Magellan Project

THE POLITICAL ECONOMY OF BEEF LIBERALISATION

A collection of international papers

A study prepared for the
Five Nations Beef Group

2003

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PREFACE

The five nations of Australia, Canada, Mexico, New Zealand and the United States ('Five Nations') are major players in world beef trade. They, and others, have a large stake in efforts to reduce support and trade barriers affecting the international beef market. Representatives from these nations initiated the Magellan Project at a conference in Australia in 2001. The aims of the project are to quantify the benefits of liberalizing world beef trade, to better understand the political forces needed to bring about reductions in support, and to devise appropriate strategies for reform.

This book is an international collection of papers by experts on the political economy of beef liberalisation in the five main potential markets for beef — Japan, Korea, France, Germany and the United Kingdom. Local authors from each of these five countries have analysed the political forces affecting beef policies, how they have changed and the new avenues these changes have opened up for liberalizing world beef trade.

This study is a component in the Magellan Project. Previous studies — described in full on the inside cover of this book — dealt with the economic impact of tariffs, quotas and domestic and export subsidies. Overall coordination of the study was by the Centre for International Economics (CIE), Canberra, with financial support from the Five Nations.

ACKNOWLEDGEMENTS

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OVERVIEW

Andrew Stoeckel,
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Australia

Beef production is one of the most protected activities in some key parts of the world. For the Doha Round of trade talks to deliver on its mandate[1] to significantly reduce agricultural protection, there will have to be substantial reform of the beef industries in the European Union (EU), Japan and Korea. In the EU, the main players are France, Germany and the United Kingdom (UK). These are the countries that could import significantly greater quantities of beef if protection levels for domestic beef producers were lowered.

Why is beef production so highly protected in these key markets? What are the pressures and prospects for change? How can the prospects for policy reform be improved? These are the questions addressed in this study of the political economy of protection for beef. The beef industries in the above countries, the various pressures for and against reform and the possibility of change are analysed by local

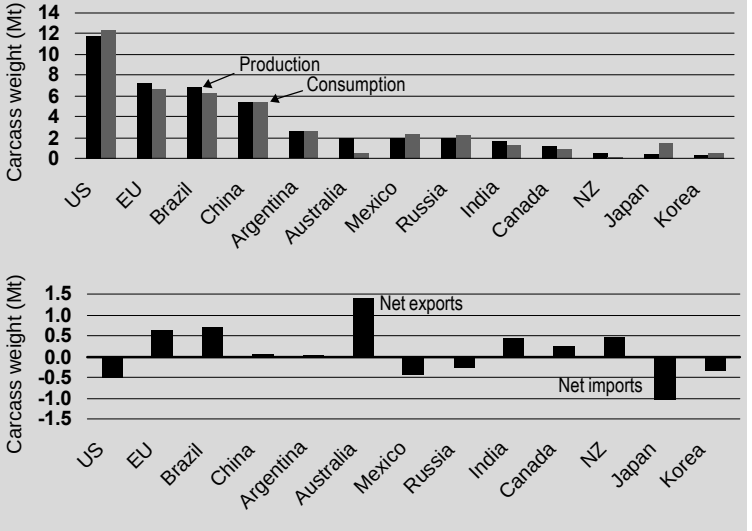
[1] The declaration to launch the Doha Round of trade talks called for agricultural negotiations to achieve 'substantial improvements in market access; reduction of, with a view to phasing out, all forms of export subsidies; and substantial reductions in trade-distorting domestic support'. WTO (World Trade Organization) 2001, *Doha Ministerial Declaration*, WTO Secretariat WT/MIN(01)/DEC/W/1, Geneva.

authors (listed in the contents) from each of the five main protected markets. This overview summarises the main issues raised in these papers. It examines the pattern of change in beef industry protection, the likelihood of reform and how the prospects for liberalisation might be enhanced. It turns out that there has been significant change in the political economy of beef protection. New 'pressure points' have opened up avenues to enhance reform. New dangers to liberalisation have also appeared that need to be countered.

The main protected markets

By far the largest beef consumer and producer in the world is the United States (US), followed by the EU (chart 1). These economies account for one-third of total beef production.

1 Largest beef producing and consuming countries and trade, 2001



Source: GMI database.

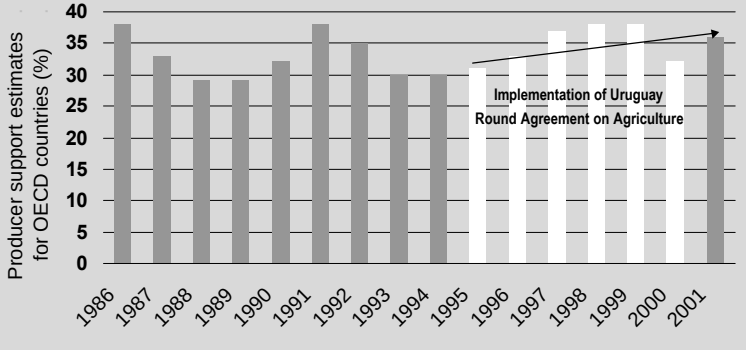
Australia is the world's largest net exporter of beef. The United States, although a large exporter of beef, imports even more and is the world's second-largest net importer of beef, behind Japan.

The total support for beef producers amongst OECD members has trended up over the last decade (chart 2). More significantly, the total producer support for beef farmers has *risen* since the start of the implementation of the Uruguay Round Agreement on Agriculture in 1995 — from 31 per cent to 36 per cent in 2001. Most of this increase in average assistance can be explained by the increased support for beef producers in Europe (chart 3).

Although in this period protection for beef has remained steady in Japan and has fallen slightly in Korea, protection remains very high in these two countries (chart 4).

In the European Union in 2001, 91 per cent of beef farmers' receipts were derived from government programs and transfers from consumers through border restrictions on imports. Some of this extra support for beef farmers is the result of additional payments to beef farmers following

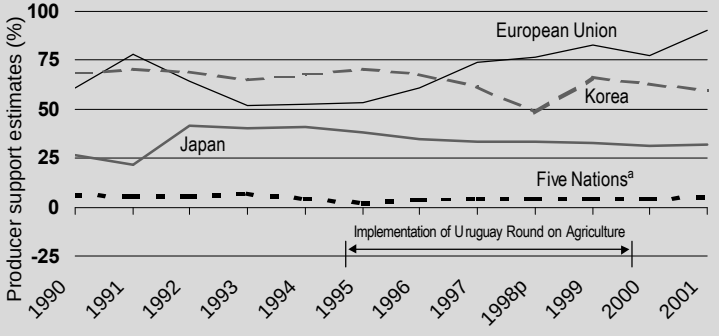
2 Support to beef producers has trended upwards



Source: OECD database.

the two crises in the beef industry in Europe — the outbreaks of bovine spongiform encephalopathy (BSE, or 'mad-cow disease') and foot-and-mouth disease (FMD). But changes in the policies for beef also explain the high support for beef. As a study undertaken for the Five Nations Group shows, even after allowing for the special

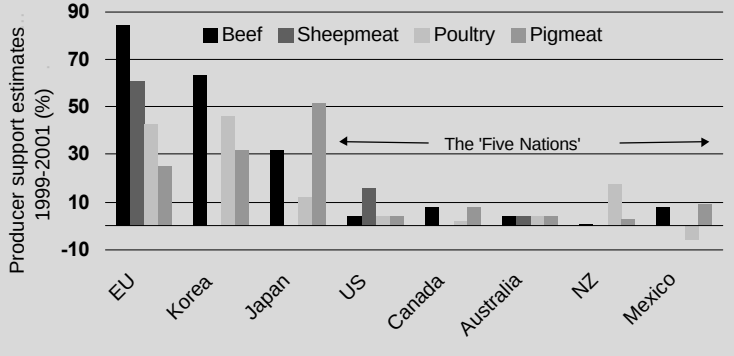
3 The European Union gives the highest level of support to beef producers



a United States, Canada, Australia, Mexico and New Zealand.

Source: OECD.

4 Beef is generally the most protected meat



Source: OECD.

BSE and FMD payments, support for beef farmers in the EU has risen over the last decade.[2] It is interesting to note that, among the protected markets, beef is highly supported compared to other meats, except in Japan, which heavily supports its pig producers (chart 4).

In the major beef markets, the most significant protection is in the EU, Japan and Korea. Within Europe, France, the UK and Germany are the largest producers and consumers of beef. In these markets, beef is more protected than any other meat.

For the Doha Round of trade talks to be successful in reducing global beef protection, there will have to be significant liberalisation in Europe, Japan and Korea.

Forms of beef protection

Europe

Beef farmers in Europe are supported by several mechanisms:

- tariff quotas, which severely restrict market access;
- internal support in the form of intervention buying and private storage aids to maintain domestic prices;

[2] The Five Nations Group comprises Australia, Canada, Mexico, New Zealand and the United States. Two previous studies have been undertaken for the Five Nations Group as part of the Magellan project. The studies can be accessed on www.thecie.com.au. The reference to the first study is Meat and Livestock Australia, 2001, *Global Beef Liberalisation, Magellan Phase 1: State of play and who wins*, prepared by the Centre for International Economics, Canberra. The reference for the second study is Meat and Livestock Australia, 2002, *Global Beef Liberalisation, Magellan Phase 2: Gains from reducing production and export subsidies*, Five Nations Beef Group study prepared for the Cairns Group Farm Leaders Meeting Santa Cruz, Bolivia, October 2002, prepared by the Centre for International Economics, Canberra.

- direct payments to producers; and
- export refunds (subsidies) paid to beef exporters.

As the paper by Hubbard on the UK (pages 1–32) makes clear, embodied in these mechanisms is a complicated array of domestic measures used to support beef farmers in the EU. There are premiums to fatten male animals, a suckler cow premium and a slaughter premium for adults and calves. On top of that there are 'disadvantage' subsidies for what are called 'less favoured areas'. Beef farms in these areas tend to be smaller and farmers can qualify for social and environmental special payments. Other so-called non-trade distorting or 'green box' measures are also made.

Producer support for beef in the EU is about €13 500 (US$12 000) per farm. Even without expenditures for BSE control of €1.3 billion in 2001, support would still have been €12 800 (US$11 400) per farm. This total level of support amounts to around €970 (US$840) per animal slaughtered in 2001.[3]

Schrader's paper (pages 62–92) emphasises how the type of support offered to German farmers has changed over time. Following the MacSharry Reform of 1992, there was a switch in policy emphasis from pure price support to direct payments and environment programs. But payments were not decoupled[4] from production; therefore, the whole reform could be judged to be inefficient because the objectives could have been achieved at a much lower cost.

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[3] Meat and Livestock Australia 2002, *Global Beef Liberalisation, Magellan Phase 2: Gains from reducing production and export subsidies*, Five Nations Beef Group study prepared for Cairns Group Farm Leaders Meeting, Santa Cruz, Bolivia, October 2002, prepared by the Centre for International Economics, Canberra, p. 20.

[4] Decoupled policies do not distort the pattern of production, consumption and trade. (However, it can be argued that all support to farmers eventually changes incentives to produce, albeit some to a greater extent than others.)

An important aspect of the MacSharry Reform, discussed in the Glaz and Messerlin's paper (pages 33–61), was the intention to improve the competitiveness of red meat compared to white meats. The concern, seen clearly in France — the EU's largest consumer of red meat — was the decline in per capita consumption of red meat, partly due to relatively higher prices compared to pork and chicken. The 'guaranteed' price for beef was lowered in the 1992 Reform — but so was the price of cereals, which had a bigger effect on reducing costs for pork and chicken production. The price of beef relative to pork and chicken did not improve; neither did consumption.

The most recent switch in emphasis in beef policy in the EU has been the attention now given to food safety and quality assurance following the outbreak of BSE. The BSE outbreak, together with the outbreak of FMD, caused consumers to question the validity of livestock support policies. Although market price support is still the dominant form of protection, the policy emphasis — at least in rhetoric — is now on decoupled support, environmentally friendly policies and organic farming. This is especially the case in Germany. Animal welfare issues, which mainly affect the more intensive pork and poultry production, are also hotly debated.

Japan and Korea

The mix of support for Japanese and Korean beef producers is different from that offered in Europe. Virtually all of the protective effect for the industry is by way of tariffs. Applied tariff rates are 38.5 per cent in Japan and 40 per cent in Korea. Japan and Korea do not use export subsidies. The days of quotas — and in the case of Korea, special outlets to sell imported beef — are gone. Japan also offers farmers a guaranteed price and a

deficiency payment for calf breeders.[5] Also, following the outbreak of BSE, a subsidy program was introduced and some existing programs were expanded. But border protection remains the main form of assistance in Japan. In both Japan and Korea, beef is one of the few rural industries for which governments have reduced protection since the early 1990s — even though tariff levels remain high by global comparison.

The end result has been a switch to a more market-oriented albeit still highly protected industry in each country. With tariffs as the main means of support, as the world price for beef changes, there is greater or less competition from imports. The important response, emphasised by both Honma and Song, is that the domestic industry has moved to differentiate its product and maintain or even increase its price premium over imported products.

The political importance of beef

Beef varies in political importance in the countries studied. In Korea, for example, historically not only were farmers ranked second in the social hierarchy after aristocrats, but Hanwoo beef signifies something special to Koreans — linking people back to their hometowns. Consumers also believe the local product is more healthy and contains the 'power of the land'. Beef in Korea is what economists call 'a superior good': highly responsive to income growth. Beef commands a much higher price than pork or poultry, and domestic beef is far more expensive than imported beef. In Korea, beef is also important politically because it is a major source of income for farmers.

[5] Korea also has a Calf Breeding Stabilisation Scheme, along with other measures described in Song's paper, but border protection is most important.

In Europe, beef is produced from two sectors: dairy beef, produced as a 'sideline' from dairying operations, and specialist beef producers. Beef farms are typically small and specialist beef producers are at the lower end of the income scale of farmers. In France, it is interesting to note that the specialist beef producers (accounting for 37 per cent of French beef) are mostly located in the hilly areas of Central France and all French presidents over the last 30 years have originated from this area. The political links with the Fédération Nationale Bovine — the independent trade union representing beef producers — have been close.

As in France, UK specialist beef farms tend to be of a small size in hilly areas with few alternative enterprises, often in disadvantaged regions. In Germany, while small farms still dominate, the trend is for the family farm to give way to larger, corporate forms of farming.

Beef production in Europe has also been influenced by protection to other industries. Supply controls on milk production only saw beef production expand — for example, in Germany, specialist beef breeds and suckler cows were negligible in the 1970s but following controls on milk production, numbers rose to over 200 000 head by 2001.

In common in the protected markets, beef farmers are well organised to maintain their protection. Although farmers' unions are present in each country, there are differences in the stances taken. Song's paper (pages 120–142) highlights how Korean beef farmers feel they were 'sacrificed' in the last Uruguay Round negotiation to prevent rice from having to be liberalised. They feel that the industrial groups have won out of trade negotiations at their expense and therefore they deserve compensation. In France, the dominant theme justifying protection in the important Central France producing region is the 'maintenance, space occupation and management of the territory (*aménagement du territoire*)'. The beef farmers' trade union draws on this

political ideal to 'occupy' the space and argues that lowering tariffs will threaten the survival of regions.

Not only farmers' unions wield power in beef policy. Honma's paper (pages 93–119) describes how other administering agencies of government policies in Japan — although not lobby groups — have an important influence on policy. Also, in Japan political interests are concentrated in some beef-cattle raising regions where effective political representation is high.

Of the three main European beef-consuming countries, evidence of a split in the position farmers have adopted to protection seems most obvious in Germany. There, the large, highly efficient corporate farms tend to support the Free Democratic Party and may accept less support for less environmental regulation. Small family farms, however, align with the Christian Democratic Union of Germany and argue for more support. A third group of farmers supports the Green Party and is engaged in 'green' or ecological farming. Their proposals imply a redistribution of resources from larger conventional farming.

Another split in the position of farmers' unions has opened in France. Up until 1997, the powerful farm trade-union shaping agricultural policy has been the FNSEA[6]. This organisation's monopoly over advice to government has since been weakened by the ascent of another trade union, the Confédération Paysanne (representing 25 per cent of French farmers). The latter defends small farmers and argues, for example, against export subsidies that hurt the interests of farmers in developing countries.

[6] Fédération Nationale de Syndicats Exploitants Agricoles — a syndicate of unions.

Forces for change and ways to enhance liberalisation

While farmers' unions are politically strong, there are social and political changes in each of the protected markets that affect the prospects for liberalisation as part of the Doha Round of trade negotiations. These changes have opened up avenues through which to enhance liberalisation. Some of these changes potentially present new dangers to freer beef trade and need to be countered. Significant differences in the political economy of beef protection among the main players imply different approaches to enhancing prospects for liberalisation. Several avenues for action are suggested.

Building on heightened consumer awareness

The BSE crisis in Europe, followed by the FMD outbreak, has been the cause of a major shift in awareness by consumers of what agricultural policy is doing. As expressed in the mid-term review of the Common Agricultural Policy (CAP), 'there are growing public concerns about both the way in which food is produced and the way in which agriculture is supported'.[7] This shift highlights a major difference between the main European beef-producing countries and Japan and Korea. Across Europe, voters have expressed a desire for more environmentally friendly, higher quality and safer food production. Animal welfare is a big issue — more so perhaps in the UK and Germany than in France. In short, European consumers (voters) have become more aware of agricultural policy and its adverse effects, not for the reasons economists would have hoped for a decade ago — namely, the high cost to consumers and taxpayers — but because of food safety.

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[7] Commission of the European Communities, 2002, *Communication from the Commission to the Council and the European Parliament, Mid-Term Review of the Common Agricultural Policy*, Brussels, 10 July 2002, COM(2002)394.

The awareness of food safety is reflected in different ways across Europe. But the policy emphasis is now on the consumer. In the UK, for example, the restructured ministry responsible for agriculture created in the aftermath of the BSE crisis does not contain the word 'agriculture' in its name. In Germany, for the first time the government appointed a farm minister who was from the Green Party and had no farming background. The re-labelled Ministry for Consumer Protection, Nutrition and Agriculture reflects this changed emphasis on the consumer. Research institutions have to redirect their focus to organic farming. Glaz and Messerlin's paper describes how in France the BSE crisis delivered a fatal blow to the longstanding 'love story' between French consumers and farmers. They describe how farmers were accused on French radio of being 'poisoners' in what the authors label 'an accusation reminiscent of the pre-revolutionary 1780s'.

Historically, it has been too difficult for consumers to organise and mount an effective challenge to protection for producers. But consumers have become aware that they are not getting a good deal out of the CAP. The challenge now is to translate that new awareness into a new formal recognition of consumers' status through institutional change, and transform consumers' new concern for food safety into a force for liberalisation.

Japan also had an outbreak of BSE in 2001 (and subsequently) and Korea an outbreak of FMD in 2000. Although consumers in both countries are sensitive to the safety of imported foods (even though imports may have a better safety record), questioning of policies and concern for the environment by consumers has not emerged to the same extent as in Europe. In Korea, consumers have traditionally sided with farmers in arguing for protection. The belief that the local product is better for their health is fuelled by the media, which emphasises food safety violations by

importers. Although attitudes are changing with the demographic mix and urbanisation of the economy, local product is likely to continue to command a higher price. This fact opens up the possibility of more product differentiation as a means of allaying fears of potential adverse effects from further liberalisation.

Product differentiation

Another avenue for change, identified clearly by Honma, is that of product differentiation. Beef is highly differentiated in Japan and Korea. Local product commands a price premium of three times (or more) that of imported beef. The only way protection for local beef producers can be removed and the domestic industry survive is if consumers are willing to pay a higher price for local than imported product. Productivity gains to close the gap between the efficiency of local production versus imports are limited in protected markets. Also, the nature of beef farming in Europe and the shift in consumer preferences to 'natural' product (organic beef being one expression of this) means imported product from extensive grazing systems will have a comparative advantage and so productivity gains from restructuring in Europe will be small.

Since liberalisation of the Japanese beef market in 1991, domestic production of wagyu beef has barely changed and even increased up to 1994. This experience shows that domestic beef can compete with imported beef by product differentiation.

Product differentiation is potentially a way forward for France to satisfy domestic producers and also liberalise its market. France has a more extensive cattle production system based on the Central France region and may have an advantage within Europe in beef production and export. Given the progressive isolation of France over its stance

towards agricultural protection within the EU over such matters as the budget, a strategy of product differentiation could break the impasse.

Liberalisation and product differentiation go hand in hand. Removal of border restrictions increases competition in local markets for beef. Competition is the proven stimulus for producers to innovate, brand and differentiate their product. In short, the time is now ripe in the aftermath of the BSE crisis to allow reform to proceed. The alternative is that in France, farmers decide that they can make a living from just exporting to other protected European markets. The problem of such a strategy, besides the efficiency loss and consumer cost, is that the industry will always be vulnerable to removal of protection sometime in the future. Consumers will not have the greatest choice. The incentive system to deliver the safest, best value-for-money product to consumers will not exist if protection persists.

