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Research Report

Russia's agricultural modernisation policy under WTO commitments: Why the EU's Common Agricultural Policy is a poor model

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Russia's agricultural modernisation policy under WTO commitments: Why the EU's Common Agricultural Policy is a poor model

How to revitalise the agricultural sector under the commitments of membership in the World Trade Organisation (WTO) has emerged as a major policy challenge for the Russian government. According to the current State Programme for the Development of Agriculture, a key support channel is via concessional credits to the livestock sector, which was singled out as the largest recipient of interest subsidies in 2013–2020. Currently, these payments are not considered green box compatible under WTO commitments, whereas similar measures within the EU's Common Agricultural Policy (CAP) are. While the Russian government may face little difficulty in dressing up its investment subsidies to make them look like green box compatible, the CAP is regarded here as a poor guide for policy reform. The available evidence shows that structural policy elements of the CAP were inefficient in reaching any of the manifold goals they were hoped to achieve. Drawing on the example of East Germany, it is argued that reforms of the institutional environment of agriculture are at least as important for successful agricultural modernisation as the generous availability of funding.

WTO disciplines on domestic support

Since the Uruguay Round conclusion in 1994, the main thrust of WTO commitments in agriculture has been to establish "a fair and market-oriented agricultural trading system", as noted in the preamble to the Agreement on Agriculture (AoA). More specifically, the objective was "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". A key policy area to achieve this goal is the domestic support that member countries provide to their agricultural producers.

The AoA divides domestic support measures into four distinct "boxes" which carry different expenditure commitments (Table 1). Only measures not placed in any of the first three boxes are potentially subject to reduction commitments ("amber box"). Their value is calculated as the Aggregate Measurement of Support (AMS) on a per product basis and for the aggregate of non-product-spe-

cific (NPS) measures. The AMS is calculated by summing up the public budget outlays for the measures related to that particular product or the NPS aggregate. However, for each product in the amber box and for the NPS aggregate separately, there is a so-called "de minimis" threshold of 5 per cent of the value of production. Only if a product- or non-product-specific AMS exceeds this threshold does it contribute to the measured support of a country. On an annual basis, this ultimate support measure called the "Current Total AMS (CTAMS)" is then subject to the support ceilings committed by the member country.

The classification of capital subsidies in Russia and the EU

In 2012, the Russian Federation entered the WTO with a developed country status and its support measures broadly fall into two groups: (a) border protection via import tariffs and non-tariff measures, particularly for livestock products, and (b) do-

Table 1: WTO categories of domestic support in agriculture

Category	Description	Reduction commitments	Examples of policy measures
Green box	Support measures have no or only minimal trade-distorting effects or effects on production (Annex 2 of AoA).	Exempt from reduction.	Direct payments to producers that meet specific criteria disconnecting ("decoupling") the payments from production, prices and factor use.
Blue box	Production limiting support measures (Article 6.5).	Exempt from reduction.	Payment levels are limited to fixed areas or number of heads and based on past yields, e.g. EU's "MacSharry reforms".
Development box	Support to encourage agricultural and rural development in developing countries (Article 6.2).	Exempt from reduction.	Certain investment and input subsidies in developing countries.
Amber box	All remaining measures.	Subject to support ceilings committed by member country.	Market price support, direct production subsidies, input subsidies.

Note: AoA = Agreement on Agriculture.
Source: Author based on AoA.

mestic support measures linked to production and input use (Sedik et al., 2013). In the base years relevant for the accession negotiations (2006–2008), most of the product-specific AMS fell below the de minimis threshold, so that the bulk of Current Total AMS was due to non-product-specific measures (Brink et al., 2013). Among these, as also reflected in the current State Programme for the Development of Agriculture, input subsidies and credit concessions figure prominently (OECD, 2013). If WTO commitments are going to restrict Russian agricultural policymaking in the future, these measures will largely be responsible for it, as they are currently not considered green box compatible. Anticipating such possible restrictions, the Russian government has already projected to increase future policy spending primarily via measures that fall into the green box. This raises the highly policy-relevant question under which conditions capital subsidies can be made green box compatible.

