

‘Multifunctionality’ and ‘free trade’

conflict or harmony?

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☪ Multifonctionnalité et libre-échange : conflit ou accord?

☪ Multifunktionalität und Freihandel - Konflikt oder Harmonie?

‘Multifunctionality’ has quickly become the touchstone position taken in trade debates. In brief, the term refers to any unpriced side-benefits additional to the production of food and fiber. While the Europeans emphasise the social functions of maintaining the cultural landscape, providing amenity goods, sustaining rural communities, and safeguarding rural environmental capital (the ‘European model of agriculture’), the Japanese seem to have made food security their flagship ‘M-argument’ (see, for example,

Norwegian Ministry of Agriculture; Japanese Ministry of Agriculture, Forestry and Fisheries). In this paper, we restrict our discussion to the *environmental* aspects of multifunctionality and term these ‘countryside benefits’.

Many of the non-market benefits of farming have ‘public good’ characteristics provided on the back of agricultural production. Hence, if reduced agricultural support threatens the viability of farming, many of these benefits may be lost or, at least, underprovided. Economists

refer to this as ‘market failure’ - countryside benefits are highly valued by the public, but supply is seen to fall short of demand. It is widely accepted that benefits from freer trade can be enhanced if domestic market failures are reduced. How then does this reconcile with the fears, expressed by ‘free-trade’ proponents, that continued agricultural support, be it on environmental, food security or other grounds, can distort international competitiveness and divert trade flows, giving rise to economic inefficiencies? (Freeman

and Roberts; Vasavada and Warmerdam, USDA-ERS).

The current debate over multifunctionality has been prompted by Article 20 of the Uruguay Round Agreement on Agriculture which stipulates that 'non-trade concerns' be taken into account in future negotiations on agricultural trade liberalisation. The debate is in many respects similar to the discussion earlier in the Uruguay Round about so-called 'non-economic objectives'.

Concept of environmental multifunctionality

Doubts arise because agricultural output and countryside benefits are often joint products of farming - to provide more of one output, say,

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environmental benefits, farmers must produce more (or less) of the other output, say, food and fiber. Accordingly, policies pursued for domestic reasons can affect trade. Figure 1 illustrates the possible relationship between these two 'outputs'.

Starting from a relatively high level of agricultural support with intensive production, a decline in support will first bring about environmental enhancement, but beyond some point, further reduction will lead to environmental decline as farmers abandon unprofitable marginal land. The environmental consequences may range from invasion of undesirable scrub species (in temperate zones) to desertification (in the Mediterranean) to loss of the landscape heritage and flood mitigation (in Japanese paddy rice landscapes). Different assumptions made about the relationship between agriculture and the environment can be seen to

underpin the different positions adopted in trade negotiations. While New-World trade negotiators focus on the first part of the argument, stressing the synergy of reduced support and environmental enhancement, the second part most concerns many countries in the Old World (Hodge). If government policies reduce agriculture to areas competitive at world prices, the associated loss of countryside benefits may be substantial and may outweigh the (politically less visible) gains from freer trade. It is not surprising then that countries will insist on their right to determine for themselves the mix of domestic policy measures best suited to optimise the non-market benefits from multifunctional

agriculture. Additional tensions may arise because New World negotiators may have a preference for a wilderness landscape and thus question the upward-sloping part of the curve. The European view of a cultural landscape and a lived-in rural environment as an amenity of everyday life for the vast, non-agricultural, majority of the population may indeed sound a rather alien concept to many Australians and Americans.

'Trade-correcting' or 'trade-distorting' domestic policies?