Convincing local farmers of the benefits of a liberalisation and product differentiation strategy will be more difficult in Europe than Japan, but, despite all the protection, the industry has moved to a more commercial footing in these protected markets. Part of this trend to commercialisation has been in response to the BSE crisis and the need for better commercial linkages throughout the supply chain for purely self-interest reasons. Some of the market orientation, especially in Japan and Korea, has been policy induced as policy makers seek to deliver the multi-functional aspects of agriculture through decoupled policies rather than distorting price support. Tariffication has been an important step forward in Japan and Korea. Not only is liberalisation important, but a tariff-only policy elsewhere is important.

Consumers need to see that more choice among branded product will create the best system of incentives to ensure they receive the safest, best quality product they are willing to pay for. The danger is that the argument about food

safety could easily be distorted by protectionists who will appeal to the prejudice in consumers and argue that protection from imports is necessary to ensure safe product. These arguments can easily, and need to, be refuted.

Working with retailers and importers

Related to the issue of product differentiation is another force for policy change: commercial pressure throughout the supply chain by supermarkets and processors. The partial shift to market orientation principles in Japan and Korea has led to some restructuring of the domestic industries. In Korea, the number of small beef farmers (less than 40 head of cattle per farm) fell by 45 per cent between 1996 and 2001 while the number of large farms (more than 40 head) increased by 13 per cent.

Although still highly protected, there has also been some commercialisation of the European beef industry, which offers important prospects for trade reform. The BSE crises in Europe have naturally caused supermarkets and other retailers to pay far more attention to the sourcing of product. The supply chain has had to become more integrated from a food safety perspective. This alone has led to some restructuring. Far greater attention is now given to traceability of product and branding.

In the UK, an independent organisation certifies 'farm assured' product that can carry the Little Red Tractor logo. In France, three nationwide labels have been developed and monitored by a third party. But while these labels may have limitations (for example, it is unclear what the labels mean and who 'owns' them), these attempts at labelling and the introduction of traceability have established powerful precursors for European suppliers to develop their own brands and to differentiate their product among themselves and from imports.

Retailers in Europe are potentially an important force for liberalisation. Many European retailers are large multinationals. They can see what works in other parts of the world and have sophisticated marketers who understand the importance of open markets and consumer choice. Indeed, for France, Glaz and Messerlin describe the restructuring of the beef supply chain as a *de facto* preparation for opening of the market. The problem is that the beef processing and retail sectors, at least in France, do not openly support liberalisation for fear of reprisals. Nevertheless, they are a force for change and could be helpful in securing more open markets.

Applying more outside pressure

Outside pressure as an additional significant force for liberalisation of the beef markets is probably most important in Korea and Japan. Beef markets were successfully partially liberalised in those two countries in the Uruguay Round. The EU is also going to have to recognise its obligation (and self-interest) in promoting an open rules-based international trading system, so essential for economic development and the alleviation of poverty. The agenda is different in the current Doha Round of trade talks. Although Europeans, Japanese and Koreans would be better off if beef was liberalised, the context of trade talks is to treat any liberalisation as a 'concession' to be exchanged for something else. In the past, that 'something else' has been reductions in tariffs on industrial goods for Japan and Korea, and removal of barriers to services trade, among other things, for the EU. Industrial tariffs are now low and there is a question of what is on offer for Japan and Korea this time besides their interest in ensuring an open well-functioning international trading system. Developing-country interests, competition policy and 'market access' issues in services are some of the items of concern in the

Doha Round of negotiations besides agriculture. Identifying what Japan's and Korea's interests are would be helpful in pushing the cause of beef liberalisation.

In the EU, there is concern for the plight of developing countries. Of interest here is previous work for the Magellan project.[8] Liberalisation by the EU mainly benefits developing-country beef exporters in South America.

Encouraging leadership by governments and use of decoupling

Governments can be a force for change if they proactively reflect changing voter sentiment in their policies and push the results from analysis indicating the new directions needed. Governments are now making many of the 'right noises' about the need for competitive industries to meet consumers' wants. The best way to do this is by introducing market-oriented policies — and removing market-distorting support. As Schrader's paper shows, there have been many attempts to move policy in the right direction. However, the outcome has been different: beef protection has worsened in Europe.

Honma describes how, up until 1999, the fundamental philosophy underpinning Japanese agricultural policy was income parity between farmers and non-farmers as expressed in the Agricultural Basic Law of 1961. The idea was to increase farm income by shifting agricultural production to industries where demand was highly responsive to income growth and to expand the scale of production. This policy proved impossible: the income gap widened too quickly and the opportunities for restructuring

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[8] Meat and Livestock Australia, 2002, *Global Beef Liberalisation, Magellan Phase 2: Gains from reducing production and export subsidies*, Five Nations Beef Group study prepared for the Cairns Group Farm Leaders Meeting Santa Cruz, Bolivia, October 2002, prepared by the Centre for International Economics, Canberra.

proved too limited. The government had to resort to protection — mostly price support — to try to deliver income parity. Reflecting the rising awareness that policies were not delivering promised outcomes, in 1999 a new Basic Law was enacted. It reflected a shift to 'fundamental principles of agricultural policy reform', whereby domestic agricultural products were to be valued at market prices. Although Japan has a long way to go in many areas of agricultural policy, the main characteristic of the new policy to be encouraged is the attempt to restore the price mechanism in agricultural markets and support farmers through decoupled policies.

Governments in Europe have also changed their thinking on agricultural policy, with more emphasis on decoupled programs. The mandate from the 1999 Berlin Summit expressed in the mid-term review calls for 'a competitive agricultural sector' and 'production methods that support environmentally friendly, quality products that the public wants'.[9] European governments have signalled the 'simplification of the system of direct payments (to beef producers) in order to better link producers to consumers' demand for better quality and safety'.[10]

The Commission also acknowledges that current direct payments based on per head payments provide incentives towards intensification of the industry. Intensive production and 'unnatural' feeding practices were, of course, part of the BSE crises. The Commission has therefore proposed to decouple per head payments and to replace them with a single income payment per farm based on historical entitlements. Their belief is that this change, together with cross-compliance conditions such as land management

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[9] Commission of the European Communities, 2002, *Communication from the Commission to the Council and the European Parliament, Mid-Term Review of the Common Agricultural Policy*, Brussels, 10 July 2002, COM(2002)394.

[10] Commission of the European Communities, 2002.

obligations, should reduce pressure towards intensive production. But, for all the rhetoric, the facts remain: official figures show beef is the most protected agricultural industry in Europe; protection has risen; 91 per cent of beef farmers' receipts were derived from government programs in 2001; and most of the support is of a market-distorting type.

Governments have to be encouraged to show even more leadership and articulate more forcefully the benefits of market-orientated policy to their citizens. They can do this by improving the quality of the studies they undertake on the issue of beef protection and increasing the transparency of the findings.

More transparency on the cost to taxpayers and consequences of enlargement

The pressure on the budget in Europe and the enlargement of the EU15 to include central and eastern European countries has been a significant discipline on the CAP, including beef protection policies. Decisions taken at the Berlin Summit and the agreed Agenda 2000 reform of the CAP were partly driven by budget considerations. Germany and France clashed for the first time over basic agricultural policy decisions at the Berlin Summit. One outcome was the introduction of the 'modulation' rule that allows national governments to cut direct payments and allocate the funds elsewhere. The basic financial framework for the CAP budget to 2013 was set at the EU Heads of Government meeting in October 2002.[11] Although one implication is that spending in existing member countries must fall, the budget is not presently restrictive because spending for 2003 is below the limit set. Even so, many national budgets are under pressure, especially Germany's,

[11] See Schrader's paper (page 77) for details.

so EU enlargement and taxpayer pressure will always be a significant — if not a major force — for change.

Taxpayers are an important voice for reform in the UK and Germany. Although budget parameters for enlargement of the EU15 have been settled, the German national budget will remain under a lot of pressure until economic growth picks up. Germany, as the biggest contributor to the CAP and with budget pressures of its own, has the potential to split with France and side with other reform-minded EU members over agricultural support. Greater domestic transparency of the high costs of agricultural support is seen by Schrader as a major plank in enhancing the prospects for liberalisation of European beef markets. Taxpayers, however, are not identified as as strong a voice for reform in France, Japan or Korea.

Highlighting the differences in stances of farmers' unions

Exploiting the differences that have opened up between unions that represent farmers in Germany and France is another way to break down the resistance to change. For example, the fact that one French farmers' union opposes export subsidies on the correct grounds that they hurt developing countries — of which beef exporting nations in South America would be the most important — can be potentially used to weaken the traditional defence of export subsidies.

Summary

Liberalisation of global beef markets means, in effect, reform in Japan, Korea and Europe, of which France, the UK and Germany are the most important players.

The most important group resisting liberalisation is — understandably — the beef farmers in these countries. These farmers are well organised and well represented politically. But their political power and influence is waning. There are many reasons for this. One is that some splits in the unions representing farmers' views have appeared in some countries such as France and Germany. Another is the declining farmer numbers and the ageing of those remaining. Beef farms are getting bigger and more commercially focused. While fewer farmers means it is easier for them to organise politically, demographics and urbanisation have weakened the political power that beef farm groups can mobilise.

Another reason for the waning power base has been the BSE crises in Europe and Japan, which alerted consumers to the fact that ministries of agriculture were looking after producers, not consumers. That has now changed.

One risk from this new consumer awareness of agricultural policies and their effects is that it has come from the perspective of food safety and not from the unnecessary, high cost of the policies. This risk means the domestic industry could take one of two approaches — one negative, one positive. The negative way is to use the fear of food safety and suspicion of imports to continue to justify import protection on 'multi-functional' grounds.

The positive route is for domestic producers to market a product that is 'superior' in the eyes of the consumer — that is, to commercially differentiate the local product and command a domestic price premium. Note the word 'commercially' here. Any attempt by government to differentiate product will fail because it necessarily must be done generically. Only through commercially oriented firms competing to promote their local brand in competition with other local brands and imports will the necessary conditions be met for a successful branding and marketing strategy.

That would not only allow domestic production to survive, but would give consumers more choice and adopt the responsible international position of trade liberalisation. The paradox is that to make this positive route possible also *requires* liberalisation of the beef market, in order to instill more competition in the market and spur innovation and product differentiation. While it might prove difficult to 'sell', the elements of this approach are in place.

The political realities of beef liberalisation differ across the five countries. In the UK, farmers seem to have come to the realisation that the high cost of support through the existing plethora of programs cannot go on forever. France still clings to its beef protection to 'occupy the territory', but even in this, consumers are turning against farmers. In Germany, there is a noticeable push towards 'natural' and 'organic' foods, which makes protected beef farming hard to justify in the face of imported product, much of which is based on extensive grazing systems. Beef production is still highly political and has deep social roots in Korea, but even there, the social gap between the rural and urban population widens with each generation. In Japan, self-sufficiency is still a concern, but the realisation that the only way the industry can survive in an open trading system is through product differentiation is starting to percolate through society. Hopefully, that idea takes root before the more negative and inward looking strategy of wrongly justifying price support on multi-functional goals takes hold.

The key elements to enable greater product differentiation of local beef are in place in the protected markets — albeit for different reasons, including crisis. Commercialisation and orientation to the market, traceability and labelling are all precursors for the emergence of branded product and trade based on reputation, reliability for safety and value for money for consumers. Building on those elements could

lead to an international trade in beef that is differentiated, open, safe, environmentally sound, gives consumers more choice for less cost, costs taxpayers less, and satisfies local producers and exporters alike.

Liberalisation of world beef trade will require a judicious mix of:

- promoting more transparency of the high cost to taxpayers of protection — likely to be more effective in Germany and the UK;
- building on the heightened awareness by consumers that they are not getting a good deal out of the CAP (of which beef is a major part) and that their wants are best met by market-oriented policies;
- working 'behind the scenes' with importers and retailers, especially in France;
- exploiting the differences between farmers' unions in Germany and France, such as the opposition by some to the use of export subsidies;
- applying more outside pressure — especially from the US and the Cairns Group — on Korea, Japan and the EU in the context of the Doha Round of trade talks;
- encouraging governments to continue to switch policy emphasis to genuinely decoupled payments in addition to reducing overall payments to producers; and
- selling the idea that if the local product has 'special' characteristics, it is far better for consumers to transfer money to local producers through the marketplace rather than through a plethora of costly, inefficient programs.

1 UNITED KINGDOM: LESS RESISTANCE TO CHANGE

Lionel Hubbard, University of Newcastle upon Tyne

Beef is currently the most highly protected of the United Kingdom's (UK's) main agricultural commodities. Assistance to beef farmers across the European Union (EU) from various government programs and border measures amounted to 91 per cent of total farm support in 2001 — up from 59 per cent in 1986–88. There were two crises in the UK beef industry in the mid-1990s: the bovine spongiform encephalopathy (BSE) or 'mad cow' disease and the foot-and-mouth disease (FMD) outbreak. These crises had an impact on the political economy of beef production and led to increased support for beef producers.

Attitudes to agricultural protection have changed quite markedly in the UK in recent times and new pressures are emerging on the political economy for agricultural support, including beef support. In this chapter, the political economy of the UK beef industry — including the various forces that promote and block change — is analysed.

Where does beef sit politically?

Beef farming in the UK

Agriculture in the UK accounts for 0.7 per cent of gross domestic product and the agricultural workforce is slightly more than half a million people, or 2.2 per cent of the total workforce. Imports and exports of food, feed and drink are £185 billion and £9 billion respectively. The UK is 63 per cent self-sufficient in its total food requirements and 75 per cent self-sufficient in indigenous foods (those foods that the UK is able to produce — which excludes, for example, bananas and coffee).

Pasture of one form or another comprises about two-thirds of the UK's total agricultural land area — that is, approximately 12.5 million hectares of the total 18.5 million. About two-thirds of the EU's beef and veal production comes from the dairy herd. Production is either pasture-based or cereal-based, which approximates extensive and intensive systems respectively.

The UK has the second-largest beef herd in the EU (France has the largest). The total number of cattle and calves is about 10.6 million and beef and veal production is valued at £1.8 billion. With two-thirds of beef cattle on hill farms, beef comprises about 25 per cent of agricultural output in Wales, Scotland and Northern Ireland, but only 10 per cent in England.[12]

In 2001, domestic production of beef and veal accounted for 73 per cent of total supply (table 5), having been more than 100 per cent in 1994 and 1995 (chart 6). With the market yet to recover fully from the turmoil of the recent

[12] There is little production of veal in the UK.

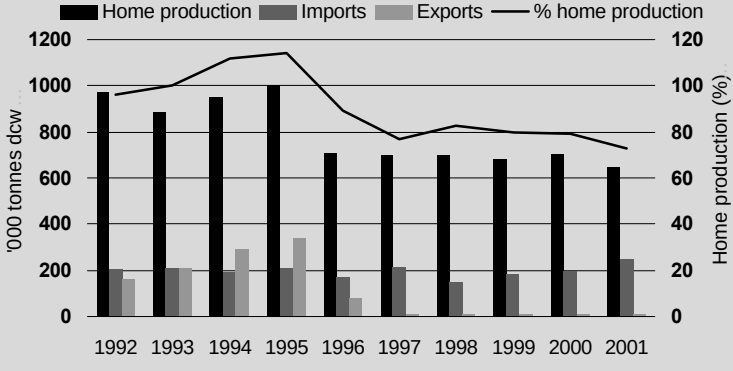
5 UK supply balance for beef and veal, 2001

Supply/demand	*Dressed carcass weight*[a]
	tonnes
Domestic production	645 000
Imports – EU	175 000
Imports – rest of world	78 000
Exports – EU	9000
Exports – rest of world	-
Total domestic supply	**889 000**
Change in stocks	-
Domestic use	889 000

[a] Provisional figures.

Source: Department of Environment, Food and Rural Affairs.

6 UK production, imports and exports



dcw: Dressed carcass weight.

Data source: Department of Environment, Food and Rural Affairs

FMD epidemic, beef production in 2002 is estimated to be 585 000 tonnes, almost 10 per cent less than in 2001.[13] Two-thirds of beef and veal imports into the UK are from the EU. Beef exports have been minimal since 1996

[13] Meat and Livestock Commission, http://www.mlc.co.uk.

because of the worldwide ban imposed on UK beef trade in that year.

Beef farming in the UK is usually a joint enterprise with sheep or dairy. Sixty-five per cent of beef is farmed in the less favoured areas (LFAs) and most of the remainder is farmed in the lowlands. Farming in the LFAs is subject to a number of handicaps — climate, soil, terrain and remoteness — which have been recognised in the system of agricultural support since 1946. The LFAs, which can be subdivided into disadvantaged areas and seriously disadvantaged areas, account for 42 per cent of the total agricultural land area of the UK and just over a quarter of the agricultural labour force. Since 2001, support for these areas has come under the EU's Rural Development Regulation, which has the following objectives:

- to ensure continued agricultural land use and thereby contribute to the maintenance of a viable rural community;
- to maintain countryside; and
- to maintain and promote sustainable farming systems that, in particular, comply with environmental protection requirements.

Cattle and sheep farms in the LFAs are typically small, with perhaps 100 hectares and 20 beef cows. Direct subsidies supply about half of the gross value of output of these farms. The 50 000 LFA cattle and sheep farms in the UK are dispersed in the hill and upland areas of England, Wales, Scotland and Northern Ireland; the 38 000 lowland cattle and sheep farms are mostly in England.

In 2000–01, 50 per cent of cattle and sheep farms in the LFAs and 75 per cent of cattle and sheep farms in the lowlands had incomes of less than □ 5000 a year. In recent years, income for many farms has been close to zero. The

average real income on LFA cattle and sheep farms in 2001–02 was 30 per cent of the average of 1994–97.

The strength of the British pound has been one of the factors responsible for the decline; the pound rose 20 per cent against the euro between 1995 and 1999. This lowered EU institutional prices (when expressed in pounds), made exports[14] less competitive and encouraged imports. Depressed world markets have also contributed, but, in the case of beef, the overriding factors have been the BSE crisis and the FMD epidemic (see below).

Additional temporary government support was given to hill farmers in 1998 and 1999 in the wake of dramatically falling incomes.

In the longer run, incomes will be determined by: the strength of world markets; further reform of the Common Agricultural Policy (CAP); the exchange rate; EU enlargement; WTO outcomes; and restructuring of the sector, which will necessitate larger enterprises and diversification.

Support for beef farmers

The array of direct payments and premiums available to beef farmers in the UK (and EU) is mind-boggling. A Beef Special Premium (BSP) is payable on all male cattle; a Suckler Cow Premium (SCP) is payable on female cattle used for rearing calves for meat production. Total expenditure through these premiums is regulated by livestock quotas, which were introduced in 1993 and are now traded on the open market.

Additionally, beef farmers in English LFAs who receive the SCP can apply for the Hill Farm Allowance, a social and environmental area payment that 'is designed to ensure that

[14] Exports here refer mainly to sheep, mutton and lamb, because of the ban on exports of beef animals and products imposed in 1996.

agriculture continues to make its irreplaceable contribution to rural society and the managed environment of the English uplands by compensating hill farmers for the difficulties of farming in less favoured areas'.[15] This scheme forms part of the England Rural Development Programme.[16]

Farmers who receive the BSP or the SCP are also eligible for Extensification Payments if their stocking densities are within prescribed ceilings, in terms of livestock units per hectare. All beef farmers are eligible to receive the Slaughter Premium, which is payable on all animals sent for slaughter.[17]

Additional payments to beef producers in the UK (and in other EU member states) can be made under the Beef National Envelope Scheme, which in the UK is in the form of an additional per-head payment on animals for which the SCP has been paid.

For a number of these direct payments and premiums there is a limit on the total amount payable to UK farmers. If this limit is exceeded, payments made to individual farmers are reduced proportionately ('scaleback').[18] Some of these payments are also subject to 'modulation' — in effect a tax (of 3 per cent in 2002) — the proceeds from which are returned to the rural economy via the Rural Development Programme.

In addition to the direct payments listed above, there is agrimonetary compensation. Transitional Agrimonetary

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[15] Eligibility criteria apply. Department of Environment, Food and Rural Affairs, http://www.defra.gov.uk/erdp/schemes/landbased/hfas/hfasindex.htm #what.

[16] Other parts of the UK have their own Rural Development Programmes.

[17] Strictly, this comprises two schemes: the Slaughter Premium Scheme and the Veal Calf Slaughter Premium Scheme.

[18] Small producers can be exempted from scaleback.

Compensation has been paid since 1999 to ease the transition to the new agrimonetary system following the introduction of the euro in 2002. In the UK, beef producers also benefit from three further types of agrimonetary compensation as a result of the strength of the pound against the euro: Direct Agrimonetary Compensation, Market Agrimonetary Compensation and Premium Agrimonetary Compensation.

