facto* standards laid down by private regulation.

A prime example is the requirement for HACCP-based (Hazard Analysis and Critical Control Points) systems in food-safety regulations. HACCP was originally developed as a voluntary, process-oriented management tool to help achieve performance goals for safe food. As a recent example, the US Department of Agriculture has required all meat-processing plants to develop a HACCP plan. Although this stipulation obviously imposes costs on the meat industry, cost-benefit analysis indicated that the



Can these cows be trusted? There is no agreement on food-safety standards, despite recent outbreaks of food-borne diseases such as BSE, *E. coli*, salmonella and listeria.

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resulting reduction in food-borne disease would yield considerable public-health and economic benefits. Perhaps equally important, consumer confidence is maintained and the threat of further 'health scares' minimised.

The Sanitary and Phytosanitary (SPS) agreement of the Uruguay Round advocates harmonisation or mutual recognition of SPS rules, and it is clear that efforts by governments to make their food-safety regulations science-based have increased since the Agreement came into force. One concern is that food safety regulations can be a moving target. The standards tend to increase with incomes; higher demands are reflected in changes to national food regulations. Such changes make harmonisation across countries difficult. Mutual recognition might prove to be more suitable (and less costly) for aligning food-safety regulations internationally. Such alignment should coincide with increased domestic effort to co-ordinate standards and procedures.

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Regulatory reform is an important means for furthering the goals of agricultural policy reform. The OECD countries are changing economic regulations that hinder economic efficiency, dis-

tort trade or restrict competition. For many emerging public concerns, such as food safety and environmental protection, there are new pressures for government regulation. Policy-makers have to address these issues in ways compatible with the objectives of reform and consistent with regulatory 'best practices'. ■

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