

Theoretical, Historical and Economic Pre-requisites of Protectionism in Agriculture

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Abstract

Agriculture has a specific role in the economy any country. At the early stages of economic development, in many countries the situation has been unfavourable for agriculture resulting in application of protection instruments in some countries. Instruments of protectionism are characterised by multiple forms, and there are different ways to classify them. The type and role of instruments of protection has also undergone changes in the upgrading process of economy. Within the negotiation rounds of the World Trade Organization (WTO), countries strive to achieve agreement on reduction of the protection level. Funds collected from tax-payers or consumers and disbursed to farmers by far not always fulfil their purpose, i.e., increase of farmers' net income. Support measures are in a number of cases ineffective and may even exercise a distorting influence both, on the sector and the economy as the whole. Therefore it is always vital to establish clear goals for every policy area in agricultural policy.

Key words: protectionism, agriculture, support payments.

Introduction

The problems of agricultural policy take their roots in the history of development of this area of production and are connected with the specific place it occupies in national economies. In early stages of economic development, despite low productivity, agriculture gave a massive contribution to national income. The technological progress of production accompanying the economic development allowed the increase of labour productivity at the same time promoting migration of population employed in agriculture to non-agricultural sectors. Reallocation of resources from agriculture to manufacturing industry is one of the underlying characteristics of a growing economy (McConnell, Brue, 1993, Tracy, 1996).

Scholars of agricultural economy (McConnell, Brue, 1993, Tracy, 1996, Grinovskis, 1996, Špoģis, 1999, Reiljan, Tamm, 2008) have summed up the main market economy problems. The majority of them are related to market of agricultural goods as a model of free competition and the dependence of the sector on natural resources and the climatic conditions. Account should be taken also of the specific use of labour, as an agricultural holding is workplace and home at the same time, and agricultural occupation may be characterised as the way of life.

Agriculture as a sector of the national economy has a specific role in ensuring its successful function, as agriculture and forestry are the only sectors generating organic matter and accumulating the solar energy in it. It has a unique strategic meaning in production of food for human consumption; it supplies

raw materials to a number of different sectors and consumes products manufactured by other sectors. Agriculture has a considerable impact on positive external balance, especially in countries importing resources. Agricultural and forestry environment is also the living and recreation environment for people (Špoģis, 1999, Grinovskis, 1996, Libermanis, 2006).

The **aim** of the present study: analysis of the historical development and the applied instruments of protection evaluating their economic nature. The following **hypothesis** was set forth: there are multiform instruments of agricultural protectionism and they exercise a varied impact on the development of agricultural sector.

The fulfilment of the following **tasks** was identified as relevant for the attainment of the above aim:

- 1) to analyse theoretical aspects of protection measures and classification of instruments applied in implementation of the protection policy;
- 2) to analyse historical development of agrarian protection;
- 3) to identify the role of international organisations in restriction of agricultural protection policy;
- 4) to provide economic evaluation of the protection measures.

The **methods** of analysis, synthesis and logical construction as well as scientific discussion were applied for fulfilment of the above tasks.

Sources by different authors (McConnell, Brue, 1993, Grinovskis E., 1996, Tracy M., 1996, Fischer

etc., 1999, Oļevskis 2000, Pilvere I. 2001, Ash, 2005, Libermanis, 2006, Reiljan J., Tamm D., 2008, **Anderson K., Swinnen J., 2008**, Torgeren F., 2008, Martin W., Mattoo A., 2008) and research papers on protection policy by international organisations (WTO, Organization of Economic Cooperation and Development (OECD), World Bank) have been used in the present paper.

Results and Discussion

1. Theoretical aspects of protectionism, instruments, and their classification

With economic development, the protectionism or the implementation of the sector protection policy does not limit itself with introduction of the customs tariffs and quotas for the protection of internal trade. The main purpose of the protection policy is protection of the local producers from external competition (Oļevskis, 2000, Explanatory Dictionary of Economy, 2000, WTO Agreement on Agriculture, 1995, Libermanis, 2006). Therefore, according to the authors of this paper, any support, administrative etc. measures applied by a country resulting in increase of competitiveness of local companies should be deemed protectionism.