Most of the capital subsidies granted to agricultural producers under the EU's CAP actually are considered as green box measures. The EU claims exemption from AMS under paragraph 11, Annex 2 of the AoA (Anton, 2009). According to these provisions, "the amount of such payments in any given year shall not be related to, or based on, the type or volume of production (including livestock units) undertaken by the producer in any year after the base period" and "the payments shall not mandate or in any way designate the agricultural products to be produced by the recipients". In the following, I argue that this classification is hardly compelling and that it serves as a poor example for structural policy measures that are in the spirit of the WTO agreement. The agricultural sector of East Germany shares a number of commonalities with Russia and is thus taken as an example (Petrick, 2014).

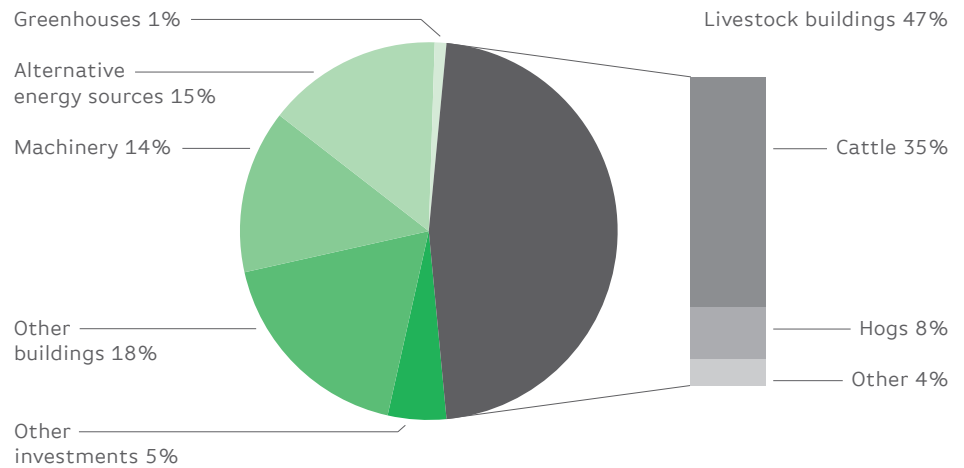
Impacts of capital subsidies in EU agriculture: The case of East Germany

Descriptive evidence comes from an ex-post evaluation of the agricultural investment support programme stipulated by the European Commission for the period 2000–2006 (Bergschmidt et al., 2008). It focuses on the most northern of the East German states, Mecklenburg-West Pomerania. The state supported agricultural investments worth 170 million euro in total, partly by direct grants and partly by interest subsidies. Figure 1 shows that almost half of the total investments sum concerned buildings for livestock production, of which cattle barns represented the single most important item. The majority of investments in livestock buildings led to a growth of livestock herds.

According to the study, many farmers regard a lack of finance as a main obstacle to investment. However, asked about their investment behaviour in a hypothetical case without subsidies, 18 per cent of the respondents would have carried out the same investment project and 35 per cent would have implemented it later or in several steps. Only 9 per cent of farmers would have cancelled the project without access to subsidies. The authors conclude that most of the possible positive effects on farm productivity would have occurred anyway, also without investment support. In its current form, the programme was regarded as insufficiently focused, inefficient and inadequately coordinated with other policies.

Based on data from three other East German states, Petrick and Zier (2012) investigate to what extent capital subsidies maintained or created jobs in agriculture. Using panel data methods that allowed the isolation of net policy effects, the authors found that capital subsidies did have a positive effect on agricultural employment. However, employment creation via capital subsidies was very expensive: about 50 thousand euros of subsidies were required annually to create one additional job in the short run.

Figure 1: Subsidised agricultural investments in Mecklenburg-West Pomerania 2000–2006 (Per cent of total investment volume)



Source: Author's calculation based on Bergschmidt et al. (2008).