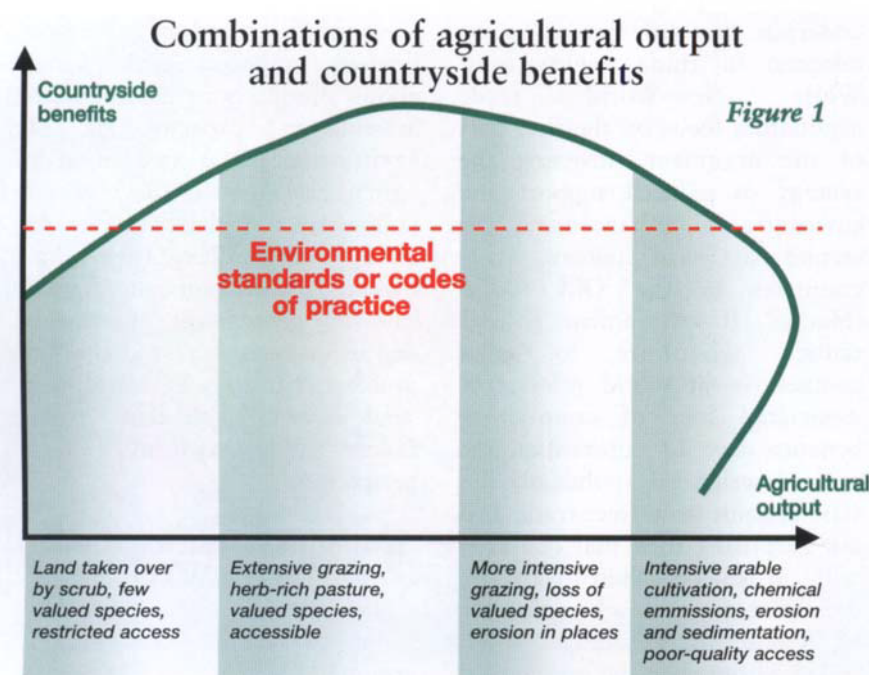
The sovereignty of nations to decide their own domestic policies has never been questioned for *negative* environmental impacts of farming. Indeed, for many years academics and policy makers argued that measures *should* be taken to internalise environmental costs in pursuit of free trade. Sutton argues that unregulated negative spillovers

constitute an *implicit subsidy* to domestic producers in that society allows producers to use the waste assimilation capacity of the environment as a free input to agricultural production. Nitrate pollution, soil erosion or salinity may serve as examples here. The resulting overproduction of agricultural goods calls for government intervention, and adequate measures to redress the problem may thus be classified as 'trade-correcting' - the classic market failure argument from a trade perspective.

Setting the scene for conflict in the WTO

It may be concluded from Sutton's argument that the existence of unregulated positive externalities (such as aesthetic landscapes, wildlife habitats or flood protection) constitutes an *implicit taxation* of domestic producers. They bear the costs of 'producing' these benefits, yet in the absence of markets or policy intervention, they receive no remuneration. Following Sutton's logic, 'trade-correcting' measures would support farmers who produce non-market benefits. This is the point at which the rights of nations to determine their own policies is likely to be challenged in future WTO rounds.

At least two issues set the scene for conflict. First, domestic policy measures designed to generate *domestic* benefits may, by virtue of joint production, harm other countries by diverting trade flows or reducing world prices for export competitors (Freeman and Roberts). Second, and probably more importantly, governments may use the *umbrella of multifunctionality* to support agriculture beyond levels of efficient countryside benefits (Vasavada and Warmerdam). Governments may institutionalise trade-distorting policies if they use 'subjective' non-market benefits to justify Green Box support (see box), misrepresent the size of those benefits, or implement unfocused or untargeted policies. Trade partners



budget, etc) of NGOs may provide evidence of legitimate concern for some issues. For example, the large membership of the Royal Society for the Protection of Birds (RSPB) in the UK may be seen as evidence that conservation of birds and wildlife is a matter of genuine concern to the British. However, we must recognise the public good nature of countryside benefits and the incentives for free-riding. Thus while an indicator of concern, the activities of NGOs likely fall short of those for efficient levels of countryside benefits, and do not replace the need for government involvement. Non-market valuation may also have a role to play in this process, although it cannot be sufficiently reliable and encompassing to offer the sole basis for government decisions.

need a framework for distinguishing 'disguised protectionism' from efficient policy that is compatible with free trade requirements and motivated by genuine concern to improve the overall efficiency of rural resource use.

The Green Box revisited

We propose that domestic policies that meet the criteria set out below be considered for inclusion in the Green Box, even if they have more than minimal impact on production and trade. These criteria widen the Green Box to account for jointness of production

of agricultural goods and multifunctional benefits, but they also ensure that only 'trade-correcting' measures can be approved.

1. Assessing evidence of genuine concern

To distinguish genuine policy from disguised protectionism, countries should provide evidence that measures target problems of genuine concern. This may not be an easy task given that the level of demand for multifunctional benefits is difficult to measure. The level of activity (membership,

2. Assessing the design of policies

Evidence of genuine concern is a necessary but not a sufficient condition for the design of domestic policies consistent with free trade requirements. The sufficient condition requires that proposed policies must maximise environmental or, more generally, 'multifunctionality gain' while avoiding excessive costs to the trading system. In essence, policies must search for 'efficient' solutions, taking account of all costs wherever imposed.