Support for UK beef farmers fluctuated during the 1990s (chart 7), but has increased in recent years. Prior to the start of the Uruguay Round of trade talks, the producer support estimate (PSE) expressed as a percentage of gross farm receipts was 50 per cent. In 2001 the OECD estimated the PSE for EU beef to be 91 per cent.[19] That is, 91 per cent of farm receipts for beef farmers is now derived from government payments. The large jump in support for beef since 1996 is partly due to extra payments to beef producers as a result of the BSE and FMD crises and the drop in market prices and general policy.

To receive this array of direct payments and premiums, farmers (or their accountants) face a mountain of paperwork, as typified by the documentation of the Integrated Administration Control System. Nevertheless, the increasing importance of direct payments in the total value of UK beef production is quite dramatic (chart 8). The contribution of direct payments increased rapidly from 10 per cent in 1992 to about 50 per cent since 1996.[20]

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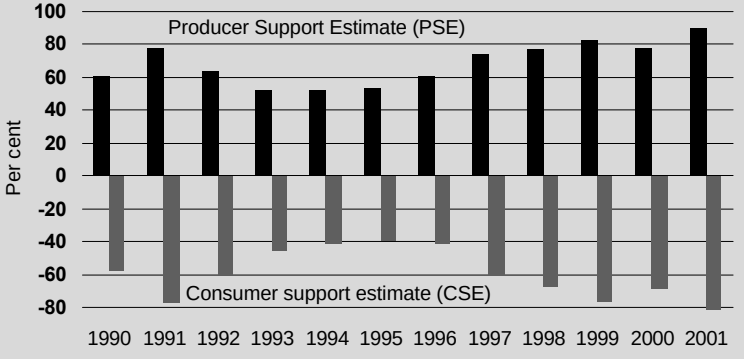
[19] OECD 2002, *Agricultural Policies in OECD Countries, Monitoring and Evaluation, 2002* and various issues. Separate PSE calculations for EU members are not provided by the OECD.

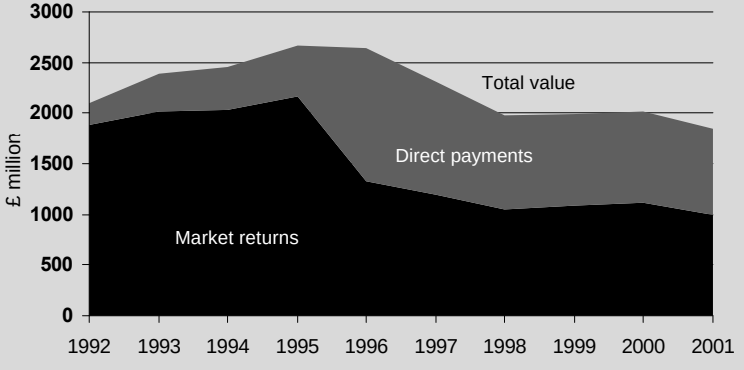
[20] Note, some of the 'market' returns received by farmers are the result of government policy — especially border restrictions — which gives the PSE of 91 per cent.

7 PSE and CSE for beef and veal in the United Kingdom



Data source: OECD 2002, *Agricultural Policies in OECD Countries, Monitoring and Evaluation, 2002* and various issues.

8 Composition of total value of UK beef production



Data source: Department of Environment, Food and Rural Affairs.

The use of growth-promoting hormones in beef production has been banned in the EU since 1989 because, in the opinion of the Scientific Committee, they pose a health risk to consumers. This ban also covers the importation and marketing of growth-hormone-produced beef throughout the EU. There is little pressure from the farming industry

for a policy change in this respect because the ban serves as a curb on imports of beef, especially from the USA.

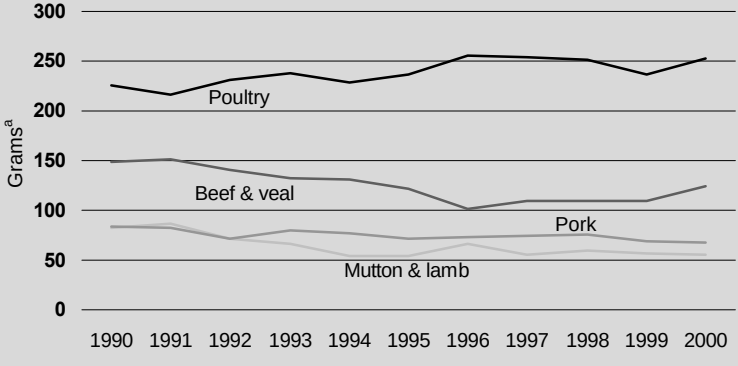
Beef consumption in the UK

Consumption of beef and veal in the UK has halved over the past 25 years, from 240 grams per person per week in 1975 to 124 grams in 2000. In the mid-1990s, consumption was hit by the BSE crisis and fell to a low of 101 grams in 1996. However, by 2000 beef and veal consumption was 2 per cent higher than in 1995 (chart 9).

In the UK, beef is expensive compared with the white meats of pork and poultry, though beef is similar in price to mutton and lamb and cheaper than fish (chart 10). The lower consumption of beef can be explained in part by price changes and in part by other factors such as health concerns over saturated fat, an increase in vegetarianism and the more recent food scares over BSE and FMD.

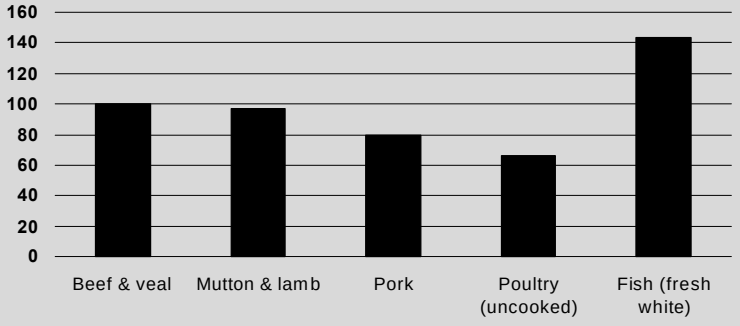
Over the last quarter of the twentieth century, the real price of beef in the UK decreased by about 30 per cent.

9 Consumption of meats in the United Kingdom[a]



[a] Grams per person per week, consumed in the home, all households.
Data source: National Food Survey.

10 Relative retail prices in the United Kingdom, 2000[a]



[a] Beef = 100.

Data source: National Food Survey.

However, in relation to other meats, beef gained a price advantage over only mutton and lamb (table 11). Over the period, the consumption of beef and of mutton and lamb halved while the consumption of pork decreased slightly and the consumption of poultry increased by over a third.

Consumers' expenditure on fresh beef and veal in the UK is twice that on mutton and lamb or pork, but considerably less than on poultry, and represents only 15 per cent of total expenditure on all meats (table 12).

Agenda 2000 reform of the CAP

The Agenda 2000 reform of the CAP reduced the 'intervention price' for beef (the price at which beef may be bought into intervention by the authorities). As such, intervention serves as a market of 'last resort' and is intended to provide a floor price for beef 20 per cent higher than world markets to improve its competitiveness in the EU. To compensate producers for the price cut, existing direct payments were increased. The extensification premium was nearly tripled and a new calf slaughter premium was introduced as an aid to veal producers.

11 Changes in prices and purchases of meat in the United Kingdom, 1975–2000

Type of meat	*Change in real price*	*Change in quantity purchased*
	%	%
Beef and veal	-30	-48
Mutton and lamb	-14	-54
Pork	-38	-13
Poultry		
Broiler uncooked	-3	+35
Other uncooked	-33	+42

Source: National Food Survey.

12 Consumer expenditure on meat in the United Kingdom, 2000

Type of meat	*Expenditure per person per week*	*Share of total meat*
	£	%
Beef and veal	0.59	15
Mutton and lamb	0.26	6
Pork	0.26	6
Total carcass meat	**1.11**	**27**
Bacon and ham	0.63	16
Poultry	0.86	21
Other	1.45	36
Total meat	**4.04**	**100**

Source: National Food Survey.

These reforms were intended to reduce beef production (and surplus), improve competitiveness and increase beef consumption. Unfortunately, these intentions floundered on the rocks of BSE. After the UK's BSE crisis of the 1990s, a 'new BSE crisis' in late 2000 prompted the European Commission to unveil a 7-point plan in February

2001 to address the serious disruption caused to the beef and veal market (see below).

The Agenda 2000 reform of the CAP should benefit beef farmers because the increased compensation payments exceed the reductions in intervention price. In the UK, it is likely that they will be the only group of farmers to benefit. However, the Ministry of Agriculture, Fisheries and Food (MAFF)[21] estimated that the lower food prices under the Agenda 2000 reform will benefit UK consumers by about □1 billion a year, equivalent to a reduction of □65 in the annual food bill for a family of four. The net benefit to the country is estimated to be □0.5 billion, which includes the negative impacts on farmers and taxpayers. One third of this overall gain is estimated to come from reductions in beef prices.

With regards to future reform of the CAP, the main preoccupation of policy makers is the WTO Round and enlargement of the EU. Extension of the present CAP to the ten candidate countries of Central and Eastern Europe to join the EU is generally regarded as being too costly in budgetary terms, especially with respect to direct payments. At present, policy makers intend to phase in direct payments for new members gradually, but this gives rise to accusations of a two-tier CAP. EU farmers and food manufacturers view the EU's enlargement with some apprehension, but the threat of greater competition from the candidate countries is countered by expanded market opportunities.

[21] Now replaced by the Department of Environment, Food and Rural Affairs (see below).

Interest groups

Department of Environment, Food and Rural Affairs

The UK's Department of Environment, Food and Rural Affairs (DEFRA) replaced the Ministry of Agriculture, Fisheries and Food in 2001 as part of a government reorganisation. DEFRA's broad aim is sustainable development. Its seven objectives can be summarised as:

- to protect and improve the rural environment;
- to promote rural areas and rural communities;
- to promote a competitive and safe food-supply chain;
- to improve enjoyment of an attractive and well-managed countryside;
- to promote diverse, modern and adaptable farming through domestic and international actions and further ambitious CAP reform;
- to promote prudent use of domestic and international natural resources; and
- to protect the public's interest in relation to environmental impacts and health, and to ensure high standards of animal health and welfare.

These objectives represent a mix of old and new, with the latter including explicit reference to food safety, the countryside, animal welfare, the environment and the prudent use of *international* resources. The MAFF had been heavily criticised for its handling of the BSE crisis in 1996 and the outbreak of FMD in early 2001, and its replacement by DEFRA signalled a change of emphasis in its responsibilities. Within a wider remit, consumer interests were elevated to counter the former ministry's preoccupation with agriculture and farming. Indeed, in the name of the new department, the word 'agriculture' is conspicuous by its absence.

Policy Commission

The Policy Commission on the Future of Farming and Food reported to the Prime Minister in January 2002.[22] Its remit was to:

> … advise the Government on how we can create a sustainable, competitive and diverse farming and food sector which contributes to a thriving and sustainable rural economy, advances environmental, economic, health and animal welfare goals, and is consistent with the Government's aims for Common Agricultural Policy (CAP) reform, enlargement of the EU and increased trade liberalisation.

The Commission concluded that the food and farming industry has a future, but sweeping change is needed. Among more than 100 recommendations, it emphasised early radical reform of the CAP, re-targeting of public funds towards environmental and rural development goals instead of subsidising production, and a new national champion for 'local' food. The report called for measures, costing about £500 million over three years, to help bring about a change of direction in farming and food.

The Meat and Livestock Commission

The Meat and Livestock Commission (MLC) was established in 1967 and works with the UK meat and livestock industry to improve the industry's efficiency and competitive position and to maintain and stimulate consumer markets for British meat at home and abroad. The MLC's work includes economic analysis, forecasting, research, new product development, marketing and the provision of information. It is financed by a levy on producers and abattoirs and through its commercial services.

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[22] The report is available from http://www.cabinet-office.gov.uk/farming/index/Press%20Releases.htm.

Within the MLC, the Cattle Strategy Council, which was formed in 1998, seeks to increase the UK share of the domestic market, to improve the beef industry's competitiveness, to develop the market for beef at home and overseas, and to work with the government to recover the export market for British beef.

The National Farmers' Union

The National Farmers' Union (NFU) represents the interests of farmers. Once a staunch advocate of production subsidies and market intervention, it now accepts that the rules of the game are changing. The NFU supports further reform of the CAP, recognising the internal pressures of EU enlargement and budgetary costs, and the external pressures of further trade liberalisation and WTO commitments. In particular, the NFU recognises the need for Europe to lessen its reliance on production and export subsidies.

The NFU has always argued that British farmers are among the most efficient in Europe because they employ modern technology and high levels of investment. It now wants government to end farmers' reliance on price support and predicts that farmers will be well-placed to compete in world markets. This may be true for some enterprises, but beef farming is unlikely to be viable without direct payments or agri-environmental schemes.

The Food Standards Agency

The Food Standards Agency (FSA) was established by an Act of Parliament in 2000 as an independent food-safety watchdog to protect the public's health and consumer interests in relation to food. It was established in the aftermath of the BSE crisis to provide advice and information to the public and government on food safety 'from farm to

fork', nutrition and diet. The Food Standards Agency's explicit objectives are to:

- improve food safety throughout the food chain;
- promote honest and informative labelling;
- promote best practice within the food industry; and
- improve the enforcement of food law.

Consumers

Although the focus of consumers' interests relating to agriculture and food has traditionally been weak, it has recently been strengthened: witness the broader remit of DEFRA, the inception of the FSA and the official efforts at both UK and EU level to promote quality assurance and labelling schemes (see below).

However, in a recent survey of EU citizens' views on the CAP, 50 per cent of the general public had never heard of the policy. More reassuringly, 92 per cent of the public thought agriculture was important.[23] Food safety and environmental protection were the top priorities of those surveyed. There was general approval of the change from production subsidies and intervention to a system of direct payments to farmers, but when asked about trade discussions with the WTO, 77 per cent of the general public responded that they had heard nothing about the discussions.

[23] Commission of the European Communities http://europa.eu.int/comm/agriculture/

Pressures for change

The BSE crisis

The BSE crisis for the UK beef industry has changed the political economy of support for the industry. The crisis arose in March 1996 when the British government announced that BSE, which had been first identified in cattle in 1986, had probably been transmitted to humans. Previously, it was not thought to be a threat to public safety. The link between BSE and its human form, variant Creutzfeldt-Jakob disease, is now clearly established, though the manner of the infection remains uncertain. The government estimates that about 100 people in the UK have died, or are dying, from variant Creutzfeldt-Jakob disease.

Prior to its 1996 announcement, the government had repeatedly assured the public that beef was safe to eat and that BSE could not be transmitted to humans. Consequently, the government's announcement caused public outrage and a feeling of betrayal. An official inquiry into BSE, which reported in 2000, criticised the MAFF and the Department of Health for underplaying the risk and for not working together closely enough.[24]

Cattle probably became infected with BSE in the early 1980s and the disease developed as a consequence of intensive farming practices, especially the use of animal protein in cattle feed. Initial beliefs that BSE was derived from scrapie, a disease affecting sheep, proved incorrect. Though not the cause of the disease, the use of meat and bone meal contributed to BSE's spread. The disease peaked in early 1993, when there were on average over 1000 suspected cases being reported each week. Since then, the number of suspected

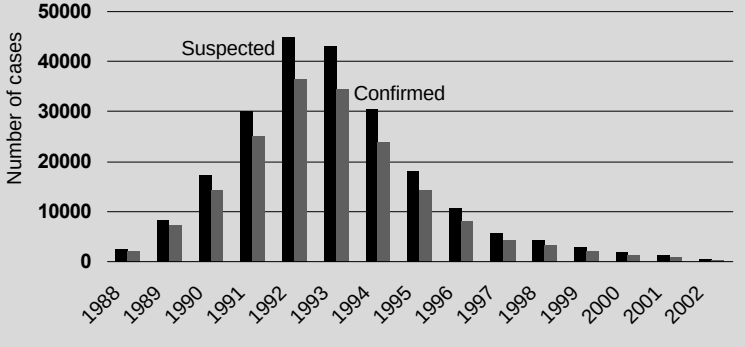
[24] The report of the inquiry is available at http://www.defra.gov.uk/

cases has been steadily declining. In early 2002, there were about 25 suspected cases per week (chart 13).

Following the government's announcement in 1996, cattle aged more than 30 months were removed from the food chain. To date, almost 6 million animals have been slaughtered under this Over Thirty Month Scheme and producers have received about □ 1.7 billion in compensation. However, given the average incubation period of five years, consumers of beef are still wary.

Towards the end of 2000, new cases of BSE arose in France, Germany, Spain, Ireland and Belgium, which severely affected beef consumption and prices across the EU. Member states responded with a range of unilateral trade restrictions. The market situation worsened further in 2001 because of outbreaks in Austria and Finland. As a consequence of this new BSE crisis, beef prices across the EU fell by an average of 27 per cent between October 2000 and February 2001. The European Commission responded with a 7-point plan, through which it aimed to reduce beef production by encouraging further extensification and to reinforce support for organic production by promoting

13 BSE cases in the United Kingdom



Data source: Department of Environment, Food and Rural Affairs.

environmentally friendly farming methods. The Commission noted that, 'The BSE crisis demonstrates the need for a return to farming methods that are more in tune with the environment'.[25]

This new BSE crisis led to intervention buying of beef in the EU — mainly in Germany, France, Italy and Spain — in December 2000 for the first time in 21 months. Consequently, intervention stocks of beef in the EU, which had been at very low levels, increased substantially to 250 000 tonnes by the end of 2001. However, no intervention occurred in the UK, which suggests that the market is improving.

In the UK, the government has introduced various schemes to protect public health and eradicate BSE: the Over Thirty Month Scheme, beef assurance schemes (see below), an offspring cull, a selective cull and a calf processing aid scheme.[26] The disease has been almost eliminated from cattle born since August 1996. DEFRA reported in April 2002 that 63 per cent of UK herds with adult breeding cattle, including 83 per cent of beef suckler herds, have never had a case of BSE. The Office Internationale des Epizooties (OIE) defines 'low incidence' of BSE as up to 100 confirmed cases per million cattle aged more than 24 months. In the UK in 2002, there were fewer than 200 confirmed cases per million cattle and, on the basis of the downward trend, the rate should fall to within the 'low incidence' category by 2003.

In March 1996, immediately following the UK government's announcement of the risk to humans, the EU imposed a worldwide ban on UK exports of live cattle, beef and beef

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[25] Press release (IP/01/195) available at http://europa.eu.int/rapid/start/cgi/guesten.ksh

[26] The calf processing aid scheme was technically a market management measure, introduced after the ban on UK exports of live calves in 1996.

derivatives. Although a framework for the progressive resumption of exports was agreed in June 1996 (the Florence Agreement), the ban remained in place for more than three years.

Not until August 1999 did the European Commission allow the UK to export de-boned beef and beef products under the Date-Based Export Scheme. This scheme applied only to animals born after 1 August 1996, the date when potentially contaminated feed was removed from farms and feed mills. The scheme ensures that beef meets rigorous safety standards, underpinned by stringent controls monitored by the EU veterinary authorities. The MLC believes that this makes British beef exports among the safest in the world. However, France initially refused to accept imports of beef from the UK, despite a ruling from the European Court of Justice in September 2001 that this was in breach of EU law. Exports of UK beef to France resumed in October 2002. Before the 1996 EU ban on exports, France was the largest export market for British beef.

To ensure that at any point in the food chain all beef can be traced back to its source, cattle born or imported after 1 July 1996 are issued with a 'passport' to accompany them throughout their lives. Cattle that do not have a valid passport cannot be accepted for slaughter for human consumption. This Cattle Passport System was refined in 1998 with the introduction of the Cattle Tracing System, recording all births, deaths and movements of animals. As a back-up, all cattle born after 1 January 1998 have been allocated unique registration numbers, which must be worn as ear tags.

The economic and financial costs of BSE are high, although difficult to quantify. The government estimates the cost to the UK Exchequer over the period 1996–2002 to be about □ 4.6 billion. This includes compensation and aid to farmers and abattoirs, costs of rendering, and

storage, some of which has been reimbursed by the EU. Exports of cattle, beef and derivatives, which were banned between 1996 and 1999, were worth □ 600 million in 1995. And the NFU estimates that the cost of BSE to UK agriculture, in terms of extra costs to farmers and loss of value of livestock and products, has been about □ 326 million a year.

The BSE crisis has had a long term effect on perceptions by the community towards food safety. If that were not enough, on top of the BSE crisis came an outbreak of FMD.

Foot-and-mouth disease

A serious outbreak of FMD occurred in the UK in February 2001. The disease, which affects cloven-hoofed animals — cattle, sheep, goats, pigs and deer — rapidly became an epidemic, peaking in March and April 2001. The last confirmed case was recorded in September 2001. In these eight months, there were more than 2000 confirmed cases of FMD in the UK.