The authors of this paper offer the following definition of **protectionism**: *economic policy exercised by the government and targeted at protection of the local production companies from outside competition by making use of an external trade regime and public support for the improvement of international competitiveness of the producers.*

Summing up the adverse effects of the protection policy implementation, the viewpoints of different authors (Tongerren, 2008, Halmai, Elekes, 2005, Ash, 2005, Libermanis, 2006, Grinovskis, 1996, Tracy, 1996, Isaksens u.c., 1992, Fischer etc., 1999, Mcconnell, Brue, 1993) seem to be in accord: discontinuation of the market protection measures once introduced is quite complicated; they cause distortions in decision-making of production and trade as well as over a long-term create high costs not only to consumers but also economy as the whole. In agriculture, implementation of the protection policies hinders structural changes.

On the basis of the above definition and studies of different authors, a conclusion can be made that the main **instruments applied** for implementation of the external trade regime and the support of the sector are customs tariffs and quotas, market intervention, government subsidies and investments, tax policy, international agreements, different norms and prohibitions (standards), exchange rate regulation, licences and permits. Pursuant to the definition of

protectionism, the support policy of a sector is part of its protection policy, since instruments applied in both areas overlap therefore actually any discussion on the support policy of a sector means also the discussion of protectionism.

The following classification groups of the applied instruments can be defined in the protection policy:

Classification by the type of motivation

According to an opinion by G. Libermanis (2006), the government ensures economic regulation of the state with the help of a leverage; the levers in a system like that may be divided into two groups: they are either economic or administrative levers. Economic levers constitute a substantial part of the social and economic motivation mechanism for they stimulate individuals to make a free choice of certain economic activities. Administrative levers like prohibitions, binding orders and norms limit the right of an individual of free choice, thus ignoring the cost-effectiveness stemming from profit and competition.

Classification by the object of support.

E. Grinovskis (1996) divides the support payments in direct and indirect payments. Direct payments support the production of goods, while indirect payments support: the acquisition of resources. The scholars of Latvian State Institute of Agrarian Economy (LSIAE) further divide the direct payments into direct payments coupled with the product (paid out per a product unit) and the production-coupled direct payments (paid out per ha or per head of agricultural animal). However there are fully de-coupled direct payments also (Latvian Agriculture and Rural Areas 2000: Policy and Development, 2001).

Classification by the source of funding. The subdivision most relevant to the specifics of agriculture is that of grouping support measures into *market price support* and *direct income support*. In case of the market price support, higher income to producer is ensured by sustaining relatively high prices on the market accomplished through regulation measures of the external market, e.g., intervention and export aid measures. The direct income support to producers is provided disbursing aid by certain criteria which may be directly or indirectly connected with production or turnovers thereof. The aid disbursed that way is funded by consumers for the money is sourced from taxes and paid to farmers according to a nationally approved procedure (Latvian Agriculture and Rural Areas 2000: Policy and Development, 2001).

According to M. Tracy (1996), the price support is effective for achievement of the stability in prices, providing just a short-term solution to farm income problems. The latest research papers on agrarian protectionism group the market price support and the direct income support together as *income support* for both are targeted at increase of

the farm income (Halmai, Elekes, 2005, Ash, 2005, Tongeren, 2008).

Classification by impact on production volumes. According to E. Grinovskis (1996), the stimulating protectionism and the limitative protectionism are two basic forms of measures, the application of which depends upon the market development level and its degree of saturation. The purpose of the stimulating protectionism is rise of the production intensification. The limitative protectionism is applied over periods of market oversaturation to protect the producers' income by paying them for producing less (unfarmed areas, reduction of animal heads).

Other Measures. Apart from market regulating and income support measures, some authors would single out measures having a long-term effect on the development of separate holdings and agricultural sector as the whole. Many of such measures are connected with investments. Thus J. Reiljan and D. Tamm (2008) propose the following classification of main measures of the protection policy:

- development-oriented measures (credit policy, information policy, and measures for product development);
- market measures (price policy, market policy, foreign trade policy, and the state intervention);
- support measures (direct and indirect support measures).

E.B. Deksnis (1998) on the contrary classifies measures into the production cost reducing measures and the structural changes facilitating measures as well as the production support.

Table 1 reflects the distribution of agriculture protection measures making use of the classifications by the above authors. The protection measures are evaluated according to the type of impact and administration of measures.

In the case of the first criterion *Regulating role of the government* the degree of the state regulatory intervention in the implementation of each support measure is evaluated. Thus it is assessed whether as the result of the particular support measure the beneficiaries are free to take their own management decisions motivated by economic viability, or the particular support measure is heavily regulated by the government (evaluation: large impact).

The next two criteria: *Improvement of the competitiveness of the sector* and *Increase of the production volumes* help form a judgement on what effect the support measure has on the upgrading of the sector: whether it is focused on the increase of competitiveness and the producers' income, or on raising the production volumes.