Green Box policies

Under current WTO rules, domestic policy measures may be placed in the Green Box if they have no, or at most minimal, trade-distorting effects or effects on production. They must be provided through a publicly-funded government programme not involving transfers from consumers and must not have the effect of providing price support to producers. The conditions preclude any linkage between the amount of such payments and production, prices or factors of production. In addition, no production shall be required in order to receive such payments. Measures that meet these criteria are exempt from reduction commitments and, indeed, can even be increased without any financial limitation under the WTO. The Green Box provides, among other things, for the use of direct payments to producers which are not linked to production decisions (so-called 'decoupled' payments), including decoupled income support, income insurance and safety-net programmes, natural disaster relief, structural adjustment assistance programmes, and payments under agri-environmental programmes. Many of these are potentially relevant to enhancing agriculture's multifunctionality, but the strict Green Box criteria do not appear to sit very well with the concept of joint production.

“Si la politique agricole restreint l'agriculture aux zones qui sont compétitives sur le plan mondial, la dégradation du paysage rural que cela entraîne peut être considérable et peut l'emporter sur les gains (moins visibles politiquement) tirés d'une libéralisation des échanges”

The Uruguay Round Agreement on Agriculture provisions relating to agri-environmental management contain two such conditions for efficiency:

- Eligibility for agri-environmental payments shall be part of a clearly defined government conservation programme and require fulfilment of specific conditions relating, *inter alia*, to production methods and inputs; and
- The amount of payment shall be limited to the extra costs involved in complying with the government programmes.

The following criteria may be added:

- Domestic policies should have clearly specified objectives, formulated in a way that allows progress to be assessed quantitatively.
- The incentive mechanism used (e.g. charge, payment) should take account of existing property rights and conform to the Polluter Pays Principle (PPP) or the Provider Gets Principle. The latter stipulates that producers be remunerated for the provision of non-market benefits beyond some reference level of environmental quality. Such reference levels are usually defined by basic environmental standards or codes of good practice such as the one shown in Figure 1. Policies to enforce the reference levels should conform to the PPP, while payments are appropriate for environmental enhancements clearly beyond those reference levels. Policies that do little more than subsidise existing good agricultural practice

would not be approved under this rule. In this context, states may be required to draw up their own codes of good agricultural practice as a means of defining reference levels explicitly and payments made to farmers may then be assessed against them.

- Environmental policies and programmes should be spatially targeted. Some problems are small scale or local, while others may be of regional, national or even global importance. The geographical delimitation of an agri-environmental programme should fit the spatial dimension of the problem in question and might be tied in with the available evidence on the patterns of environmental concerns.
- Contracts for the provision of environmental benefits should be offered on a competitive basis. This could be done by inviting farmers to tender bids, allowing the programme administrator to target the most cost-effective producers, thus reducing the degree of overcompensation (Latacz-Lohmann and Van der Hamsvoort).
- Countries submitting domestic policies to the WTO should demonstrate an appropriate administrative framework for implementing the proposed policies, monitoring compliance and evaluating progress at pre determined time intervals. Proper programme administration can present a heavy drain on the agency's resources and may require significant amounts of public money (Falconer and Whitby). Evidence that the

programme is achieving its objectives is not only important for programme management, but essential to satisfy WTO partners that the programme is a legitimate exercise (Ervin).

- Transparency of designing and implementing domestic policy programmes should be an imperative principle for the validation process. Transparency is necessary to bridge the cultures of environmental and trade interests, to build trust, and to facilitate open trade-environmental panel discussions and decisions (Ervin).

3. Probing for less trade- 'impacting' alternatives

Satisfaction of all the above conditions will reduce the likelihood of dispute in the WTO, but will not guarantee that domestic policies are immune from challenge. Even an optimally designed and targeted policy may, by virtue of joint production, have 'adverse' trade impacts. Trade negotiators will, therefore, want assurance that policy makers do not have equally effective, yet less trade-impacting alternatives (Ervin). The search for cost-effectiveness should take account of costs imposed on third party trades as well as costs imposed within the domestic economy.

The trade impact of any particular policy, even if well-designed and targeted, depends largely upon the extent to which agricultural output and multifunctional benefit are joint products. This link is relatively weak for policies which, for example, encourage the planting and maintenance of hedgerows or the rebuilding of stonewalls as means of enhancing landscape value. In contrast, measures like support to maintain mountain pastures, payments for organic conversion, or environmental set-aside of productive farmland involve a more direct link between environmental objectives and agricultural output. Alternative, more 'de-linked' measures should be

“Wenn der Abbau von Agrarsubventionen dazu führt, dass Landwirtschaft auf Standorte zurückgedrängt wird, die zu Weltmarktpreisen wettbewerbsfähig sind, könnte der damit verbundene Verlust an Umweltgütern schwerer wiegen als der (politisch weniger sichtbare) Wohlfahrtsgewinn durch Freihandel”

Conclusions

We do not argue that current mechanisms or patterns of support for agriculture are ideal or that they would necessarily meet our criteria for efficient trade and countryside benefits. Far from it. Many observers have documented agriculture's damage to the environment. Policies need to be better targeted on specific outputs to more effectively reach trade and environmental goals. However, progress towards effective policies will not be possible if arbitrary WTO rules prevent *any* actions that significantly affect production levels of traded products. Green Box boundaries must allow some policies - those meeting fairly rigid criteria, we emphasise - that enhance countryside benefits, even if they appear to subsidise trade.