The outbreak led to the slaughter of 6 million animals, of which more than 1 million were cattle. Almost 1500 veterinarians were mobilised and, at the peak of the epidemic, more than 2000 army personnel were deployed in dealing with the consequences. The most likely source of the outbreak was (illegally) imported meat that found its way into pig feed via food wastes.

The epidemic was obviously a traumatic experience for livestock farmers and the wider rural community. But it also caused much anxiety among the general public.[27] During the 12 months following the outbreak, agricultural markets

[27] The disease is thought not to affect humans, though public anxiety about possible effects to the food chain was fuelled by concerns over BSE.

were closed, the movement of animals off farms was restricted, massive pyres of carcasses became a common sight, public footpaths were closed and access to farms and the countryside was denied. In short, the countryside became a 'no-go' area. This had a major impact on recreational activities in the countryside and on rural tourism — sporting events and holidays were cancelled or postponed.

In January 2002, all areas of the country attained 'disease-free status' and the UK regained international 'FMD-free status without vaccination' from the OIE. The latter cleared the way for exports of animals and animal products to OIE member countries[28] and in February the European Commission lifted all export restrictions. In the same month, the first cattle market re-opened in the UK and other restrictions were relaxed.

The previous outbreak of FMD in the UK was in 1967–68.[29] On that occasion, there were a similar number of confirmed cases but their coverage was geographically localised, confined mainly to the West Midlands and the north-west of England. Although at the peak of the 2001 outbreak, there were fewer new cases per day (50 cases compared with 80 in 1967–68), the effect on the nation was greater than in the previous outbreak as the whole of the nation was directly or indirectly affected. The rapid spread of the disease was due in large part to the greater movement and transportation of animals, particularly sheep, compared with 35 years ago. In 1967 there were more than 800 live auction markets and over 3000 slaughterhouses in the UK — today these numbers are 170 and 520 respectively.[30]

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28 Exports to third countries have to be negotiated on a bilateral basis.

29 An isolated outbreak occurred on the Isle of Wight in 1981.

30 Department of Environment, Food and Rural Affairs, http://www.defra.gov.uk/footandmouth/about/current/comparisons/changes.asp. Accessed 16 December 2002.

Although the FMD epidemic is now over, it has had a dramatic impact on beef farming, the food industry and the rural community. The NFU estimates the direct and uncompensated financial impact on the UK livestock sector to have been about □ 900 million. There are still a number of restrictions on farmers, but these will be relaxed as the disease's threat recedes. Illegal imports of meat are thought to be a possible source of the infection[31] and the NFU is concerned that controls to prevent these entering the UK are inadequate. It has also argued against increasing the EU import quota for beef from Argentina.[32]

These crises in the beef industry have lead to major changes in the perception of food safety by consumers and in quality assurance programs.

Quality assurance

The recent BSE and FMD scares have heightened consumers' concerns over food safety: in a survey of the general public across the 15 member states of the EU in 2001, only 36 per cent of people thought agricultural policy ensured that the food they bought was safe to eat.[33] Both government and the food industry have responded with a number of measures, at UK and EU level, to allay these concerns.

A Beef Labelling Scheme was implemented in the UK in 1997 and recently tightened by EU legislation. From 2002, all retailers are obliged to label fresh and frozen beef with its origin (birth, rearing and slaughtering). Together with the identification and registration of all live animals (cattle

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[31] The 1967 FMD outbreak was most likely to have been caused by the entry into the animal food chain of infected Argentine lamb that had been legally imported.

[32] NFU Press Release, 22 May 2000.

[33] http://europa.eu.int/comm/agriculture/

passports and ear tags) this enables beef to be traced 'from farm to fork'. A 'traceability number' links the retail product to the specific animal from which it came. Compulsory country-of-origin labelling also applies to imported beef from third countries.[34]

Currently, the EU is funding a number of information programs on beef and veal in the member states. These are designed to inform consumers about EU and national legislation relating to safety controls in the beef and veal food chain, providing information on the way the product is produced, controlled, labelled and marketed.

Since 1992, the EU has operated a system of quality labels that relate to foods produced in a particular region or by a traditional method — the Protected Designation of Origin and the Protected Geographical Indication labels — linking at least one of the stages of production, processing or preparation to a specific place or region. In the UK, Orkney beef and Scotch beef are registered under the Protected Designation of Origin and Protected Geographical Indication schemes and can therefore use these labels to help create a brand name for promotion and advertising.

In the UK, farm assurance has been a key element in livestock production since the mid-1990s. Schemes have been set up to provide a mechanism for farmers to demonstrate to consumers and retailers that standards of husbandry, welfare and environmental protection on the farm meet nationally agreed levels of best practice. An independent organisation, Assured British Meat, sets standards covering all elements of the meat supply chain from feed suppliers through to retailers. About 33 000 livestock producers in

[34] If more than a single third country is involved in producing and processing the beef, the product may be labelled as 'non-EC'.

the UK are 'farm assured', with 75 per cent of beef covered by the schemes.[35]

These schemes tend to be owned by trade organisations representing farmers, auctioneers, abattoirs and processors. The schemes cover: identification and traceability; animal management; environment and hygiene management; food composition, storage and usage; housing and handling facilities; veterinary-medicine treatments; slaughtering and processing; transportation; and product specification. Independent inspectors make both routine visits and random spot checks to ensure consistent application of the standards.

Consumers can identify farm-assured beef by the Little Red Tractor logo. Beef bearing this logo can be found in all the main food supermarkets.[36] An independent organisation, Assured Food Standards (AFS), manages the Little Red Tractor stamp of approval and licenses producers, processors and packers who meet the Assured British Meat standards. AFS's wider remit is to provide a forum for liaison between the various assurance schemes and to promote assurance throughout the food chain. AFS is owned by sections of the agri-food industry, including several of the farm assurance schemes, the NFU and the MLC. Its board of directors includes members representing retailers, consumers, academics and environmentalists. It is financed through contributions from the various farm assurance schemes and, for its first two years, by a government grant.

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[35] Four of the farm schemes are Farm Assured British Beef and Lamb, Farm Assured Welsh Livestock, Scotch Quality Beef and Lamb Farm Assurance and the Northern Ireland Farm Quality Assurance Scheme.

[36] The Little Red Tractor logo is also used on other foods.

Animal welfare

Since beef production in the UK is predominantly pasture-based and extensive in nature, it can be considered relatively 'animal-welfare friendly'. The farm assurance schemes include the Farm Animal Welfare Council's codes of practice and five basic freedoms: freedom from hunger and thirst; freedom from discomfort; freedom from pain, injury or disease; freedom to express normal behaviour; and freedom from fear and distress. Consumers now have the reassurance, when buying meat displaying the Little Red Tractor or similar logo, that the beef has been reared in an acceptable, animal-welfare friendly way.

Organic beef

Consumers' fears about unsafe food and technological developments such as genetic modification, and a growing public awareness of the damage to the environment caused by agriculture, have led to a reappraisal of farming and production methods. Organic farming, once seen as serving a niche market, has come to the fore as an alternative form of production that is regarded as both safer and more environmentally friendly.

The EU market for organically-produced food is estimated to be growing by 30 per cent a year. In 2000, the EU launched its own organic farming logo. Within Europe, the UK is the fastest growing market for organically produced food. The NFU has an Organic Committee and DEFRA intends to launch an Organic Action Plan in 2003 to increase domestic production. At present, 70 per cent of the organic food on sale in the UK is imported.

The growth in the quantity of organically-produced beef in the UK has been exponential, boosted by a three-year conversion grant from the government. Beef farmers in the LFAs have found it relatively easy to switch to organic

production because their conventional systems are pasture-based and extensive. Lowland beef farmers have found the conversion to organic production more difficult because of their generally more-intensive production systems. However, the price premium attached to organically produced beef is likely to limit expansion of the market, given that beef is an expensive meat, even when produced conventionally.

The environment

An increasing number of farmers participate in agri-environmental schemes. These are long-term voluntary agreements with DEFRA or other agencies to manage and enhance the countryside. Payments to farmers for these types of agreement grew substantially during the 1990s, from about £11 million a year at the start of the decade to £193 million in 2000.

In a recent survey, three-quarters of farmers felt that they had an obligation to maintain the appearance of the countryside, and nearly four out of five farmers felt they should preserve wildlife and habitats. Ninety-two per cent of farmers reported some form of environmental practice as part of their farm management.[37]

The reforms of the CAP during the 1990s (MacSharry and Agenda 2000) reduced the intervention price of beef, and therefore reduced market returns, while increasing direct compensation payments to farmers. These policy changes encouraged lower stocking rates by increasing the extensifi-

[37] McInerney et al. 2000, 'Who cares — A study of farmers' involvement in managing and maintaining the countryside', Agricultural Economics Unit, University of Exeter.

cation premium, which was a crude concession to the environmental lobby.[38]

Because few farms rely solely on beef production, environmental impacts depend crucially on the relationship of the beef enterprise with other enterprises on the farm. In the hills and uplands, cattle are usually reared in conjunction with sheep. Cattle on the LFA farms are an effective means of managing the uplands and moorlands because they trample bracken and graze the coarser grasses left by sheep. However, lowland beef farms are more likely to be associated with negative environmental impacts because beef is likely to be a joint enterprise with dairy or arable production.

Nevertheless, both upland and lowland livestock farmers contribute to conserving what are generally regarded as traditional landscapes. Grazing can help to create a diversity of sward, conserve wildflower meadows and ensure the retention of hedgerows as natural field boundaries. This 'helps to maintain and shape the patchwork of fields and pastures which make up our treasured landscape, the bedrock of the tourist industry'.[39] Without cattle (and sheep), particularly in the hills and uplands, Britain's rural landscape and the communities that live in them are likely to be very different.

Conclusion

Cattle farms in the UK tend to be small and located in the hills and uplands. British cattle farming is generally associated with animals grazing freely in the countryside com-

[38] Lowe et al. 1998, 'United Kingdom' in Brouwer, F. and Lowe, P. (eds) *CAP and the Rural Environment in Transition*, Wageningen Press, The Netherlands, pp. 103–140.

[39] British Farm Standard, http://www.littleredtractor.org.uk/products.asp?id=beefandlamb.

posed of a patchwork of green fields. Production is seen as animal-welfare friendly compared with the 'factory farming' of pigs and poultry; veal production, unlike in continental Europe, is not widespread. Overall, this image approaches the rural idyll of the small family farm, at the opposite end of the spectrum from the large-scale cereal estates of East Anglia, which suffer the negative connotations associated with hedgerow removal, vast fields, mono-cropping and very wealthy farmers.

Viewed in this way, beef farming presents a relatively positive image within agriculture and possibly a more deserving case for protection, if such a case exists! However, the occurrence of surplus beef 'mountains' suggests an inappropriate policy regime. More recently, the sector has suffered major shocks as a consequence of BSE and FMD. These have severely damaged the general public's perception of livestock farming in particular and of agriculture in general.

Despite the recent setbacks, beef farmers in the UK insist that they are producing an excellent product under tight and closely-monitored regulations and that producers in other countries, both in the EU and beyond, are subject to far less-rigid production and marketing controls. The suspicion that the FMD outbreak was due to illegal imports of infected meat is seen as evidence of farmers' unjust predicament. Rightly or wrongly, beef farmers argue that the playing field is not level — if it were, they would be getting a much better deal.

Consumers in the UK know that beef is an expensive meat. Poultry and pork are cheaper, being less protected under the CAP, though this is not widely appreciated. However, consumers' concerns of late have focused as much, if not more, on food safety as on price. The BSE crisis was associated with, at best, government incompetence and, at worst, an official cover-up. The concerns that this raised

about food safety and the way in which food is produced were compounded by the FMD outbreak.

Attitudes of all the main interest groups to agricultural protection have changed quite markedly in recent times. *Farmers*, represented by the NFU, now recognise that the historic levels of protection afforded to agriculture are unsustainable. Budgetary costs, the Uruguay Round GATT and the prospect of an enlarged EU have cemented this change of attitude.

Consumers are now aware that they are not getting a good deal from the CAP, although this is due more to concerns about food safety and environmental issues than about artificially-high food prices and the concomitant economic welfare losses.

In response to these concerns, *government* is re-thinking policy, giving due regard to the 'multifunctional' role of agriculture in terms of the environment, rural development, food safety and animal welfare. A number of new organisations have also appeared to champion the consumer — for example, the Food Standards Agency and Assured British Meat.

The *environment lobby* has also acquired a louder voice, as the damage inflicted by agriculture on the countryside and public health becomes more apparent. The growth of 'green politics', though less evident in the UK than in continental Europe, is reaching a wider audience.

The main concern of *EU policy makers* is eastern enlargement of the EU and the current WTO round of trade talks launched at the ministerial meeting at Doha. For budgetary reasons, extension of the present CAP to the ten candidate countries of Central and Eastern Europe will be too costly, especially with respect to direct payments. Policy makers continue to engage in reform of the CAP, and a mid-term review was held in 2002.

In summary, resistance to change is lessening, though largely as a result of indirect issues rather than distorted food prices and economic cost. Further reform is likely to be driven by concerns about food safety, food quality, animal welfare, the state of the countryside, EU enlargement and an acknowledgement that the GATT was only the first step along the long road of trade liberalisation.

Nevertheless, there is still an in-built conservatism in agricultural policy. Decades of subsidised production have left an agricultural sector that needs to be weaned gently. This is underway with the switch from market-based price support to direct payments. The extent to which the latter are considered decoupled from production, and therefore non trade-distorting, will be a crucial issue for the EU in the current WTO round.

Less trade-distorting support implies more trade. Against this has to be weighed the strength of the anti-globalisation lobby. Although extreme in its views, this movement strikes a cord with more of the public than those prepared to wage street battles with the police. Indeed, such anti-trade sentiments may not be so far removed from the promotion of 'local' foods, a movement that is now gaining official backing in the UK and the EU.

Arguments relating to the economic welfare losses from the CAP have, in the past, cut little ice with the general public or policy makers. In the future, the more successful pressure groups are likely to be those aligned to the indirect issues referred to above; for example, concerns about safety of imported beef vis-a-vis domestically produced beef. For many products, there is an in-built consumer preference for the domestic good — a 'home bias'. A sufficient price differential will overcome this, but domestic preference can act as an effective barrier to trade and may be difficult to counter even in the absence of trade-distorting policies.

2 FRANCE: AN ERODING BASE FOR SUPPORT

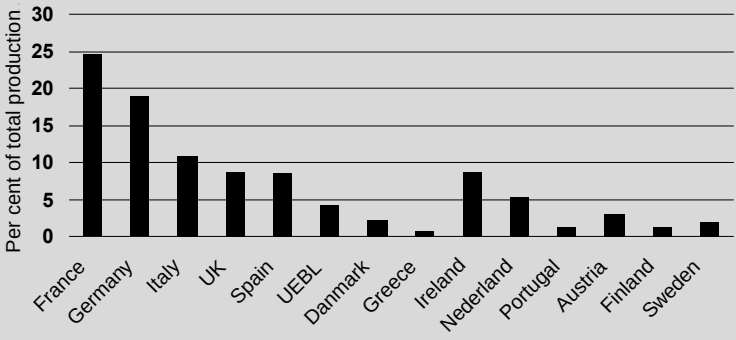
Claude Glaz, Nouveaus Territoires Counseils and Patrick Messerlin, Institut d'Etudes Politiques de Paris

In 1999, there were slightly more than 660 000 farms in France, of which 400 000 were labelled as 'professional' and contributed 95 per cent of total French farm production.[40] With 900 000 active farmers, the farm sector represented 3.5 per cent of the total French labour force and contributed 2.2 per cent of French gross domestic product — roughly as much as the food-business sector.

France is the most important producer of farm products in the current European Union with fifteen member states (EU15). France produces farm products worth €63 billion, or 23 per cent of EU15 farm output. French farmland covers 28 million hectares — 50 per cent of French territory and 24 per cent of EU15 farmland — and French fodder areas, mostly permanent meadows, cover 13 million hectares. France is the largest European producer of beef, with 25 per cent of EU15 total beef production. The

[40] 'Professional' farms are defined by the French Ministry of Agriculture as farms of at least 12 hectares of wheat and operated by the equivalent of a three-quarter time farmer or more.

14 Beef and veal production in the EU, 1999–2001



Source: Ofival (major association of cattlers), Eurostat.

French herd numbers roughly 15 million head older than one year. (Germany is the second-largest European beef producer, with 19 per cent of EU15 production — see chart 14.) In the short or medium term, the EU enlargement process will not change France's dominance in beef production. Central European countries currently produce 0.6 million tonnes of beef: less than 10 per cent of current EU15 production. Poland's beef production (the largest in Central Europe) is one-fifth the size of France's production (table 15).

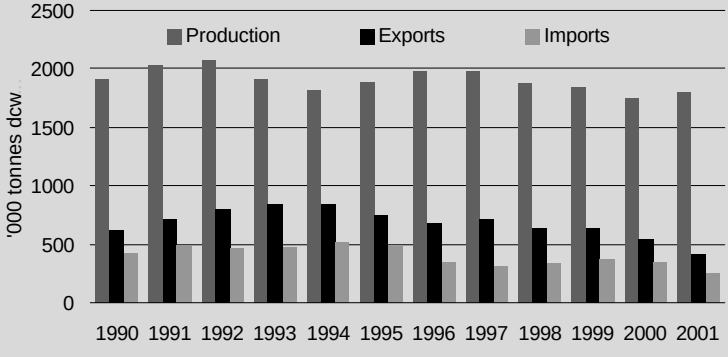
French exports of beef represent 23 per cent of French bovine output, and are mostly sold to the rest of EU15. French beef imports represent 17 per cent of domestic consumption and come mainly from the rest of the EU (table 15 and chart 16). Since 1995, French beef exports have declined, mostly due to the EU15 commitments on export subsidies of the Uruguay Round Agreement on Agriculture. The decline in exports can also be attributed to the ban on French beef imposed by many EU15 member states and third countries after the bovine spongiform encephalopathy (BSE, or 'mad cow' disease) crisis in 2000 — the second such crisis.

15 French supply balance for beef and veal, 2001

	TEC ('000)
Production	1802
Imports — EU	222
Imports — rest of world	38
Exports — EU	376
Exports — rest of world	39
Change in stocks	109
Domestic uses	1538

TEC: Tonne Equivalent Carcass
Source: Ofival based on Ministry of Agriculture and Fisheries (SCEES).

16 French beef and veal production, exports and imports



dcw: Dressed carcass weight.
Source: Ofival.

The paper is organised as follows. In the next section, the main features of the French beef sector are described. Next, the key actors in farm policy are described. There follows an analysis of the recent evolution in the French approach to farm policy issues. The final section presents a few concluding remarks.

Features of the French beef sector

The French beef sector has a long tradition, producing well-known breeds such as *charolaise*, *limousine* and *salers*. French beef production has an important specificity compared to the rest of the European beef sector. More than half of French production comes from cattle of suckler cows, whereas two-thirds of European beef production comes from cattle of dairy cows (table 17). During the two last decades, the number of these 'specialised' cattle of suckler cows increased by one million, while the number of cattle of dairy cows decreased by 40 per cent. These evolutions are due to the combined effects of the Common Agricultural Policy (CAP) milk quotas and to the increase in dairy productivity allowed by genetic improvements.

A great variety of producers

Producers of beef can be classified into three major groups according to production method. First, there are roughly 52 000 professional farms specialising in beef. Professional farms produce 37 per cent of total French beef. This group itself is very heterogeneous, and it can be divided again into two major subgroups. The *éleveurs naisseurs* specialise in selling the young lineage of their cows as live animals (*broutards*), predominantly to Italy and Spain (see below). By

17 Source of beef cattle in France and the EU, June 2001

	France		*EU*		*France/ EU*
	million head	*%*	*million head*	*%*	*%*
Dairy cows	4.2	49	20.3	62	20
Suckler cows	4.3	51	12.3	38	35
Total	**8.4**	**100**	**32.6**	**100**	**26**

Sources: Ofival; Eurostat.

contrast, there are few *éleveurs naisseurs et engraisseurs* who also fatten the lineage of their cows. Farms of these two subgroups are mostly located in Central France (Auvergne, Limousin, Bourgogne, Midi-Pyrénées) and in certain hilly or mountainous areas. Their production is based on extensive (grass-based) methods — hence their major role in 'occupying' and shaping French territory. These farms tend also to be relatively small, with an average farm size of 75 hectares. Their average income (before tax) in 2001 was €19 000 per farm, or €14 000 per annual full-time farmer. This income is among the lowest of French farmers. But it should be added that direct subsidies paid by the EU15 alone represented 110 per cent of their incomes in 2001.