Evaluating the criterion *Regional Development* account is taken of how the particular support measure impacts the process of regional development

Table 1

Evaluation of the main protection measures applied in implementation of the agricultural policy

Protection measures and their evaluation criteria *	Price support	Direct payments coupled with production	De-coupled payments	Production efficiency promotion measures	Production volume limitative measures	Support to observation of environment protection requirements
Regulating role of the government	xxx	xx	x	x	xxx	xxx
Improvement of competitiveness of the sector	x	x	xx	xxx	0	x
Increase of the production volumes	xxx	xxx	x	xx	0	0
Regional development	0	xx	xxx	xx	x	0
Development of rural environment	0	0	xx	0	xxx	xxx
State budgetary outlays	x	xxx	xx	xx	xx	xx
Administration efficiency	x	xxx	xxx	x	xx	x

* xxx – large impact, xx – medium impact, x – small impact, 0 – no impact

Source: authors' research

and whether it has just focussed on the promotion of agricultural production efficiency or also on creating pre-requisites for higher employment in rural areas.

The criterion *Development of Rural Environment* is to a certain extent connected with the previous criterion. Evaluating it, a close attention is paid to what qualities of the rural landscape the particular support measure is going to promote.

Any measure funded from the government budget shall be assessed from the point of view of the implementation costs and the administrative load. As the funds for financing of almost all support measures are sourced from the budget (just in case of the market price support when a part of funding is collected directly from the consumers) and in our case the purpose is not to differentiate between the EU budget and the government budget, the evaluation “*large impact*” is assigned to measures the implementation of which, according to the opinion of the authors, require larger budgetary outlays and at the same time, when looking back, have brought the least effect.

Evaluating the criterion *Administrative Efficiency*, the evaluation “*large impact*” is assigned to measures the administration of which according to the authors, has been most effective: i.e., the best trade-off has been found in respect of the amount of costs and the administrative load.

2. Historical development of agricultural protectionism

Distinctions of agriculture and its specific circumstances are the main arguments exploited as justification for different forms of the public intervention and protection targeted at the market stabilisation. The agrarian protectionism is practised in most countries of the world for already more than a century (Table 2).

According to the research conducted in 1996 by M. Tracy on European countries, several stages may be singled out in the development process of agricultural policy after 1945:

- for improvement of the food supply under the food shortage conditions of the post-war period, income guaranties were granted to farmers as well as there was a price support either introduced or re-introduced as an instrument, besides the credit policy and subsidies of that time were tailored to promote the farm investment;
- at the start of the 1950s, when the agricultural production was already capable of satisfying the demand, the impact was shifted to extension of specific sub-sectors and increase of the agricultural production efficiency;
- in the 1980s, the support measures so far applied, had promoted the production extension and created overproduction depriving the farmers of incentive of adjusting the supply structure and volumes to the market demand,

Table 2

Protection measures applied in the agricultural sector of different countries at the end of the 19th century and the beginning of the 20th century

Time period	Protection measures	Countries
1980s of the 19 th century – 1920s and 1930s of the 20 th century	Customs tariffs	France, Germany, Italy, Belgium, Switzerland, Austro-Hungarian Empire, Sweden, Spain, Portugal, Russia, the USA
1930s of the 20 th century – 1940	Customs tariffs	France, Germany, the United Kingdom
	Local grain addition percentage	Norway, France, Germany, Sweden, Italy
	Restriction of imported volumes, import quotas	France, Germany, the United Kingdom, Belgium, the Netherlands, Italy, Switzerland
	Intervention, state stocks' procurement	France, Switzerland, Sweden, the USA, Canada
	Subsidies	the United Kingdom, Switzerland
	Cross border agreements, agreements	the United Kingdom, France, Germany, Hungary, Romania, Yugoslavia, Australia, New Zealand
	Export subsidies	Canada, Argentina, Australia, South Africa, the Republic of Ireland, New Zealand

Source: summary by the authors according to M. Tracy, 1996

consequently the governments were more and more obliged to intervene the market regulation. As the farm income level was still not satisfactory, the need appeared to address the structural policy.