This evidence suggests that capital subsidy programmes in the East German farm sector suffered from a lack of focus and have not typically made efficient use of taxpayers' money to improve the resource base of agriculture. A recurrent problem of such programmes is that their specific objectives are quite vague. While programme documents typically contain long lists of seemingly unrealistic policy effects, including an improved competitiveness of agriculture but also environmental stewardship, animal health issues or job promotion in rural areas, it often seems doubtful that politicians are aiming at truly economic goals. They may rather have in mind to serve their political constituencies. If the objective is to make productive use of capital in an economic sense, it is not clear why an administrative bureaucracy should be in a favourable position to allocate these funds efficiently, compared to a private bank facing competitive pressure and a hard budget constraint.

While these studies question the effectiveness of agricultural investment subsidies in the (East) German farming sector, it seems indisputable that such subsidies actually do promote (or "mandate") future production in some ways. If almost half of the investment aid in Mecklenburg-West Pomerania went into the construction of livestock barns (Figure 1) and if most of these were growth investments, a direct link to future production increases appears obvious. For agricultural policymakers, this insight implies a dilemma: they either have to admit that investment aid is completely ineffective and purely redistributive, in which case it may legitimately be classified as green box. But if there are any productive effects to be expected from these programmes, they can hardly be considered as non-distortionary.

Prospects for transforming Russian capital subsidies into green box payments

In 2013, the Russian government introduced an area payment that replaced previous fuel, fertiliser and pesticide subsidies as well as loans for sowing and harvesting purposes. The regulations declare this payment to be "decoupled" (*nesvyazannyi*), following established terminology of the CAP. At the same time, it is stipulated that funds should be used to increase the intensity of production. The level of payment depends inversely on the soil quality and it is paid under the condition that the eligible area receives fertiliser and pesticide applications. No doubt such provisions are not in the spirit of the green box regulation on decoupled direct payments, which requires that the payment shall not be based on the employed factors of production and shall not require production as such (Annex 2, para 6 (d) and (e)). There are also plans to make the credit concessions more green box compatible, although the details are as yet unknown.

It seems that neither the EU's nor Russia's current policies of capital subsidisation in agriculture would pass an economic litmus test of non-distortion. The reasons why the EU measures are considered green box, whereas Russia's are not, are likely of a political nature. Several WTO members have challenged the green box eligibility of the CAP investment aids in the past. But as the EU has a lot of leeway to increase its Current Total AMS before reaching the bound commitments, other members have little incentive to probe the case exhaustively. On the other hand, the Russian government may have had an incentive to inflate its non-product-specific AMS in the accession negotiations in order to reach a high level of Current Total AMS to begin with. In fact, the non-product-specific AMS in the base years was only slightly above 5 per cent of the value of production, and it would have seemed easy to push it just below this threshold (Brink et al., 2013).

Conclusions and recommendations

Referring to the EU as a model, the Russian government may face little difficulty in dressing up its capital subsidies and make them look like green box compatible. However, judged against the WTO principles, the structural elements of the CAP are a poor guide for policy reform. Yet, there may be lessons to learn from successful agricultural transition in East Germany. While East German farmers have benefited from rapid access to capital and plentiful government subsidies, even insiders of the farming community are eager to stress that reforms of the institutional environment were at least as important as the generous availability of funding. As an outcome of these reforms, East German farmers are now served by a professional government administration, a network of both cooperative-based and privately managed up- and downstream com-

panies, a diversified rural banking industry, and a widely inclusive political interest representation (Petrick, 2014). With regard to livestock farming, the role of member-oriented, democratically legitimised service associations focusing on the areas of knowledge extension, quality control and breeding progress can hardly be overstated. These factors ensured that qualified management was kept on the farms, genetic resources could be fully exploited, fodder generation and allocation optimised and technological innovations realised throughout the meat and dairy chains. Rather than pouring money into a sector without targeting its structural weaknesses, the Russian government should engage into thorough institutional reforms that improve the fundamentals of the sectors' competitiveness. East German transition may provide instructive insights concerning the roadmap for such reforms.

Further information

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