The second group of beef producers comprises farms specialising in dairy production. These number roughly 75 000 farms and produce approximately 30 per cent of French beef. Once again, there is a wide variety of farms in this group, with two major subgroups. The first subgroup (70 per cent of the dairy farms) consists of farms entirely specialising in dairy production, and for which beef production flows from the sale of culled cows; that is, it is a joint product of dairy production. These farms are mostly located in Western France (Bretagne, Pays de la Loire, Normandie) although they can also be found in Eastern France (Lorraine). Cattle are raised using intensive methods and relying on grass and corn. The second subgroup (30 per cent of dairy farms) consists of farms with a noticeable complementary fattening activity. These farms keep beef and bull calves with their cattle. They flourished with the lavish premiums paid for male cattle under the first CAP Reform (1992). However, since then, many farmers have abandoned this activity because of its poor financial profitability due to heavy investments (in building) and limited domestic markets.

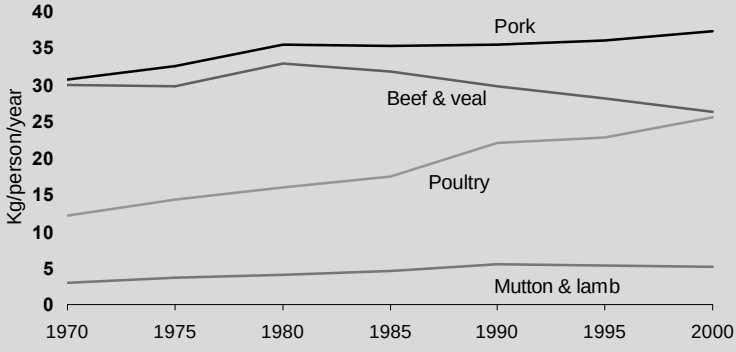
The distinction between these first two groups is important because, as shown below, unlike the farmers specialising in dairy production, farmers specialising in beef are well organised in associations or cooperatives for selling their products.

Lastly, there is a third group of 'mixed' farms with both dairy and suckler cows, which produce both dairy products and beef. This group produces 18 per cent of French beef. The last 15 per cent of French beef output is produced on many other kinds of farms for which beef production is very marginal.

French production and consumption

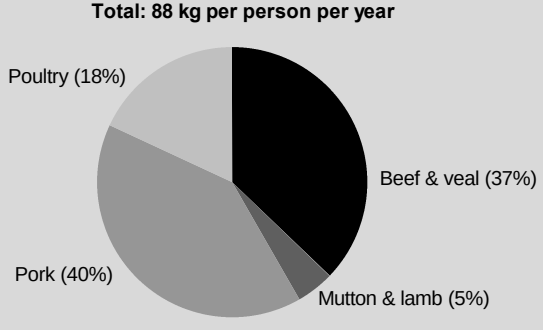
In 2001, France produced 1.8 million tonnes of beef, of which 0.24 million tonnes was veal. French consumption of beef was roughly 1.5 million tonnes — one fifth of the EU15 consumption. This makes France the largest consumer of red meat; the French consumed almost 27 kilograms per person per year, compared to an average of 20 kilograms for the EU15. However, while French consumption of meat has increased during the last 30 years, the consumption of beef has decreased since the early 1980s (chart 18). Nowadays, beef represents only 27 per cent of total meat consumption, compared to 37 per cent 20 years ago. With an increase of almost 70 per cent since the early 1980s, today French consumption of poultry equals that of red meat (charts 19 and 20).

18 Consumption of meat in France



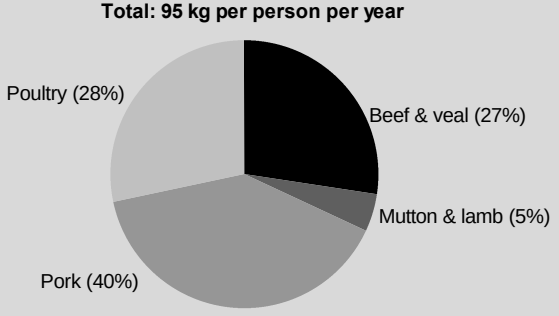
Source: Ofival based on Ministry of Agriculture and Fisheries (SCEES).

19 Consumption of meat in France, 1980



Source: Ofival.

20 Consumption of meat in France, 2001



Source: Ofival.

Several factors explain this decline in beef consumption. First, food standards and health policies have changed over this period. Such standards and policies have various aims, from preventing cardiovascular disease to food safety crises — the most serious of which were the successive BSE crises which struck Europe during the last decade.

The second factor behind the decline in beef consumption is that red meat is increasingly expensive compared to other types of meat (particularly white meat, such as pork and poultry — table 21). The 1992 CAP Reform aimed, among other objectives, to improve the price competitiveness of red meat compared to white meats, by decreasing the level of the 'guaranteed' prices for beef. But the 1992 Reform also decreased the guaranteed prices for cereals and hence substantially decreased the cost of producing white meats. As a result, the relative price of beef did not improve over the 1990s (chart 22).[41]

[41] Institut National de la Recherche Agronomique estimates the price elasticity of demand for beef to be around -0.7 in France. The income elasticity of demand for all types of meat is very low in France, due to the relatively high average

21 Prices of meat in France, 2000–01

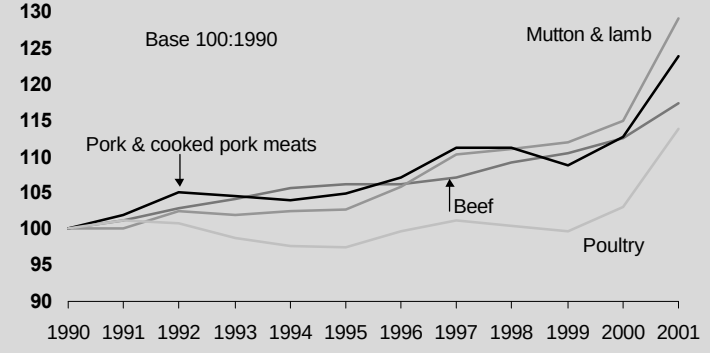
	€ per kilogram	*Relative price*[a]
Beef	9.4	100
Veal	11.7	124
Mutton and lamb	9.4	99
Pork	5.7	60
Poultry	5.8	61

[a] Beef = 100

Note: average price for consumer

Source: Ofival based on Secodip.

22 Price index for consumption



Source: Ofival, d'après INSEE.

The French trade feature: producing live animals for EU15 southern member states

Imported beef represents only 17 per cent of French beef consumption. Imports mostly consist of fresh carcasses from Germany and the Netherlands, and beef meat from Ireland. Imports from non-EU sources are very small: they

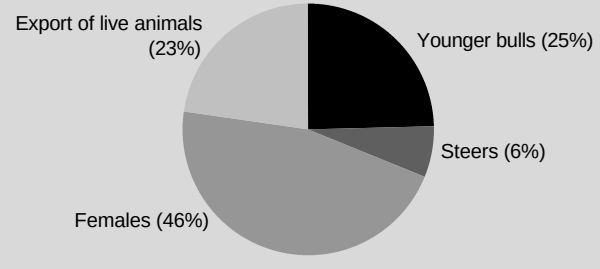
French income (although this average hides very different behaviours, as a function of different income levels and social factors).

amount to only 7 per cent of total French imports. They consist of fresh or frozen carcasses imported under the tariff quotas scheduled in the Uruguay Round Agreement on Agriculture.

France exports 23 per cent of its total beef production. Almost all exports (90 per cent) are sold to the rest of the EU15 (chart 23). Two-thirds of French exports consist of live animals. The remainder consists of fresh carcasses of young bulls, sold mainly to Germany and Greece. Outside the EU15, beef is exported mostly to Russia, Lebanon and Egypt. There are almost no exports without export subsidies towards these countries. Beef is also exported under food aid programs (which are not covered by the current Uruguay Round Agreement on Agriculture).

In sum, live animals represent the largest share of French trade, with 4.8 million head of cattle (excluding veal cattle) exported. Almost one-quarter of the live animals exported (14 per cent of the volume) are young — aged between 7 and 15 months — and exported mostly to Italy and Spain for fattening. These young animals come mostly from

23 Beef production in France (head of cattle)



Source: Ofival 2001.

farms specialising in suckler cows from Central France and strongly related to Federation Nationale Bovine as shown below.

Interest groups

Before describing the major interest groups in the beef sector, it is important to underline France's progressive isolation in the EU15 on farm issues because of the strength of farmer sentiment on this issue. It explains why the November 2002 Chirac–Schröder deal (discussed below) has taken many French observers by surprise, and why it often appears an unsustainable event — and with harsh consequences in particular in the context of the WTO negotiations.

France's progressive isolation in the EU15

With the creation of the CAP and its financial instruments (essentially the European Fund of Guidance and Guarantee), European member states transferred a portion of their decision-making capacity to the EU. By fixing the level and support modalities for production prices and direct payments, the EU15 plays a major role in the economic orientation of farm activities. In 2001, the EU15 farm budget was €44.5 billion; that is, 45 per cent of the total EU15 budget.

The 1999 Berlin Council, among other things, modified the Common Market Organisation for beef. The main goals of the reform were essentially:

- to improve the stability of the market;
- to reinforce the competitiveness of red meat with respect to white meat in Europe;
- to enhance the competitiveness of European production in international markets; and

- to induce producers to turn towards more 'extensive' production methods (following the BSE crises).

In order to achieve these objectives, the main support price (the intervention price) has been reduced by 20 per cent, and has been replaced by a basic price for private storage. The reform has maintained a 'safety net' (similar to the former public regime of intervention) which can be triggered when the average price of young bulls and beef is below €1560 per tonne. To compensate farmers for decreases in the support price, direct aid to farmers has been increased (tables 24 and 25).

In July 2002, the European Commission proposed a mid-term review of the CAP, in conformity with the 1999 Berlin Agreement. The Commission argued that the farm sector still relies too much on a set of instruments that have not sufficiently succeeded in reducing intensive methods of production. As a result, the Commission tabled a reform based on:

- a better decoupling of the subsidy from production by introducing an unique income subsidy per farm, which would be based on historical rights; and
- the widening of agri-environmental measures in favour of quality, food safety and animal welfare.

The proposed decoupling of subsidies from production (which ought to be also implemented for crops) is similar

24 Intervention price in the EU

Before Agenda 2000	*Agenda 2000 (2002)*
Intervention price: 2775 € per tonne	Private storage price: 2224 €/tonne Intervention price ('safety net'): 1560 €/tonne

Source: European Union.

25 Per head payment rates in France

	2002–03	Change in EU price 1999 to 2002–03
Suckler cow premium	250 €/year	+ 42%
Special beef premium:		
▪ Bull*	210 €	+ 56%
▪ Steer**	150 €	+ 35%
Slaughter premium:		
▪ Calves	50 €/head	new provision
▪ Adult cattle	80 €/head	
Extensification premium		
▪ Stocking density: 1.6 <2 LU/ha	40 €/year	
▪ Stocking density: <1.6 LU/ha	80€/year	new provision
National additional payment		
▪ depending on characteristics of the animal (sex, age, breed)	18 to 132 €/head	new provision

** claimable once in the lifetime of the younger bull*

*** claimable twice in the lifetime of the steer*

LU/ha: Livestock units per hectare of forage area (OECD definition)

Source: European Union.

to the system that the United States is moving towards for their crop sector. It will allow the EU15 to table new proposals in the ongoing WTO negotiations, such as requesting the classification of these new subsidies as 'green box' (that is, measures of support that do not distort trade), rather than 'amber box' (subsidies to be monitored and decreased because they distort trade). A decision on this proposal is scheduled for March 2003 by the European Council (heads of states or governments) and due to be implemented in 2004.

However, France has shown at the last 2002 Council meeting that it wants to interpret the 1999 Council decision to launch new reforms at the time of the mid-term review very restrictively. France wants to implement the reforms

adopted by the Berlin Council without changes until 2006. The November 2002 Franco–German agreement suggests that the rest of the Community has accepted the French position, albeit very reluctantly.

In fact, on these proposals as on many other aspects of the 1999 Reform, France appears increasingly isolated within Europe. Nordic member states want more radical reforms that take into account environmental objectives. Britain, where the farm sector has less political clout than in France, would be ready to decrease support to farmers in the context of the WTO negotiations. Germany, which is facing economic difficulties, is increasingly less ready to be the key funding source of the CAP. Germany pays 24 per cent of the EU's total budget (France, 16 per cent) and Germany's net position is €-9 billion (France, €-1.4 billion). French farmers receive 22 per cent of CAP subsidies and are the main beneficiaries. As a result, Franco-German agreements on this issue are increasingly tenuous.

Lastly, the accession of Central European countries to the EU15 will require a large financial commitment from the EU15 to the new member states. French farmers are very conscious that they could lose much from the enlargement process. The cap on subsidies (the 'first pillar') to be paid to farmers has been imposed by the 2002 Council (€44 billion). There is no cap on the 'second pillar' (subsidies for multi-functionality purposes). This degree of freedom is a way of circumventing the cap on the first pillar. A point to stress is that the first pillar is not a severe restriction, because the number of farmers is declining. In fact, the cap imposed since 1999 has led to an increase in subsidies per farmer.

Ministry of Agriculture

Decision making for the CAP is mostly done at the European level, with the main measures for farm markets being decided on by the European Council of Ministers (Agriculture and Finance). The role of the French Ministry of Agriculture is limited to implementing European decisions and to adopting supporting or additional measures. Following the Berlin Council in 1999, the French Parliament adopted a law that defines the broad principles of French farm policy. The main objective of the law is to reconcile agricultural development with new societal demands. Besides the key function of producing farm products, it encourages French farmers to:

- contribute to the management of French territory;
- maintain traditional landscapes;
- improve product quality; and
- use more environment-friendly production processes.

Hence, the policy openly advocates — for the first time in France — the multi-functional dimension of the farm sector.

The law's main innovation is the introduction of contracts between the government and individual farmers. In return for subsidies, farmers are to take concrete actions in favour of the above-mentioned goals. This contractual scheme, which is co-financed by the French government and the EU15, is the only mechanism of its kind in Europe, although some member states (Britain and Portugal, for instance) are interested in introducing similar schemes. However, the new government formed by the June 2002 elections has suspended this scheme, although officially only on a transitional basis and because the existing scheme was too complicated and bureaucratic.

As a result, the most important aspect of the law may only be the official expression of the 'new approach' to farm issues. The French government seems to have realised that the legitimacy of public support for farmers will no longer be understood and accepted by society without serious and deep adjustments (although this statement may be nuanced by the current government's actions). This change of attitude can be partly explained by the food safety crises in Europe and France of the last decade. In addition, the environmental damage done in areas of intensive farming has progressively weakened the close emotional links between French society and its farmers.

The farm-wide trade union: still a powerful lobby

The weight of farmers in the French economy and society has radically fallen during the four last decades. In 1950, farmers comprised 28 per cent of the total labour force, compared to only 3.5 per cent today. Only 18 per cent of the rural population are farmers. And one-quarter of today's farmers are 55 years old or more. Farmers' share of Parliament seats is becoming small, even declining in the Senate (the House more structurally favourable to rural constituencies) from 11 to 9 per cent after the September 2001 elections. Farmers' direct political influence is now mainly through mayorship, with one-third of French mayors being farmers. (Mayors play an important role in the presidential elections by giving their support to candidates who need 500 signatures to be able to run.) This influence is also channeled by quasi-public institutions, particularly the Chambres d'Agriculture, which are comprised of elected farmers.

Historically, one powerful farm trade union — the Fédération Nationale des Syndicats des Exploitants Agricoles (FNSEA) — has been the key and unique counterpart of all the successive French governments from

1945 until the late 1990s, including in the day-to-day management of farm policies[42]. Key FNSEA leaders have held official positions, such as François Guillaume, who was FNSEA president before becoming Minister of Agriculture in Chirac's government (1986–88); or Christian Jacob, who was president of Centre National des Jeunes Agriculteurs (the FNSEA branch for young farmers) before becoming an adviser to President Chirac in the late 1990s.

Traditionally, the FNSEA has had a very defensive approach to farm trade issues, and has always aimed to minimise the impact of any trade liberalisation, for instance by:

- opposing tariff decreases;
- supporting the current European subsidies (which are defined on a per hectare or per head basis) in the 'blue box'; and
- arguing that institutions such as the New Zealand Dairy Board or US food aid are equivalent to export subsidies.

In 1997, the FNSEA monopoly was somewhat weakened when the government started discussions with another trade union — the Farmers Confederation — which was politically closer to it. Although the CP had existed since the 1970s, its opposition to the CAP basic instruments and its defence of small farmers (who benefit little from the CAP) have brought it more recently to the fore. The CP has also benefited greatly from the anti-globalisation movement and the media skills of its ambiguous 'spokesman' José Bové. The CP now represents 25 per cent of French farmers and defends an agenda based on farming methods largely opposed to the CAP-consistent methods as developed during the last 40 years. The CP is against any opening of European farm markets to foreign competition,

[42] In other words, this is the only body with which the government talks about farm policy on a regular basis.

but is in favour of the elimination of EU15 export subsidies, which it sees as destroying farming in developing countries.

Product-based trade unions: more and more 'societal' claims

In addition to the FNSEA, which is a syndicate, farm sectors have trade unions. Fédération Nationale Bovine (FNB) is an independent trade union limited to cattle farmers, but is unofficially close to the FNSEA. The majority of the FNB constituents are specialist beef farmers from Central France, who produce beef by non-intensive methods on small farms, often in difficult hilly or mountainous regions.

Undoubtedly, these farmers contribute to the maintenance, space occupation and territory management (*aménagement du territoire*) of Central France, and the FNB has understood the political advantages that it can draw from these specificities. Its main agenda is to keep tariffs high to limit imports that could damage the 'environmental' situation, and the economy and survival of certain French regions. The FNB seems to renounce any export capacity for European cattle production — though a minority of intensive beef farmers in Western France seem export-oriented.

The political influence of the FNB is important. During the last 30 years, all French presidents have had very close relations with FNB-related farmers, because they originated from Central France, or had been acquainted with them for a long time. Georges Pompidou (president in 1971–74) was from Cantal; Valéry Giscard d'Estaing (president in 1974–81) was politically well-established in Auvergne; François Mitterand's (president in 1981–95) political base originated in Nièvre; and Jacques Chirac (president since 1995) is from Corrèze.

Abattoirs: the move to regulate

This sub-sector has radically changed twice during the last decade. First, it has faced a profound economic restructuring. There are roughly 300 abattoirs in France. But during the last decade, four enterprises (Bigard, Socopa, Charal-Sabim and Soviba) have progressively increased their combined market share up to half of the whole slaughtering business. These four firms have been joined by 14 smaller enterprises (some of them owned by large retail firms) in a trade union, Syndicat National de l'Industrie de la Viande, which accounts for 75 per cent of French slaughtering (1.3 million head).

The second radical change was due to the BSE crises. Until the 1996 BSE crisis, the activity of the abattoir firms was limited almost entirely to 'first transformation' (production of carcasses and boned meat). Today, 40 per cent of the work done in abattoirs comprises the 'second transformation', that is, packaging meat for retail stores. This change is the consequence of the withdrawal by retail firms from the second transformation market because of the sanitary risks and of the costs associated with traceability obligations.

To meet the quality and quantity requirements of large retailers, this new type of abattoir has recently launched long term initiatives with respect to beef farmers in order to reverse the traditionally supply-driven approach in the sector. Abattoirs are now introducing contracts of production with beef farmers in order to get a better balance and control, in terms of both quality and quantity, of supply and demand.

The large retailers — an ever increasing weight

In France, 70 per cent of beef is consumed by households. The rest is consumed in restaurants, cafeterias and by other

forms of collective consumption. Three-quarters of household consumption is served by the large retailers (supermarkets and 'hyper-markets'), which are dominated by four firms (the largest, Carrefour, being the second largest world retailer — see chart 26).

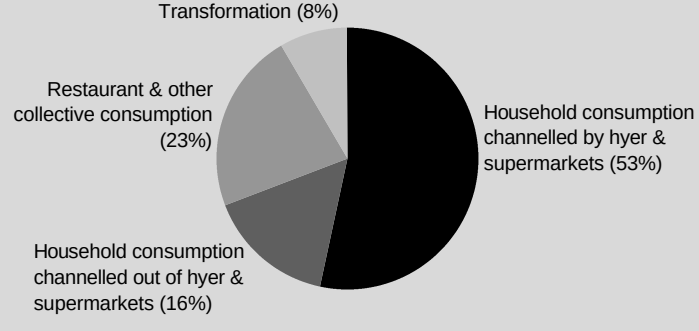
Large retailers are increasingly influential in beef production because:

- they own some of the largest abattoirs (roughly 50 per cent of French activity) or work with others under exclusive contracts; and
- they develop production contracts with beef farmers, with strict norms of production.

Consumers: the desire for transparency

There are several consumer organisations in France. They tend to be weak (and often dependent on the government). One consumer organisation, UFC-Que Choisir, played an important role in the 1997 negotiations with the beef sector about labelling and traceability.

26 Consumption of beef according to distribution network



Source: Institut de l'élevage based on Ofival and Secodip.