Protectionism was widely applied also in countries of the former Soviet Block, creating market distortions, combining together the collective property, centralised distribution of resources, price dictation and government-regulated market system. K. Anderson and J. Swinnen (2008) have singled out several periods in the development of protectionism under the Soviet system:

- the middle of the 20th century (1950-1980) was characterised by the flourish of the agricultural sector. About 30% of investment was channelled into agriculture. The protection policy was implemented through centrally set high sales prices and low prices for resources;
- in 1989-1991 the development of the sector was affected by the dilapidating process of the Soviet Union and the following liberalisation of the market relationships. The farm income fell dramatically, for the raw materials' prices grew much more rapidly than the sales prices of products. The protection level of the sector was negligent;
- at the mid-1990s due to the political pressure, the support to agriculture increased and new support mechanisms were introduced;
- starting with the year 2000, the general economic growth improved the budgetary revenue of many former Soviet Block countries allowing enhancement of support to agricultural sector leading to gradual increase of the protection levels to agriculture. The impetus to agricultural

support was provided also by foreign investment into the agro-food sector of the region. The policy changes implemented over this period in agriculture were underpinned by the intention of the former Soviet Block states to join the European Union (EU).

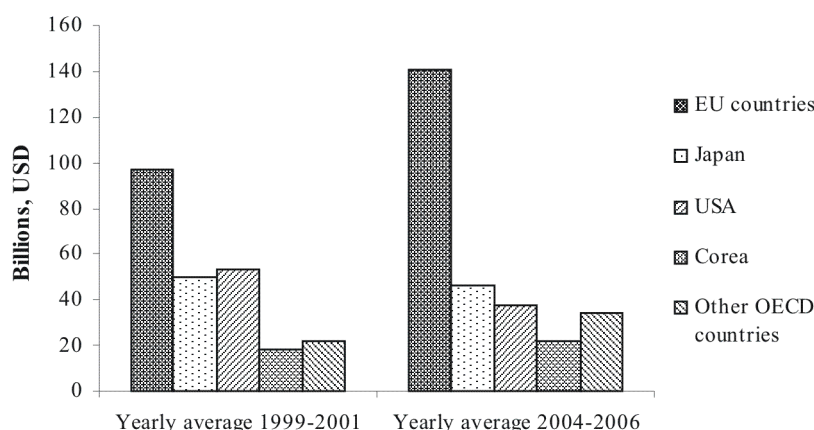
3. Role of the international organisations in restriction of the protection policy

As noted by G. Oļevskis (2000) and S. Fischer etc. (1999), the economy globalisation forces the protection policy to take more concealed expression forms, applying non-tariff trade restrictions. Most countries of the world are the WTO members, therefore in mutual trade they have to adhere to the provisions of the WTO Agreement. The latter provides for trade among countries on mutually profitable conditions without excluding the opportunity to apply the internal market protection measures if appropriate (Pilvere, 2001). The main international regulatory enactments governing the agricultural and rural development policy on the level of inter-governmental level are the following:

- Treaty establishing the European Community (1957) and Single European Act (1987);
- WTO Agreement on Agriculture (1995);
- Doha WTO Ministerial Declaration (2001);
- OECD Positive Reform Agenda (2003).

As the result of agreements achieved within the WTO the agricultural protection is being reduced all over the world, however the largest countries or groups of countries spend massive amounts on agricultural protection which have no tendency to get smaller (Figure 1).

F. Tongeren (2008) points out that in the period of 2004-2006, 54% of agricultural support provided



Source: J.P. Chauffour, 2008

Figure 1. Support to agricultural production in OECD countries in 1999-2006, billion USD

for in the OECD countries consisted of the market price support.

4. Economic evaluation of agricultural protection

Assessing the overall effectiveness of protection measures, the authors' starting point is the latest research conducted on agrarian protection using the analysis of income support measures for identification of problems. This group of measures includes both the application of the external trade regime as well as several types of the public support measures. The most extensive research is carried out within international organisations: OECD, WTO and the World Bank, arriving at a concordant opinion of the negative impact produced by support measures (Tongeren, 2008, Chauffour, 2008, Anderson, Swinnen, 2008, Courleux, Guyomard, 2006, Ash, 2005, Halmai, Elekes, 2005, Ablar, 2004 etc.).

Efficiency and distorting effect of the income support measures. Analysing the income support policy, it should be noted up to what extent the funds collected from tax-payers or consumers increase the farm net income or what is "the income transfer efficiency". The results of research carried out within the OECD (Ash, 2005) show that the farm income support is not effective means of increasing the said income. Figure 2 summarises the four main types actual beneficiaries of income support (input subsidies, production-coupled area payments, deficiency payments having the aim of off-setting the product prices and market price support) measures.