Finally, we would like to emphasise that many of the suggestions and conclusions in this paper, especially those on policy design, are appropriate for positive environmental externalities, but would not necessarily fit food security or rural viability concerns. Writing trade rules to cover the latter is set to be even more complex - and controversial.



preferred, although it must be accepted that the intangible and interrelated nature of countryside benefits mean that progress towards partitioning, measurement and targeting will always be limited.

4. Assessing the distribution of benefits and costs

It is obviously difficult to assess the distribution of benefits and costs of domestic policies in a quantitative manner. Yet, a more qualitative assessment may help reduce conflict. For example, if one measure imposes a greater burden on foreign competitors than domestic producers, an alternative that allows the burden to be more equally shared may be favoured.

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Further reading

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Figure 1: Combinations of agricultural output and countryside benefits

'Multifunctionality' ' and 'free trade' - conflict or harmony?



Joint production of agricultural and environmental 'outputs' means that domestic policies aimed at enhancing the multifunctional character of agriculture may affect trade flows and world prices and may impose burdens on a country's trading partners, setting the scene for conflict in the WTO. The paper argues that appropriately designed domestic policies to encourage the provision of environmental benefits do not necessarily contradict free-trade requirements even though they may have more than minimal impacts on production and trade. Agricultural policy reform is needed to enhance the provision of multifunctional benefits, but policy options should not be constrained by arbitrary rules preventing any actions that have any significant effects on production and trade. The authors call for a widening of the Green Box to accommodate jointness of production and propose an extended set of Green Box criteria to ensure that only 'trade-correcting' measures can pass.

Multifonctionnalité et libre-échange : conflit ou accord ?



Du fait de la production jointe de "biens" agricoles et environnementaux par l'agriculture, les politiques agricoles nationales visant à favoriser la multifonctionnalité de ce secteur peuvent affecter les échanges commerciaux et les prix mondiaux et imposer des contraintes aux partenaires commerciaux, ouvrant ainsi la porte à des conflits dans le cadre de l'OMC. Cet article montre qu'il n'y a pas nécessairement contradiction entre les exigences du libre-échange et la mise en oeuvre de politiques destinées spécifiquement à encourager la fourniture d'aménités environnementales, même si ces dernières peuvent avoir un certain impact sur la production et les échanges. Pour favoriser la fourniture des biens produits par une agriculture multifonctions, une réforme de la politique agricole est nécessaire, mais les options possibles ne doivent pas être encadrées par des règlements arbitraires qui empêcheraient toute action ayant un effet sur la production et les échanges. Les auteurs préconisent d'élargir le champ couvert par la Boîte verte, ce qui permettrait de tenir compte du caractère joint de la production agricole. Ils proposent à cet effet un ensemble de critères plus étendu n'autorisant l'admission dans la Boîte verte que des mesures "correctrices des échanges".

Multifunktionalität und Freihandel - Konflikt oder Harmonie?



Die Koppelproduktion von Agrarprodukten und Umweltgütern hat zur Folge, dass nationale Politiken zur Förderung einer multifunktionalen Landwirtschaft Handelsströme und Weltmarktpreise beeinflussen können und somit die Handelspartner eines Landes belasten können. Dies kann Anlass für Konflikte innerhalb der WTO bieten. In diesem Artikel wird argumentiert, dass sachgerecht zugeschnittene, zielgerichtete nationale Politiken zur Förderung einer multifunktionalen Landwirtschaft nicht unbedingt im Widerspruch mit Freihandelszielen stehen, selbst wenn sie mehr als minimale Auswirkungen auf Produktionsmengen und Handelsströme haben. Zur Förderung einer multifunktionalen Landwirtschaft sind weitere Reformen der gemeinsamen Agrarpolitik notwendig. Politikoptionen sollten jedoch nicht durch willkürliche Regeln eingeschränkt werden, die jegliche Maßnahmen verbieten, welche spürbare Auswirkungen auf Produktions- und Handelsmengen haben. Die Autoren halten eine Erweiterung der Green Box für erforderlich, um der Koppelproduktion von Agrar- und Umweltgütern Rechnung zu tragen. Sie schlagen eine erweiterte Kriterienliste für die Green Box vor, die sicherstellen soll dass nur 'handelskorrigierende' Massnahmen genehmigt werden können.