Changes ahead

Despite the (tenuous) emergence of some export-oriented interests, the French beef sector appears strongly resistant to change. However, it has been hit by exogenous shocks, which may become the source of substantial change.

The emergence of food safety issues: the BSE crises

Officially, there have been 700 reported BSE cases in France since the introduction of the epidemio-monitoring network in 1990. Most of them have occurred in dairy farms in Western France.[43] However, there is a strong suspicion that there has been a noticeable underreporting of French BSE cases, which could be as high as 4700–9000 infected cows.[44] Interestingly, one now expects the same number (300–400) of BSE-related human deaths in Britain

[43] The BSE crisis can be considered to be a consequence of the CAP to the extent that the CAP has induced French (and European) farmers to shift resources away from unprotected soya (protein-rich) crops to highly protected cereals, beef and sheep. In order to get the amount of protein needed to improve productivity in dairy and meat production, European farmers have often fed their cattle with a by-product — the 'meat-and-bone meals' (MBMs) — of the abundant (since highly subsidised by the CAP) European beef production. MBMs are beef parts, offal and bones burnt in a process known at least since the 1880s. French MBM producers are linked to knackers enjoying regional monopolies granted by the French State. As soya cakes and MBMs are highly substitutable, MBM prices compete with soya prices. In order to reduce MBM costs after the 1970s oil shocks, European producers decreased the level of heat and solvent used in MBM production. It is generally agreed that these relaxed production conditions have made MBMs the agent of dissemination of the BSE because the BSE virus ('prion') is almost entirely concentrated in certain beef parts (brain, spinal cord and offal).

[44] Donnelly, C.A., 2000, 'Likely Size of the French BSE Epidemic', *Nature*, vol. 408 (14 December), pp. 787–88. There is evidence that French farmers were still unable in autumn 2000 to diagnose clear BSE cases, and there are doubts about the quality of sanitary detection procedures.

and France, though the numbers of officially reported cases are very different (177 850 cases in Britain — chart 27).[45]

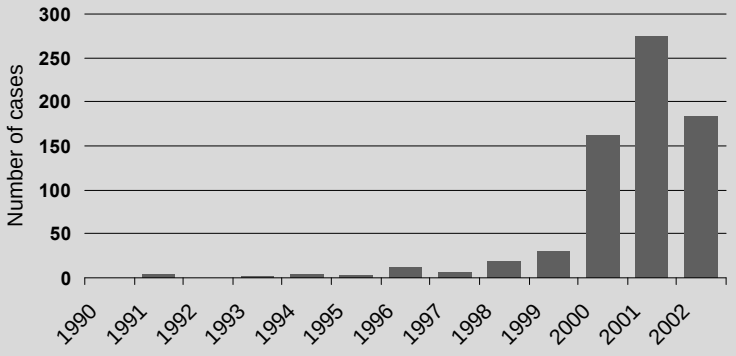
The first BSE crisis started in 1996, after the announcement in Britain that a new variant of the human Creutzfeld–Jacob disease could be related to consumption of BSE-infected beef products. France immediately imposed an embargo on imports of live cattle and beef from Britain. Despite this measure, French consumption of domestic beef declined by 5–7 per cent in 1996. However, the consumption level slowly increased again, regaining roughly the 1995 level in 1999.

The second French BSE crisis arose in November 2000, when veterinary services detected a suspicious cow in a slaughterhouse. Similar discoveries in several European countries allegedly without BSE cases amplified the French crisis, and triggered a true panic in France. Once again, beef consumption in France collapsed. But this time, French exports also collapsed, contributed to by prohibitions from importing countries, including from other EU15 member states. The price decline observed in 2001 amounted to 11 per cent on average, with more severe declines for certain types of meat, for instance, -22 per cent for bulls, -18 per cent for large bovines and dairy cows, and -4 per cent for suckler cows.

These successive BSE crises have increasingly shaken the European common beef market by triggering bans between the member states of the European Community since 1989. Intra-EC beef trade decreased by 15–17 per cent in 1996 and 2001. More importantly for the long run survival of the CAP, BSE crises have delivered a fatal blow to the long-standing 'love story' between French consumers and

[45] Pascal, G. 6 December 2001, Interview to *La Dépêche du Midi* (reported on INRA website, *Vache folle en ligne*, http://www.inra.fr).

27 BSE cases in France



Source: Ministry of Agriculture and Fisheries.

farmers. In December 2000, farmers blocking roads in Northern France were accused of being 'poisoners' on French radio — an accusation reminiscent of the pre-revolutionary 1780s.

BSE crises have also underlined the low accountability of successive French governments. A recent report from the French Senate on the BSE crisis has devastating pages describing how since the late 1980s all the French agriculture ministers have fought, delayed and limited all the necessary measures for protecting human health. (In a very revealing way, Prime Minister Lionel Jospin granted responsibility for the government's public relations during the autumn 2000 crisis exclusively to Agriculture Minister Jean Glavany, not to the Health Minister — despite the key issue being human health.)[46]

In fact, French governments have almost always taken the necessary anti-BSE measures several years after Britain did. For instance, Britain banned meat-and-bone meals for

[46] Sénat, 2001, *Farines: L'alimentation animale au coeur de la sécurité alimentaire*, Les Rapports du Sénat, no. 321, Paris: Sénat. See in particular pages 136–156.

animal consumption in July 1988. France did so in July 1990, but only for cattle. This was a disastrous limitation because it opened the door to cross-contamination through imperfect cleaning of the machines producing food for different species (such as beef and poultry), which were subjected to different standards, as well as allowing mere errors or straight fraud. Britain banned almost all BSE-sensitive beef parts (such as brains, spinal cords and offal) for human consumption in April 1990. It took six years for the French government to take the same decision (in July 1996) — and once again, some serious limitations (guts for sausages) persisted until 2000.

That being said, the sanitary regime currently enforced relies on three components:

- epidemio-monitoring based on a national network aiming to detect any living cattle showing suspicious neurological trouble (a provision existing since 1990);
- epidemio-monitoring focusing on 'risky' cattle, that is, cattle older than 24 months or those killed for health reasons (a provision introduced in 2000); and
- a systematic BSE tracking of cattle arriving at abattoirs (a provision introduced in January 2001).

The BSE crises are likely to have two long-lasting effects, which are still hard to fully assess. First, families of BSE-related victims have to go to court (with tiny chances of success) to sue the French State for appropriate compensation. Meanwhile, farmers with BSE-infected cattle have swiftly received subsidies for buying brand new herds — on average, €2000 per animal.[47] With such a shocking asymmetry, it will not take long for families in pain and for

[47] INRA, 29 August 2000, Un éleveur victime de l'ESB, *Vache folle en ligne* (INRA website, http://www.inra.fr). BSE-related subsidies are estimated to have been €1.1 billion per year in 1996–2000, roughly equal to the amount of sales lost in Britain and France.

the French population to note that BSE-related subsidies, presented as protecting consumers, are there more for farmers than for consumers. Moreover, fully compensating farmers is unlikely to make them more careful about health risks in the future than they have been in the past.[48]

Second, while slow to take the domestic anti-BSE measures required by human health, the French and other Continental EC governments were quick to impose bans on British products — for protectionist purposes as documented by the Senate Report.[49] The great paradox is that, while closing French markets to British beef (in 1996, Britain was the fourth-largest EC beef producer) undoubtedly improved the French farmers' situation, it is likely to have led to a deterioration in the health of French consumers. This is best illustrated by the 1996 ban (enforced until November 2002) on imports of British 'muscle-meat'. As BSE risks are much lower in muscle-meat than in other beef parts, eliminating better-monitored British muscle-meat from French and European markets could only increase health risks to French and European consumers. Similarly, trade bans on British BSE-sensitive beef parts have not protected Continental European consumers from the risks of domestic BSE-sensitive beef parts and of their derivatives.

A 'quality' approach and the segmentation of the beef market

Following the 1996 BSE crisis, everybody in the beef supply chain from farmers to retailers have taken initiatives

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[48] Hence, the rumours about farmers having been offered infected animals in order to get subsidies in the foot-and-mouth disease control program (*Le Point*, no. 1507, 3 August 2001, p. 37).

[49] Sénat, op. cited, for instance page 129 (delaying the introduction of a better German process for meat-and-bone meal production) and page 137 (on the decision to ban British meat-and-bone meals for 'competitiveness' reasons).

in order to regain consumers' confidence.[50] In 1997, they signed an 'inter-professional' agreement, according to which all the kinds of beef should receive a label with the following indicators: its origin (country of birth, country of breeding, country of slaughtering), its category (calf, steer, heifer, cow, bull) and its breed (dairy or meat cow). Again, this initiative does little to address the fundamental issues; as demonstrated by the BSE crises, the country of origin says little about the health risks posed by the product.

Retailers have also developed segmentation strategies by using the quality dimension. Three official (nation-wide) labels have been developed and implemented under monitoring by a third party. First, the '*certification de conformité produit*' testifies the stable existence of key specific features (for instance carcass quality, breed type and maturation). Three operators represent a large share of this market: McDonald's, Carrefour (the largest French supermarket firm) and Boeuf de Tradition Bouchère (a nationwide association of individual butchers). Second, the 'Agriculture Biologique' label certifies that the current production techniques used by farmers are respectful of environmental conditions (but they generally do not specify the initial environmental conditions of the land used, which may have been polluted by an intensive use of chemical products before being turned to bio-farming). Last, the 'Label Rouge' signals beef of higher than average quality (table 28).

[50] Interestingly, parts of the French private sector have reacted more rapidly and decisively to the BSE crisis than the government. For instance, the French association of producers of pet food, FEDIAF, recommended eliminating imported and domestic meat-and-bone meals from pet food production in 1989. See Sénat, op. cited, p. 140.

28 Commercialisation of beef under official quality labels in 2000

	Label Rouge	*Agriculture Biologique*	*Certificat de conformité produit*	*Total*
Tonne	25 600	4 000	146 200	175 800
Percentage of French beef consumption	2	0.3	11	13

Source: Cerqua, Cepral and Interbev.

The future of these various labels (and their corresponding market segments) is hard to ascertain. Certain operators expect that such labels may grow to represent up to 30 per cent of domestic consumption. But the many ambiguities on which the labels are built (assessing quality by the country of origin; disregarding the initial situation of the land) are dangerous weaknesses.

Animal welfare and environmental protection

European regulation on animal welfare has been mostly adopted for the poultry sector. In the beef sector, there are minimal rules for transporting live animals and for breeding conditions (for instance, breeding calves in individual cages will be prohibited in the future).

France has been much slower to act on environmental issues than Anglo-Saxon countries (from the United States to Germany and the Nordic countries). This is illustrated by the fact that an Environment Ministry was created only ten years ago. Nowadays, some environmental issues are politically important, such as intensive breeding of pigs and poultry in Western France and intensive growing of cereals in the Parisian Basin. In all these regions, water pollution by nitrates and pesticides caused by the sewage of animal

faeces and the massive use of fertilisers and phytosanitary products has reached worrisome levels.

Since Agenda 2000, the EU has promoted the concept of 'sustainable agriculture' aiming at reconciling economic, social and environmental aspects of farming. It has introduced the concept of 'eco-conditionality', which requires every member state to define appropriate environmental constraints. It opens the possibility for member states to subordinate part of direct aid to the fulfillment of these constraints. Moreover, the policy of rural development (the 'second pillar' of the CAP) includes 'agri-environmental' provisions.

Concerning the beef sector in particular, three types of measures have been adopted:

- the '*programme de maîtrise des pollutions d'origine agricole*', which is co-financed by the EU15 and France, and aims at facilitating the implementation of norms for buildings devoted to breeding and for the treatment of effluent;
- the '*prime au maintien des systèmes d'élevage extensif*', which is financed by the French authorities, and aims at subsidising existing grazing farms; and
- subsidies for facilitating extensive farming and decreasing the number of cattle per hectare.

Conclusion

French farmers have benefited greatly — and continue to benefit — from massive support from the CAP. But Europe's increasingly strong rejection of the current magnitude of financial support for farmers, and of the internal and external modalities of this support, is increasingly isolating France in the EU15. This evolution is amplified by the fact that the weight of farmers in European society has diminished enormously with their

rapid decline in numbers. Furthermore, the traditionally deep relations between farmers and the French government are becoming tenuous.

In the case of beef, two forces are dominant. On the one hand, the FNSEA and the FNB have been forced to shift their line of defence from narrow farm issues to broader social issues, such as the role of farmers in the '*aménagement du territoire*' and in the economic survival of certain French regions. A majority of French cattle farmers appear to be close to renouncing exporting to world markets in exchange for the full protection of European markets against foreign imports.

On the other hand, this slow retreat does not capture the whole story. During the last decade, the beef processing and retail sectors have undergone deep restructuring, and they are sharing increasingly common economic and financial interests. By progressively implementing contractual production processes with cattle farmers, they are slowly reducing the traditional supply approach of the sector. By increasingly imposing quality standards for every segment of the beef market, they are *de facto* preparing an opening of the markets — an objective that they do not oppose, but that they do not support openly for fear of reprisals exerted with impunity against their assets and persons.

3 GERMANY: NEED FOR GREATER AWARENESS OF POLICY COSTS

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Germany has had a long tradition of agricultural protection. Grain customs were introduced by Bismark as early as 1880 and protection culminated during World War II and the post-war period. German and European Union (EU) agricultural policy continues to be very protective, which results in serious welfare losses. In this paper, the evolution towards the present objectives of German agricultural policy is explained, with particular emphasis on beef.

German agricultural policy can be divided into three distinct periods (see box 29). The first period covers the post-war period and ends only before the MacSharry Reform of 1992. The second period covers the MacSharry Reform, when the EU introduced direct payments for farmers, and the Uruguay Round and other developments until 1998. The third period encompasses the change in German government in 1998 and more recent policy developments, including institutional changes on the political level in Germany.

For the first period (that is, the post-war period), society's attitude towards agriculture and farmers is described, and

29 Key events affecting the political economy of beef

Period 1:	**Post-war years and food security**
1950s	Self-sufficiency concerns
1955	Agricultural law
1957	Treaty of Rome
1984	Implementation of milk quotas
1986	Uruguay Round commences
1988	Additional supply restrictions
Period 2:	**From price support to direct payments**
1992	MacSharry Reform
1994	Uruguay Round concludes
1995–2000	Implementation of Uruguay Round Agreements
Period 3:	**Change of government and swing to organics**
1998	Coalition of SPD and Green Party
1999	Berlin Summit on CAP reform
2000	BSE crisis
2000–03	Price cuts for milk etc.
2002	Decisions on EU budget for agriculture until 2013
2002	Agricultural Policy Decisions for the enlarged EU

SPD: Social Democratic Party.
BSE: Bovine spongiform encephalopathy.

some information on the structure of production and protection with particular attention to the milk–beef sector is given.

During the second period, a long-overdue change in policy arose as a reaction to the obvious negative consequences of the old policy. During this period, societal preferences shifted from 'secure food supplies' to 'food safety', 'better' (organic) food and to less resource-depleting agricultural production processes.

In the third period of agricultural policy, which continues to today, the bovine spongiform encephalopathy (BSE or 'mad cow disease') crisis spurred the public debate about

food safety and sustainability of production processes, while traditional incentives for agricultural production remain basically unchanged. However, there have been several internal German institutional reforms. Also, political support for organic farming has intensified and has been supplemented by stronger rules on animal welfare.

In two concluding chapters, new developments in the Common Agricultural Policy (CAP) are analysed and options to bring about agricultural policy change are discussed.

Period one: agricultural policy in the post-war period

German agricultural policy in the post-war period was heavily influenced by the legacy of Germany's war-time objective to have secure domestic food supplies and the emotional legacy of widespread hunger during the war and the post-war period. Political support for agriculture was strong: producer price support — the dominant agricultural policy — was an undisputed political objective. Securing the incomes of (family) farms later became another political objective. These farms were under pressure from growth in the non-agricultural sector, limited agricultural productivity increases and stagnant producer prices in saturated EU markets. Political support was manifested in the agricultural law of 1955 and later in the Treaty of Rome (article 39), which is now article 33 of the European Community (EC) treaty.

Electoral support for protectionist agricultural policy — despite the policy's high economic costs — can be explained by two main factors:

- voters' attitudes to farmers were traditionally supportive because a significant proportion of voters had ancestors or relatives in the farm sector; and

- voters had insufficient information about the costs of the policy and about food prices in other (non-EC) countries.

The information policies of federal and state farm ministries, farmers' unions, farm-related industries and cooperative-farm trade organisations contributed to the lack of public information. Consumer organisations were weak in the political arena, rarely offering clear-cut policy alternatives.

The German farm model

For decades, the model of German agricultural policy was the family farm, on which working capacity was limited to the family and hired labour was the exception. This type of farm dominated across Germany, but farms decreased in size, on average, from north to south. Generally, strong production incentives, scarce land and increased opportunity costs for labour led small farms to invest increasingly in livestock production. Farmers invested particularly in labour-intensive milk–beef production and raised double-purpose breeds to ensure their agricultural income. The increased investment in the milk–beef sector and the sectors' significant share of Germany's total agricultural revenue (37 per cent in 1999–2000) drew the bias of both German and EU political support.[51] Producer support for beef and veal was exceptionally high in 2001 in the aftermath of the (BSE) crisis (table 30), due mainly to the sharp decrease in beef consumption and high cost of export subsidies.

In general, the massive support for agricultural production generated a highly intensive farming system with respect to

[51] Beef and veal production was 10 per cent of Germany's total agricultural revenue in 1999–2000.

30 Producer support estimates (PSE) in the European Union percentage PSE

	1986–88	*1999–01*	*1999*	*2000*	*2001*[a]
Wheat	52	48	55	46	44
Maize	52	40	43	41	37
Oilseeds	59	39	35	42	40
Sugar	60	52	60	50	46
Milk	57	44	51	43	40
Beef and veal	59	84	83	78	91
Sheepmeat	70	61	58	53	72
Pigmeat	7	25	37	19	20
Poultry	14	43	31	53	46
Eggs	14	11	17	6	8
All commodities	42	36	39	34	35

[a] provisional.

Source: OECD 2001, *Agricultural Policies in OECD Countries, Monitoring and Evaluation*, Paris, pp. 189–190.

labour, capital and yield-enhancing inputs. This had three increasingly harsh consequences:

- escalating trade conflicts due to the disposal of agricultural surpluses on world markets;
- high budget outlays due to huge stockpiles of grain, butter, milk powder and even beef; and
- greater negative environmental externalities.

Early selective reforms in the 1980s

The causes of the above problems were the strong production incentives in the agricultural sector and their resulting high economic costs, especially high food prices. However, the public debate, because of extensive reports in the media, merely focused on the obvious symptoms of the problem, such as the butter 'hills', wine and milk 'lakes', and the destruction of fresh fruit and vegetables. Policy makers reacted accordingly, tackling the main issues of income support for farmers and limitation of budget costs

and trade conflicts in a 'politically convenient' way: by bureaucratic supply controls. In 1984, the EU introduced the German-initiated milk-quota regime and later the set-aside regulation of basic field crops.

This approach, despite being largely ineffective, was accepted by the public because the contentious public issues — which in fact were only symptoms of the problem — had seemingly been solved. Furthermore, farmers' unions were supportive because looming price cuts had, to a great extent, been avoided. Moreover, several cow slaughtering (buy-out) programs to reduce cattle stocks and expected quota rents for the future appeased milk producers. Debate among academic economists about the economic costs of this policy and its adverse distributional consequences never gained momentum in the public political debate, but petered out on the administrative level.

Farmers' reactions to selective supply controls

Farmer's economic reactions to the selected supply controls were foreseeable: because overall agricultural production incentives had not been reduced, farmers shifted resources to production of commodities without supply controls.

This reaction was particularly prevalent in the traditionally closely inter-linked milk–beef sector. As milk production was restricted, beef production expanded. The number of single-purpose cattle breeds and suckler cows expanded from negligible numbers in the 1970s to 13.4 per cent of the total 5.3 million cows by 2001. Over time, a sharp shift in the producer support estimate (PSE) from milk to beef was observed. Allocational distortions might be even greater because — using the PSE as an indicator — the allocational effect for milk could be overestimated due to quota restrictions. However, because calves of milk cows are also an 'input' in beef production, high beef protection

will be partly shifted to milk producers via increased prices for feed calves. This effect cannot be deducted from the relative PSE, but will act to reduce the effective protection of beef.

Compared to beef and milk, other products — such as pork, poultry, eggs and crops (except sugar beet) — received less protection (table 30). This was both the cause and the consequence of more competitively scaled farm operations with higher animal stocks per farm in these sectors.

Explanations for agricultural support

The lopsided political support of agriculture originated in an unwritten agreement of political parties to leave agricultural policy to individuals with vested interests in agriculture. Agricultural policy was left to 'experts' who were themselves farmers or had closely related rural occupations. Such experts stood as candidates in the rural election districts: once elected, they dominated parliamentary decision-making bodies at regional, national and EU levels.