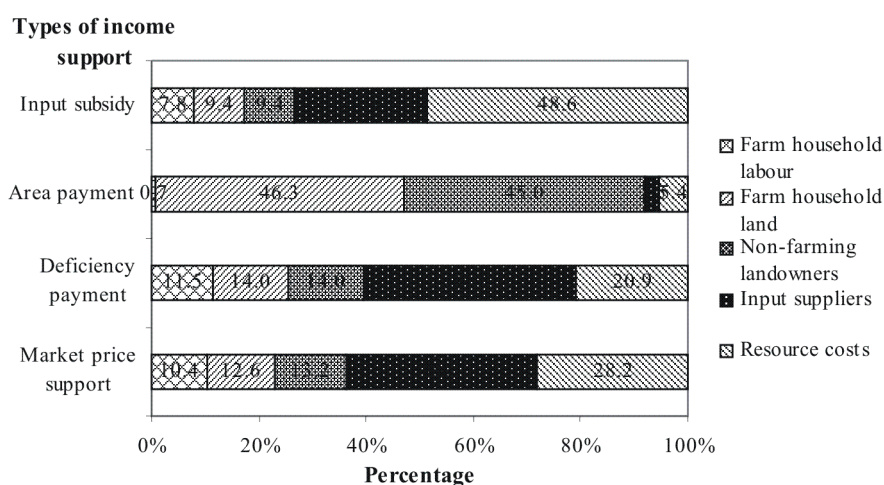
The loss of purposefulness of support is related to the programme administration costs, additional costs to suppliers of resources, land owners and payments to/from other countries.

The research shows (Figure 2) that in case of the market price support and deficiency payments only the fourth part of funds actually cause the income increase, while in the case of resource subsidies this share is less than 20%. According to J.P. Chauffour (2008) the support for the production volume is the type of support most harmful to the environment. In the case of subsidies to production resources, market price support, and deficiency payments, the stimulation of demand for resources results in the most part of the disbursed funds being actually paid to resource suppliers and capitalised in the value of land.

The share of financing efficiency is closely linked with the distorting effect on the market of the respective type of support. F. Courleux and H. Guyomard (2006) refer to the research carried out by J. Dewbre, J. Anton and W. Thompson (2001) comparing the income support measures as to their distorting effect on agricultural production and trade (Figure 3).

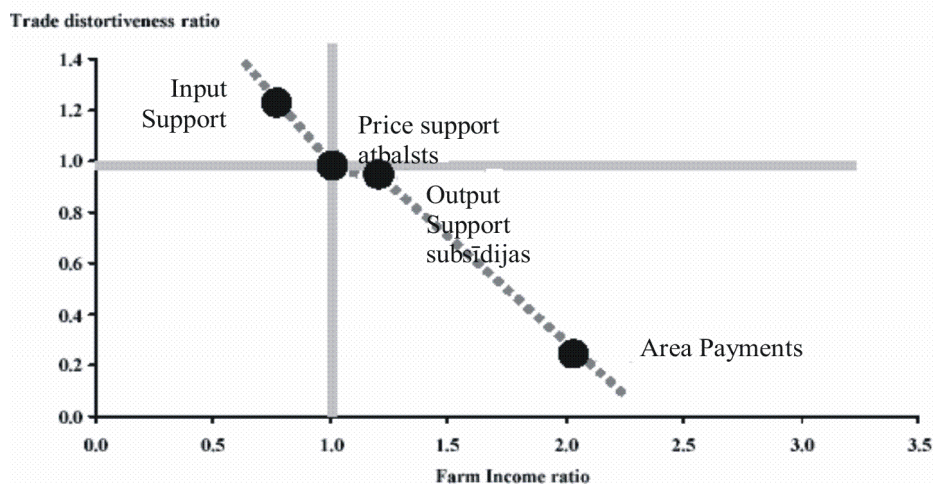
In their research, the above authors have chosen the price support as the point of reference (100%). They come to a conclusion that subsidising of production resources is the type of support with the highest distorting impact (about 130%); while the subsidies related to production and the price support have the distorting impact of 100%. The production-coupled area payments are less distorting (about 35%). The least distorting impact is laid by the decoupled area payments. Any type of support is less profitable to small holdings, for the largest part of support payments related to production volume is disbursed to large holdings (Ash, 2005).