There are a large number of political-economy arguments and models to explain such behaviour of politicians and parties, which, via protection and subsidisation, generally reduces overall economic welfare. As Soltwedel[52] notes, there is, however, an important asymmetry between costs and benefits. Typically, benefits are less dispersed, accrue quicker and are subject to less uncertainty than the costs. Hence, the benefits are more visible than the costs. And the benefits generally accrue to groups that are better organised and politically more influential than the groups that bear the costs.

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[52] Soltwedel, R. 1997, *Competition, Responsibility and Solidarity — The Social Market Economy Ensuring Success in the Global Economy*. Gütersloh, pp. 73–81.

Agricultural policy may not be the decisive factor in the electoral choices of most voters: it may even be rational for most voters to be ignorant about parties' agricultural policy agendas. However, for farmers and members of closely linked professions, parties' agricultural policy agendas may be the main, or even only, determinant of their electoral decision.

It may thus be rational for parties to promise and pursue policies that are in the interest of farmers even if they hurt a rationally ignorant majority of voters. And, at least in Germany's electoral system, it may even be rational for parties to nominate farmers or functionaries of farmers' unions as local candidates in rural election districts. This makes a party's commitment to a farmer-friendly policy more credible and helps to gain farmers' votes.

While this simple argument seems to be of considerable practical relevance, a number of additional factors have to be considered in explaining German agricultural policy. These factors include the long-term ideological orientation of Germany's political parties and their traditional voters, and the role of the bureaucracy in an — at least partially — highly technical policy field.

Although the conservative Christian Democratic Union (CDU) has always been more in line with the demands of farmers' unions than has the Social Democratic Party (SPD), the difference between the parties' agricultural policies was rather small until the time of the Uruguay Round. During the period of government by the coalition of Free Democrats (FDP) and SPD (1969–82) — with an FDP agriculture minister — the main government objective was to avoid trouble with the farmers' union. After the MacSharry Reform, the German agricultural policy landscape became more differentiated. Ecological ideas gained momentum and the Green Party was founded.

Another important influence on the political decision-making process is the agricultural bureaucracy. Because of Germany's long bureaucratic–regulative tradition and three-tiered federal system, the bureaucracy has an enormous informational advantage over politicians and the public. Bureaucrats might have a vested interest to support decisions in favour of agriculture, because bureaucrats naturally have close relationships to the objects of their administration. Also, a not insignificant proportion of agricultural bureaucrats are descendants of farmers and land owners.

Period two (1992–1998): switch from pure price support to direct payments and environmental programs

Supply restrictions — milk quotas and the instruments of the EC summit decisions of 1988 such as the voluntary set-aside program and the stabilisation regulation — merely addressed the symptoms of the agricultural problems. Trade surpluses continued to grow and caused increasing disagreements in the preparatory meetings of the Uruguay Round. Budget problems continued to grow, and the environmental impacts of the highly intensive farming system continued to worsen. These developments, and a strengthening environmental movement that culminated in the foundation of the Green Party in Germany, were the background for the MacSharry Reform of 1992.

The political reaction to the above-mentioned problems was multifaceted and differentiated with respect to the range of instruments available to the various federal decision-making levels in the EU. However, the most sensible policy solution, that is, the reduction of production incentives, was not included. Rather, farmers were compensated for losses due to the compulsory set-aside

program and the partial reduction of price incentives for some basic crops and for beef, by payments per hectare and per head of cattle respectively. However, production incentives were hardly reduced, because these payments were not decoupled from production and potential income losses were often overcompensated. In addition, farmers were allowed to grow renewable resources, such as rapeseed for car fuel, on set-aside areas without losing their eligibility for per-hectare payments.

German support for policy switch

Germany supported the EU's fundamental policy switch from price support to direct payments, although Germany's budgetary net payment position worsened further. This again demonstrates the continuation through the 1990s of the conservative/liberal government's emphasis on the objective of 'farm income support' relative to the budget objective. Because the direct payments quickly amounted to large sums per farm and per worker on large farms, the political rationale for these payments was adapted to new objectives: environmental protection and the conservation of the 'cultural landscape'. According to the new rationale, payments should be understood as compensation for new restrictions on input use (fertiliser, pesticides, herbicides) on the one hand, and as a payment for supposed positive externalities of farming on the other hand.

Besides general direct payments, a variety of environmental programs was initiated, mostly under EU rules, but outlined at the regional (Laender) level and co-financed by the national government and the EU.[53] Despite the diversity of programs, there were two common objectives: the protection of specific habitats; and the less intensive use of

[53] If a program is not in line with EU regulations, it has to be financed exclusively on the regional level.

land. The latter involved financial support for organic farming and the limitation of the number of cattle fed per hectare of grassland.

Despite switch, price support remains

Although the farm support that had been justified by ecological reasoning included serious restrictions on production, the new policy mix's aggregate effect on production remained ambiguous. Price incentives were only slightly reduced: measures that limited the withdrawal of agriculture from marginal areas remained in place. This is of particular relevance to beef production on grassland areas in the middle hills and in the foothills of the Alps. German unification gave greater political weight to larger farms, which dominate in the eastern regions, and led to a challenge to the lopsided support of small farms by means of regressive payments per head (in the beef sector) or per hectare (in the crop sector). However, environmental programs still tended to favour smaller farms.

Reforms in this period again revealed the implicit political weight given to the various social and economic objectives, with income support for the farm sector still ranked first. In Germany, not surprisingly, the conservative/liberal government was responsive to the farmers' union, which protested against price cuts. The union considered the budgetary (direct) payments to be risky, at least in the medium to long term, since payments could easily be reduced in times of budgetary strain. To overcome farmers' opposition, compensation was rather generous. In the public debate, direct payments were justified not only as compensation for price cuts, but increasingly — with strong support from farmers' unions — as payments for the conservation of the landscape: that is, for positive externalities of farming. This argument developed in application to mountainous areas where 'marginal agriculture'

may indeed generate positive externalities (for tourism) by preserving certain landscapes and land-use structures. However, the argument was simply generalised and extended to all farming areas in spite of conflicting interests between farming and ecological objectives. The political solution was to initiate a wide variety of environmental programs at regional (Laender) level. However, regions have an incentive to oversupply environmental programs because they do not bear the full costs of their implementation.

Unsuccessful policies

The whole reform package was inefficient: the stated objectives could have been achieved at much lower cost. A reduction of all production incentives would have drastically reduced the opportunity cost of land for environmental purposes, in many cases to zero. Even the farm income objective has not been met: price support and direct payments are being transferred as economic rents to the owners of land and quotas who are, to an increasing extent, not farmers.

In spite of additional measures to curb production, such as the set-aside program and several programs with payments for more extensive land uses, the policy was unsuccessful. On the one hand, resources were shifted to products without production restrictions, especially beef. On the other hand, production intensity was not reduced as expected because of price cuts. Because payments were not decoupled from production, there was no incentive to reduce productive capacity. Despite this effect being well known, it seems to have been a misconception even among economists and during the negotiations of the Uruguay Round, when EU trade partners accepted the inclusion of direct payments into the 'blue box' category.

Period three: a change in government and the Berlin Summit

Following the 1998 general election, a coalition of the SPD and the Green Party formed Germany's federal government. Although agricultural policy certainly had not been a decisive factor in the election's outcome, the incoming government set new priorities in this political field. The SPD pointed to the unacceptable distributional consequences of the CAP among EU member countries, while the Green Party placed environmental objectives high on the agenda. The most important environmental objectives were to increase the national park area, establish a network of habitats covering 15 per cent of the land area, promote a shift in farming towards 'sustainability' and improve animal welfare.

New accents in SPD agricultural policies

The SPD tackled the problem of high farm subsidies only indirectly, by complaining about Germany's high share of the EU budget. However, for the first time, it became clear that the government was prepared to rethink the CAP in general and thereby risk a confrontation with the farmers' union at home. This marked a clear change from the quasi-'cartel', 'no trouble with farmers' approach followed by the earlier SPD government. At least three conditions encouraged this policy shift:

- The government needed to address the growing budget problem. This budget problem had several causes. First, the newly invented 'Maastricht Criteria' in the EU limited the new-debt-quota in national budgets to 3 per cent. Second, the planned EU enlargement posed a major risk of sharp increases in EU and national budgets, especially for agriculture. Third, Germany urgently needed tax reform, including cutting taxes without endangering the objective of budget consolidation.

- The SPD perceived that farmers did not have a strong voting preference for their party.
- The government wanted to gain freedom to cut deals in the forthcoming international trade negotiations.

Green Party agricultural policies

The Green Party, in contrast to the SPD, had well-developed ideas about agricultural policy reform before the 1998 elections. The basic idea was to promote sustainable agriculture, that is, low input farming systems with respect to mineral fertilisers and all kinds of pesticides, herbicides and fungicides. The Green Party's paradigm became organic farming, which had been practised by an increasing number of mostly small farms for at least a decade. Economically, organic farming involves substitution of capital and yield-enhancing inputs with labour.

The higher production costs of organic farming compared to conventional farming were — in the early years — covered by higher prices earned on local markets, often in direct on-farm selling to consumers. Also, the MacSharry Reform subsidies were distributed to organic farms because of their supposed positive environmental effects.

Politically, organic farming was, at first, an attempt to keep alive small farms that would otherwise have closed down. The rationale of organic farming was to avoid the negative externalities of conventional farming. Large, conventional farms and especially large livestock producers soon began to acquire a poor public image. These farms were often short of land and therefore had difficulty disposing of natural manure without violating environmental laws. Large livestock producers were also criticised for poor animal husbandry conditions, characterised by the catchword 'Massentierhaltung', such as laying batteries for hens or 'split grounds' for pigs and cattle. Moreover, several

criminal feeding practices — adding prohibited hormones and/or antibiotics to feed — were discovered.

The alternative offered by organic farming was to grow and keep animals in a 'natural' environment. The alternative farming model also advocated that local and regional marketing should be fostered to avoid negative externalities of transport; genetically modified organisms should be banned; and subsidies to conventional farming should be greatly reduced and — at least partly — redirected to organic farming because of the latter's positive environmental externalities.

These alternative farming ideas met, to a great extent, the changing preferences of 'spin doctors' — influential, often rich professionals, especially journalists in radio, television and print media. These people pursued romantic ideals of a revival of traditional farming that would produce healthy and safe food from happy animals and thereby would assuage their guilty consciences about consuming meat at all. In any case, the shift in the community's perception of food production, animal welfare and environmental effects of agricultural production should not be viewed as temporary. Higher prices were often welcomed as an alleged warranty of safe and healthy food. Support for these ideas was much stronger in the public political debate than in real markets: revealed preferences indicated that organic farming's market share was only about 3 per cent. Nonetheless, the strength of the public debate might have strengthened the poll for the Green Party.

The formation of organic-farming unions

As organic farming expanded during the 1990s, unions for organic farming were established and competed with the previously monolithic farmers' union. Organic farming unions seem to be more recognised in the north of

Germany, where the divergence in objectives between the dominant larger and more efficient farms and the smaller organic farms is more pronounced. In the south, where farms are smaller on average, the divergence is less pronounced, and different political parties and agricultural interest groups have overlapping objectives of landscape conservation and environmental protection.

The Berlin Summit decisions on agriculture

Decisions with implications for agriculture made at the 1999 Berlin Summit by the heads of EU governments include:[54]

- the EU budget to 2006;
- market and prices policies; and
- rural development policies.

These decisions were more restrictive toward agriculture than previous EU agricultural budgets had been. The decisions would potentially have restricted agriculture in the event of EU enlargement, because the decisions excluded new member countries from receiving direct payments. This exclusion was at the centre of continuing massive conflicts between EU governments and between potential new members and the EU.

The market and prices policy continued the shift from price support to direct payments. The milk sector was included in the policy: price cuts began in the financial year 2000-01 and compensation payments will commence only in 2005. For the beef sector, the policy continued the shift from price support to premiums per head of cattle in a rather complicated system.

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[54] For details see Schrader, J.V. 2000, 'CAP Reform, the Berlin Summit and EU Enlargement', *Intereconomics*, vol. 35, no. 5, pp. 231–242.

The new 'rural development policy' is a combination of the earlier structural policy and new environmental policies. It encompasses a range of interventions, from investment subsidies for farming or forestry to subsidies for organic farming. There are few instruments for strictly 'rural' development. The rural policy has been allocated extra funds: there seems to be broad agreement on this policy among EU member states and among Germany's regions, regardless of their governments' varying ideological persuasions.

One reason for this broad support is the 'mixed financing' arrangements for regions and countries. Under these arrangements, regions have some freedom to pursue specific policy objectives without being charged full implementation costs. This means that individual regions can pursue locally important objectives — such as the preservation of certain habitats or the general extensification of farming — alongside the broadly agreed objective of preserving the 'cultural landscape'. For example, Germany's southern regions, which have conservative governments and smaller farms, are able to continue their traditional structural policies alongside new environmental measures. Regions where the Green Party has more influence might stress environmental programs.

However, the vast majority of these measures are inefficient with respect to stated objectives and/or are inconsistent with other policies. Moreover, the mixed finance system is inefficient. It induces moral hazard at the lower administrative level where the measures are planned and executed, because finance is derived partly from the higher levels of government. This would only be efficient if federal funds corresponded to the size of interregional externalities.

From an economic point of view, it is important to differentiate between the EU's internal inefficiencies and distortions between the EU and third countries. Internal

inefficiencies do not always distort the international allocation — they may even improve it. For example, some environmental measures reduce production and thereby compensate for any increased production caused by price protection. Rural policies also created internal inefficiencies; however, they added to distortions caused by price protection by keeping marginal agricultural land and labour in production.

At the Berlin Summit, the EU's financial framework to 2006 emerged as a key area of dispute. For the first time, the German government came into conflict with France over basic agricultural policy decisions. Being a 'net payer' in the EU agricultural system, Germany tried to reduce its financial burden by suggesting that national governments should bear part of the cost of the direct payments. Germany's negotiation position was unsuccessful, despite support from other northern member countries that traditionally took a more liberal approach to the CAP. The only change was the introduction of a 'modulation' rule: national governments would be allowed to cut direct payments by up to 20 per cent and allocate the funds to other objectives, on the condition that they contribute an equal sum from their national budgets. This would increase the total payments and could even distort internal competition within the EU. However, the German position showed a clear shift from earlier years, consistent with the judgement on the new government discussed previously.

Political impact of the BSE crisis

An enduring media campaign held the large, conventionally reared livestock herds responsible for the BSE crisis. However, the crisis merely revealed the failure of national safety laws and other checks on food and feed. In short, the crisis neither proved that BSE was the consequence of large

livestock herds nor that large herds are the consequence of farm subsidies.

The effect of the BSE crisis on beef markets was substantial, although consumption has now recovered. The political reaction was straightforward: the government removed the farm minister — an SPD representative of conventional farming — and recruited a new minister from the Green Party. The government also enlarged the responsibilities of the (now) Ministry for Consumer Protection, Nutrition and Agriculture.

The new minister, a jurisprudent by profession with a very visible media presence, seized the opportunity to announce basic changes in agricultural policy (Agrarwende). The minister announced that local production, including of feed, should be preferred; 20 per cent of farm products were to be organically produced; the government would introduce and financially support a new label for organic products; and animal welfare was to be a major political objective. Besides political programs and the integration of consumer protection into the Ministry, there was a mass retirement of the top office-bearers in the Ministry. Moreover, the scientific advisory committee, consisting of the leading German agricultural economists, was dismissed after a quarrel with the new leadership of the Ministry.

Although the retirements from the top positions of the Ministry offered the chance to unravel the close relations between farmers' unions and the Ministry and to inject more independence into the agricultural bureaucracy, posts were merely transferred to representatives of the other farm interest group, organic farming. At the same time, research institutions that were financed by the Ministry were advised to redirect their focus toward organic farming. According to political surveys, this historic realignment of agricultural policies was greatly welcomed by a large majority of voters.

Under the rural development programs, more financial support was given to organic farming, and several regulations on animal welfare and husbandry were enforced or are underway. However, due to long-term financial frameworks and the strong influence of the CAP, the real economic (allocational) changes were rather limited.

Challenge to organic farming

The euphoria over organic farming was recently dampened when a prohibited chemical, Nitrofen, was found in organic food. This demonstrated that safety rules and controls have been insufficient for organic as well as for conventional food. At least temporarily, the strong belief of many consumers in the superiority of organic food was shattered. The Nitrofen episode also showed that the strong expansion of organic food production and consumption during the last one to two years has lead to larger production units and reduced the differences in marketing channels and means between production methods.

Consumers have strong preferences for 'natural' food and environmentally friendly production methods, but not for 'organic' food production per se. Therefore, the government's intervention in favour of the organic production method seems inefficient insofar as:

- final food products cannot be scientifically differentiated;
- many self-defined restrictions of organic production cannot be based on scientific standards; and
- given environmental outcomes and standards could be achieved at lower cost.

The establishment of standards for production and processing methods and international trade

The ecological 'Agrarwende' in Germany intensified the debate about animal welfare and the search for instruments that can improve animal husbandry standards without endangering local production through increased costs. A case in point is a new national regulation on battery hens,[55] which is more restrictive than similar regulations in other EU member countries. Egg production might shift to other member countries or to new EU member countries where standards are lower. Similar problems are likely to arise in poultry, pig, beef and milk production. Regulations are not limited to intra-EU trade — they can involve WTO rules. Therefore, the political and scientific debate centres on potential animal-welfare regulations that compensate local producers without coming into conflict with WTO rules. The EU has already called for an explicit debate about these regulations in the ongoing trade negotiations[56] and suggested three possible solutions:

- multilateral agreements;
- labelling; and
- some form of compensation.

Because multilateral agreements would be likely to be below EU standards, it has been suggested to treat compensation payments in a similar way to environmental payments, which are allowed in the 'green box'.[57] Discrimination will be in conflict with the WTO's 'like-product principle' so long as interventions treat local public good problems;

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[55] The minimum space per hen in cages will be continuously increased from 450 cm^2 in 2002 to 750 cm^2 in 2012

[56] WTO 2000, 'European Unions' Proposal on Animal Welfare and Trade in Agriculture', *WTO Document G/AG/NG/W/19*, 28 June.

[57] Isermeyer, F. 2001, *Die Agrarwende — was kann die Politik tun? Arbeitsbericht* 2/2001 des Instituts für Betriebswirtschaft. FAL Braunschweig.

therefore, it has been suggested to handle animal welfare as a global public good.[58]

Two main mechanisms to compensate local producers are available: additional import duties on products that fall below the increased standards; or direct compensation payments for local producers. The consequences differ: additional duties could be an efficient solution and give higher prices to exporters to the EU who meet the standards. However, the neglect of the 'like-product principle' will not conform with WTO rules, and animal welfare is not an accepted global public good. In any case, the height of the duty would be disputed, and there would be high transaction costs involved in setting the various process standards.

The alternative would be to directly compensate local producers for bearing higher production costs. But this alternative would disadvantage exporters to the EU who meet the standards. These exporters would not receive compensation and prices in the importing country would be lower. Even though this option is economically inferior, there is a higher chance that this kind of regulation would be implemented, because it would not be in conflict with basic WTO rules. The outcome would be a matter for international negotiation, which would take into account the EU farm subsidies implemented in the name of rural development policy. This issue has important implications for beef exporters like Australia. Australia and other countries that practice year-round outdoor cattle grazing can easily outperform even the German standards for organic farming, which are mainly related to conditions in cattle stables.

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[58] For a more thorough discussion of the problem, see Grethe, H. 2001, *Potentielle Auswirkungen der ökologischen Agrarwende in der EU auf die Entwicklungsländer*, Deutsches Institut für Entwicklungspolitik, Bonn.

The benefit of a general increase in animal welfare standards is at least debatable for three reasons. First, specialists are far from having consensus on what improves the wellbeing of animals. Second, people's preferences differ widely with respect to the ranking of various animal welfare objectives if minimum standards are met. Third, technical research now shows that the new high standards of animal keeping (such as using straw and open stables) can greatly conflict with new and more restrictive EU and especially German environmental standards. For example, open-air husbandry could pollute ground water and the use of straw can lead to higher emissions of ammonia (NH_3).

A third possible alternative to implementing rules on animal welfare within the WTO is labelling. Labelling is not part of the WTO Technical Barriers to Trade Agreement. However, the EU already accepts 'eco-labels' from non-EU member countries. If countries legislate for organic farming and their production and control standards are similar to EU standards, they can be put on a 'Third Country List'. Australia is one of six countries on that list.

New developments: changes ahead in EU and German agricultural policies?

Although the mid-term review of the CAP was published in July 2002 final decisions on changes to the CAP will be taken only later in the course of 2003. The reason for the delay was the strong intervention of the German chancellor. The chancellor insisted that the financial framework of the Berlin Summit should remain in place after EU enlargement and direct payments for new members, which are not included in the framework, should be financed by the reduction of direct payments in the existing member countries. This position is in line with the SPD's slightly changed attitude towards agriculture after the elections of

1998. It remained the government position of the renewed coalition of the SPD and the Greens after the German national elections in September 2002.