The capitalisation of the support payments. Within the current ongoing process of agricultural



Source: made by the authors according to K. Ash (2005)

Figure 2. Share of financing structure of income support in agriculture



Source: F. Courleux, H. Guyomard (2006)

Figure 3. **Income support impact on trade and income from agriculture**

policy reform, the price support is replaced by support related to land. This trend of reform dominates not only in the European Union but also in the USA, Mexico and Norway. Therefore the support capitalisation as an inevitable side effect of the support apportionment is coming to the forefront. F. Tongeren (2008) has defined this phenomenon as increase of the ownership value of the agricultural holding under the impact of agricultural support payments. Capitalisation effect is especially well expressed for all area support payments making them a hindrance in the way of a dynamic growth of the sector. The increase in the land value raises also the leasing rental thus encumbering the entrance of new players in the agricultural sector as well as raising costs for the land lessee. K. Ash (2005) notes that the gain of farmers-landowners from the land value increase cannot be attributed to farm income.

The distorting effects of the agricultural policy. The common finding of all latest research is that decoupling of support from the production essentially decreases the level of distortion and improves effectiveness. However any agricultural support programme leaves a considerable impact on decisions made in agriculture and trade, consequently a “perfect” agricultural policy cannot exist.

The appropriate support measures regarding the multifunctional role of agriculture. The benefits from different agricultural support programmes are concentrated in one sector, while the costs are distributed among the society as the whole. Therefore it is important to establish optimum mechanisms of agricultural protection policy.

The agricultural and rural development policies in developed countries are currently dominated by the aggregate support of market prices and direct income

support hardly providing desirable results. Over the recent years, the multifunctional role of agriculture and the trenching of rural development aspects from the agricultural development get more and more emphasis. Instead of defining clear and attainable goals in both areas separately, many countries including the EU try to address both areas with the same support measures. The EU, for instance, apart from decoupled area payments, introduces also the requirement to observe the cross-compliance rules. As it is pointed out in the latest research by the OECD and the World Bank (Tongeren, 2008, Chauffour, 2008) this is an indirect and thus an ineffective way of ensuring adherence to environment provisions or animal welfare requirements. Choosing clearly defined and targeted policy goals, the result might be achieved much more effectively and at lower costs; e.g. entering into specific contractual relationships with farmers on provision of specific environment services.

Conclusions, proposals and recommendations

1. The protection policy has been applied for the protection of agricultural sector already since the end of the 19th century. Also nowadays agriculture is a sector with a high level of protection.
2. The agricultural and rural development policies in developed countries are currently dominated by the aggregate support of market prices and direct income support causing undesirable side-effects as capitalisation of the support payments and ineffective distribution. According to the research conducted by the OECD, the majority of the received support is actually further paid

to resource suppliers and capitalised in the land value.

3. The agreements recent of liberalisation of the agricultural policy of multinational alliances (WTO, EU and OECD) prescribe re-orientation from the production or the price support to the land area-related support. The decoupling of the support payments from the production essentially reduces the distorting impact of support on the production and trade decisions as well as improves the effectiveness.
4. Taking account of the conditions summarised above which define the special role of agriculture in any country's economy and the downward welfare trend created as the result of the economic development, it can be concluded that internal market protection measures, are, on the whole, necessary. The agriculture protection policy implemented in this country should be perfected, so that it is:
 - more effective (better targeted);
 - harmonised with international requirements.

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Kopsavilkums

Lauksaimniecībai ir īpaša loma jebkuras valsts ekonomikā. Ekonomikas agrīnajā attīstības stadijā daudzās valstīs situācija lauksaimniecības nozarē bija nelabvēlīga, kā rezultātā dažādās valstīs ir pielietoti lauksaimniecības protekcionisma instrumenti. Tie ir daudzveidīgi un ir iespējama daudzveidīga to klasifikācija. Attīstoties ekonomikai, pielietoto protekcionisma instrumentu veidi un nozīme mainās. Pasaules Tirdzniecības organizācijā notikušajos sarunu raundos valstis cenšas panākt vienošanos par protekcionisma līmeņa samazināšanu. Līdzekļi, kas tiek iekasēti no nodokļu maksātājiem vai patērētājiem un izmaksāti lauksaimniekiem, ne vienmēr sasniedz savu mērķi- palielina lauku saimniecību tīros ienākumus. Atbalsta pasākumi ne vienmēr ir efektīvi un tiem ir kropļojoša iedarbība gan uz nozari, gan ekonomiku kopumā. Tāpēc lauksaimniecības politikā ir nepieciešams izvēlēties skaidri noteiktus un uz katru politikas jomu attiecinātus mērķus.