The delay of the decisions on the CAP again reveals the basic CAP-related distributional conflict between France and Germany. France, in line with the Mediterranean EU members, opposed any cut in direct payments. After the French elections, which brought a conservative government into office, the French position was even more pronounced.

However, at the conference of the heads of the EU governments in Brussels on 25 October 2002, agreement was achieved on the basic financial framework for the CAP until 2013. According to this compromise, the total budget will be stabilised at the 2006 level decided upon at the Berlin Summit in 1999, plus a yearly increase of 1 per cent between 2007 and 2013. Direct payments for new member countries are to start in 2004 at 25 per cent of the level of existing member countries and should increase to the full level by 2013. This decision implies that the level of payments in existing member countries has to be reduced to meet the total budget limit. However, the budget is at present not restrictive because the effective spending for 2003 is expected to be €2.7 billion below the limit. However, at the Copenhagen summit on enlargement (16 December) old and new member countries agreed to slightly change the rules for direct payments. By reallocating financial sources from rural development policies (2nd column of the CAP) new member countries could start direct payments already in the year of entry to the EU (2004), at a level of 55 per cent and could reach the level of payments in old member countries already in 2010.

Possible changes to the CAP at the EU level

At the heart of proposals for change arising from the mid-term review of the CAP is the decoupling and simplification of direct payments. Moreover, payments are to be conditioned on aggravated standards for environmental protection and animal welfare (cross compliance). One reason for this change is that these kind of direct payments are expected to be accepted in the Doha Round as 'green box' measures. In this context, per-head cattle premiums could be converted to a simple payment per hectare of grassland and finally per farm. Compensation payments for milk production, which were originally to be tied to the reference milk quantity, could also take the form of a payment per hectare of grassland on commencement in 2005–06. This kind of change would generate a shift toward extensive land uses in general, and from highly intensive milk production to more extensive beef production in particular. However, the overall result is difficult to predict because many details — in particular the value of per-hectare payments and future relative prices — are as yet unknown.

A second proposal is 'compulsory modulation', whereby every year, 3 per cent of direct payments — to an upper limit of 20 per cent — would be transferred to rural development. This change would be combined with an upper limit on payments of €300 000 per farm and with an exemption of €5000 for each of the first two full time workers.

A third and even more radical proposal, which is not included in the mid-term review however, would be to decouple direct payments completely and gradually reduce them over time. This would undoubtedly restrict production and factor use in agriculture.

Final policy decisions on proposals of the EU Commission based on the 'mid-term review' will be taken only later in the course of 2003.

The first (decoupling) and second (modulation) proposals are likely to be supported by all political parties in Germany, with the qualification that the CDU/CSU will probably plead for higher payments than the SPD. The third proposal is likely to be in line with SPD ideology, but could encounter resistance from the conservative parties, which are worried about losing rural votes. However, this kind of radical proposal is unlikely to be adopted because of resistance within the Council of Ministers (especially from France and southern member countries). To complete the impression of the divergence of views in the political arena, it should be noted that the European Parliament pleaded — as recently as June 2002 — for an increase in the agricultural budget to enable farms all over the Community to survive.[59]

Bringing about change in agricultural policy

In Germany, public opinion has undergone a strong and lasting shift towards support for agricultural production methods that are less damaging to the environment, take account of animal welfare, and produce safe, high quality food. Attitudes towards the farm sector remain positive and the community displays a pronounced willingness to accept budgetary payments to agriculture[60] and higher-than-

[59] Agra-Europe 2002, *Agrarpolitischer Pressedienst*, vol. 43, no 26, Laenderberichte, Bonn.

[60] This view is supported by regular opinion surveys (Eurobarometer) on behalf of the EU Commission (GD VI). It shows that Germans are prepared to contribute an even higher share of the budget to agriculture than they do currently (*Eurobarometer Flash Survey 85*, 'The Public's Attitudes Towards the CAP'. Produced for the GD VI, September–October 2000. Gallup Europe).

necessary food prices. However, at the same time, the demand for environmentally protected areas is steadily increasing. It is obviously difficult to communicate to citizens that supporting farming increases the costs of environmental land use and that a reduction in agricultural support would not reduce food quality but rather would reduce consumer prices and taxes.

Farmer attitudes

Farmers, not surprisingly, oppose a general liberalisation of markets and a reduction of agricultural support. However, farmers and their representatives are no longer a monolithic bloc. The farm sector is in flux: the number of farms is falling, farm size is steadily increasing, and traditional family farms are increasingly combining to build larger units in the form of legal corporations. Three groups of farms can be differentiated:

- large, highly efficient farms, often legal corporations with an increasing share of rented land;
- smaller family farms practising conventional farming on mainly their own land; and
- family farms engaged in ecological farming, many of which are now of considerable size.

The first group is increasingly likely to accept a reduction in support, if possible, as a trade-off for less environmental regulation. They understand that farm support increasingly benefits fixed factors of production — in particular, land as opposed to farm managers.

The second group is likely to fight liberalisation and ask for more support. This group is concentrated in topological

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However, the stated opinion that people are prepared to pay higher prices for organic food is only partly confirmed by higher sales. Between 2000 and 2001, the share of agricultural area allocated to organic food increased from 3.2 to 3.7 per cent.

and climatically more disadvantaged areas in the middle and south of Germany and is constantly under financial pressure. This group dominates in terms of numbers of farms and is represented by the traditional farmers' union.

The third group's objective is to gain support for ecological farming, which often implies redistribution away from large conventional farms. This group had been represented by several ecologically oriented farmers' unions, which only recently merged to the 'Bund Oekologische Lebensmittelwirtschaft' and now encompasses the whole value-added chain from 'the fields to the sales counter'. In the struggle to survive, the third group's interests often overlap with those of the second group, from which most farms in the third group originated.

Farmer groups

Different types of farm are best represented by different political parties. The first group is best represented by the FDP, the second group is traditionally most strongly represented by the CDU/CSU, and the third group is closest to the Green Party. Sympathy for the SPD might be dampened in the first group because this party not only tries to reduce support, but to concentrate it on smaller farms.

National politicians face serious obstacles to bringing about a more efficient agricultural policy on the EU institutional level. One obstacle is the unanimous voting rule in the Council,[61] by which members can block reforms if their national interests are threatened, as demonstrated by the current impasse over direct payments. There is only little

[61] According to the EC Treaty, decisions on the CAP are subject to qualified majority voting in the Council. The Luxembourg compromise, however, allows a member state to veto a proposal if it considers it to be a threat to its vital national interests. Although the Luxembourg compromise is not enshrined in any Union Treaty and has no legal force, its relevance for CAP decisions cannot be overestimated.

hope that this stalemate will be overcome after the scheduled EU enlargement.

A second institutional feature that increasingly complicates the realisation of efficient solutions is the tendency to widen the EU's role, for example to include agricultural structural policy, environmental policy (rural policy) and regional policy. The lower federal levels accepted this tendency because of the burden sharing offered by the EU. The resulting mixed financing and the moral hazard induced at the lower level due to partial funding by the EU led to an oversupply of supposed public goods.

Suggestions for trade partners to improve the situation

Though it is obvious that there is little opportunity for third countries to tackle the institutional deficits directly, there seem to be two parallel courses of action open to third countries to bring about change: international trade negotiations and information campaigns through national media.

Doha Round of negotiations

First, international trade negotiations offer an opportunity for third countries to influence internal EU agricultural policy. The Doha Round presents a chance to further reduce protectionist measures, consisting of border protection and internal price support, and direct payments for various purposes. Trade partners should give top priority to further reductions in border protection and internal price support, both of which basically tax consumers and distort trade. If EU politicians will not or cannot abstain from compensatory direct payments, which ought to be decoupled, or other compensatory instruments, this will increase (or at least give less relief to) budgetary pressures. In the present situation of very tight national budgets, this

is the most promising way to reduce the overall support for agriculture and thereby production.

The effect of reduced prices on consumption should be positive, even though the price elasticity of demand for food commodities is rather low in high-income countries such as Germany. Moreover, attempts by the Commission — supported (among others) by Germany — to soften the 'like-product principle' because of animal welfare or consumer protection objectives should be carefully analysed to avoid new barriers to trade.

Doha Round trade negotiators ought to find excellent co-operative partners with overlapping objectives in the Bundesverband des Groß- und Außenhandels (Federation of German Wholesale and Foreign Trade) as well as in the Bundesverband der Deutschen Industrie (Federation of German Industries). Both organisations frequently enter the internal debate in support of agricultural trade liberalisation. In contrast, consumer organisations are almost exclusively focused on food safety and health issues, and play little role in the political debate about high food prices, tax burdens and trade liberalisation.

Wider transparency of benefits and costs

Second, information campaigns through national media can do much to influence change. German consumers and voters are not well informed about the obvious inconsistencies of agricultural policies. This is partly due to the lopsided information campaigns run by government institutions and interest groups, which are not balanced by countervailing information from consumer organisations.

Information campaigns of foreign agricultural trade partners should inform voters and consumers within the EU about the inconsistency of EU agricultural and environmental policies, and the inefficiencies inherent in these

policies. Voters and consumers also need to be informed about food products that are produced without subsidies and by environmentally friendly methods in 'land rich' non-member countries. Information about rigid control systems for food safety and food quality assurance is also of utmost importance. Information campaigns should target the 'spin doctors' of the media, especially journalists in radio and television — perhaps by means of field trips.

Consequences of reform for trade

Finally, what are the possible consequences for beef exports to Germany or the EU in the case of complete market liberalisation for all commodities, or at least a complete decoupling of direct payments in the EU? Such a policy would certainly create large efficiency gains. Looking at beef as a single commodity, such a policy would not necessarily imply a low level of self-sufficiency within the EU and large exports of beef to the EU. Market liberalisation or complete decoupling of direct payments would release large areas of marginal agricultural land that is currently used for field crops or intensive milk production. This land could be allocated to beef or sheepmeat production, which has a lower labour and capital intensity.

4 JAPAN: PRODUCT DIFFERENTIATION – THE WAY FORWARD

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In 2000, Japanese agriculture produced commodities worth 10.2 trillion yen at farmgate prices and created 5.5 trillion yen of value added. Agriculture's share of the total economy, however, is declining. Agriculture represents only 1.1 per cent of Japan's gross domestic product and 4.6 per cent of its labour force.

Three million workers from 3.12 million farm households are engaged mainly in agricultural activities. It is notable that the number of workers engaged mainly in agriculture is less than the number of farm households. This means that some farm households have no workers engaged mainly in agriculture. This arises because the definition of 'farm household' includes many small part-time farm households in which there are no full-time farm workers.[62] Indeed, full-time farm households in which there are no workers engaged in non-agricultural industries account for 13 per cent of total farm households.

[62] Japan's Agricultural Census defines a farm household as a household that conducts farm operations on at least 10 metric ares of farmland, or that has at least 150 000 yen of farm product sales a year.

But this does not mean that Japanese farm households are poor. In reality, the average income of a farm household is comparable to or higher than that of a non-farm household. For example, in 1999, the average income of a farm household was 8.5 million yen or 23 per cent more than that of the average non-farm household. Income from agricultural activities, however, accounts on average for only 14 per cent of the total income of a farm household.

With regard to the beef industry, the number of Japanese farm households raising beef cattle was 104 200 in February 2002. The number of beef cattle was 2.8 million and the average herd size was 27.2 head, which is small by Australian standards but larger than the herd size of only 5.9 head in 1980 as shown in table 31.

The Japanese beef industry is based on dairy–beef breeds (Holstein and its hybrids with traditional breeds) and the traditional beef breeds — Japanese black, Japanese brown, Japanese polled and Japanese short horn — collectively known as 'wagyu cattle'. The Japanese black breed accounts for about 60 per cent of all beef cattle and is capable of producing highly marbled beef. The other breeds produce beef considered to be of lesser quality. As a result of the growth in the dairy industry over the past thirty years, more than one-third of domestically produced beef now comes

31 Number of households raising beef cattle, number of beef cattle and average herd size in Japan

	1980	*1985*	*1990*	*1995*	*2000*	*2002*
Number of households ('000)	364.0	298.0	232.2	169.7	116.5	104.2
Number of beef cattle ('000)	2157	2587	2702	2965	2823	2838
Average herd size (head)	5.9	8.7	11.6	17.5	17.5	27.2

Source: MAFF, *Annual Livestock Statistics*, various issues.

from dairy breeds. This close tie between the beef and dairy industries complicates the effects of policy changes for these industries.

The economics and politics of Japanese beef

Demand for and supply of beef in Japan

Beef and other livestock products were not widely consumed in Japan until the Meiji Restoration in 1868, mostly because cattle were very important for use in farm work. The prevailing Buddhist code also prohibited violence toward (and thereby slaughter of) animals. In the Meiji era it was recommended to eat beef as a symbol of cultural reform, however annual consumption of beef was as low as 700 grams per person in the 1910s. The beef cattle industry was established only after World War II.

Even in 1970, Japanese beef consumption was at a low level of 1.8 kg per person per year, as indicated in table 32. In the 1960s, retail prices of beef, pork and chicken were more or less comparable. However, the prices of pork and chicken subsequently declined relative to the price of beef due to expanding production of pork and chicken and their lower production costs. As a result, Japanese consumed less beef per person than they did pork or chicken.

In the early 1990s, import liberalisation made beef cheaper for ordinary consumers, causing a steep rise in beef imports. Increased demand for beef was also partly attributed to changing dietary habits in Japan. Fast food and family restaurants were becoming popular, particularly among young people, and beef was increasingly used in prepared and processed food.

32 Annual supply and consumption of beef in Japan

	1970	*1980*	*1990*	*1995*	*2000*
Production ('000 tonnes) (a)	282	431	555	590	520
Imports ('000 tonnes) (b)	33	172	549	941	1055
Total supply (a)+(b)	315	597	1095	1526	1553
Self-sufficiency ratio (%)	89.5	72.2	50.7	38.7	33.5
Consumption per capita (kg)	1.8	3.1	5.5	7.5	7.6

Note: Production, imports and total supply are in carcass weight. Consumption per capita is in boneless primal cut weight. Total supply includes changes in stocks.

Sources: MAFF, *Annual Livestock Statistics*, various issues; MAFF, *Food Balance Sheet*, various issues.

Special mention should be made of the liberalisation of Japan's beef imports in 1991, as this preceded the conclusion of the Uruguay Round negotiations and anticipated GATT tariffication of import restrictions to increase market access. Up until the 1980s, Japan's beef imports were regulated by quotas and tariffs. The governments of Japan, the United States and Australia reached agreement on beef reforms in 1988. Import quotas were initially expanded, and then abandoned and replaced by tariff-only protection. The tariff was then reduced from 70 per cent in 1991 to a bound rate of 50 per cent two years later. The applied tariff is now 38.5 per cent. Beef imports and consumption have increased as a result of lowered domestic consumer prices due to the removal of quotas and reductions in tariffs; however, continuing trends in incomes, tastes and demographics have also, no doubt, contributed. Beef consumption has doubled since 1985, with consequent improvement in consumer welfare.[63]

Farmers in the Japanese beef industry are classified into four types: those breeding wagyu cattle; those fattening

[63] Rae, A. 2000, 'Japan's livestock sector: consumption, production, policies and trade,' *Pacific Economic Papers*, no. 300, AJRC, Australian National University, Canberra.

wagyu calves; those breeding dairy cows; and those fattening dairy calves. Until the late 1970s, there was a clear division between calf-rearing specialists and fatteners of dairy animals. But in the dairy–beef sector, calf rearing and fattening operations are increasingly integrated. Hybrid beef cattle are also increasing in number.

As tariffs on imports of beef have been lowered, wholesale prices for beef have declined, especially for lower quality cuts used for meat processing. Prices for domestically produced wagyu beef (higher quality beef from specialised traditional Japanese breeds) have not fallen as much because wagyu beef is rarely a substitute for imported beef. Nevertheless, the decline in wagyu beef prices is indirectly related to the tariffication of beef imports and the resulting drop in prices of higher grade, domestic dairy steer beef and higher quality imports. Beef is graded in Japan (box 33) with the higher grades receiving higher prices.

33 Beef grading in Japan

The beef grading system introduced in 1988 involves scoring carcasses on meat quality and meat yield. When assessing quality, the meat characteristics to be considered are fat marbling, meat and fat colour (each assessed on a five-grade, 17-point scale) and beef texture and firmness. Meat quality is assessed on the basis of a sample of beef taken from between the sixth and seventh ribs. Carcass yield takes into account rib thickness, subcutaneous fat thickness, rib eye area and cold left-side weight. Depending on the yield from a carcass, it is classified into three classes: A (yield of over 72 per cent), B (yield of 69–72 per cent) or C (yield of less 69 per cent). The quality scores and the yield classifications are combined to give 15 grades. Carcasses graded as A-5 fetch the highest prices.

Beef farming in Japan

In 2000, Japanese beef production was worth 451 billion yen, which accounted for about 5 per cent of the value of total agricultural output. Roughly speaking, the livestock sector — including beef, dairy, pigmeat and poultry — accounted for one-quarter of the value of total agricultural output, or a similar share to the rice sector and the vegetables sector (table 34).

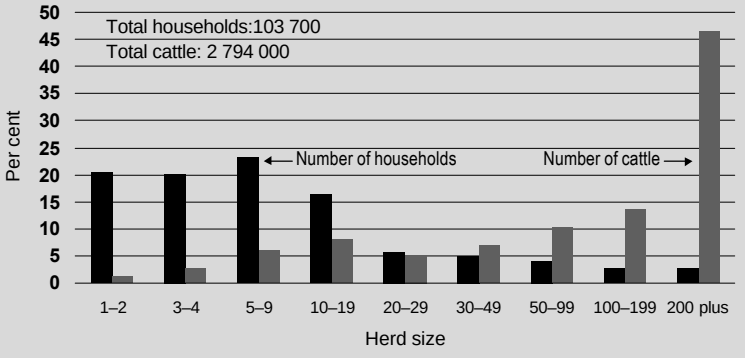
Although the average herd size (27.2 head) is small by Australian standards, beef production in Japan increasingly depends on larger herds. Indeed, farm households raising 200 head or more produce 46.5 per cent of Japan's beef, though they comprise just 2.5 per cent of beef farm households (chart 35).

34 Japan's agricultural output, by sector

	1990		*1995*		*2000*	
	¥ bn	%	¥ bn	%	¥ bn	%
Agriculture, total	**11493**	**100.0**	**10450**	**100.0**	**9122**	**100.0**
Livestock	**3084**	**26.8**	**2513**	**24.0**	**2454**	**26.9**
▪ Beef cattle	598	5.2	449	4.3	451	4.9
▪ Dairy cattle	906	7.9	792	7.6	773	8.5
– Milk	763	6.6	701	6.7	686	7.5
▪ Pigmeat	631	5.5	506	4.8	466	5.1
▪ Poultry	862	7.5	701	6.7	697	7.6
– Eggs	478	4.2	410	3.9	421	4.6
▪ Other	87	0.8	65	0.6	67	0.7
Crops	**8295**	**72.2**	**7851**	**75.1**	**6599**	**72.3**
▪ Rice	3196	27.8	3186	30.5	2325	25.5
▪ Vegetables	2588	22.5	2398	22.9	2112	23.2
▪ Fruits	1045	9.1	914	8.7	809	8.9
▪ Other	1466	12.8	1353	12.9	1353	14.8

Source: MAFF, *Production Agricultural Income Statistics*, various issues.

35 Distribution of beef cattle by size of herd in Japan



Source: MAFF, *Annual Livestock Statistics*, various issues.

Japanese beef production is characterized by high costs of fattening calves and heavy reliance on imported feed grain. The dependence on imported feed reflects a deliberate policy in Japan to withdraw from feed grain production, under which more liberal treatment was afforded to imports of feed grains than to many other commodities. Imports of maize for feeding purposes were freed from restrictions in 1951 and sorghum imports were allowed duty-free entry in 1964. Imported feed grains are mostly used in compound feed production. Compound feeds are composed mainly of wheat, wheat bran, soybean meal, maize and sorghum. These products are mixed with animal- or vegetable-based ingredients, including skim milk powder and molasses, depending on the types of animal being fed and the animal's stage of growth. These ingredients are imported duty-free if used in compound feeds.

Table 36 shows the average production costs of farms fattening wagyu and dairy steers in Japan. For wagyu steers, the major part (56 per cent) of the production cost is the initial purchase of the calves, while the cost of feed accounts for a quarter of the total cost. For fattening dairy

36 Average costs of beef production for calf fattening farms in Japan, 2001 Yen per 100 kilograms in live weight

	Wagyu steers	Per cent of total cost	Dairy steers	Per cent of total cost
	¥/100 kg	%	¥/100 kg	%
Calf	60 607	55.9	11 238	26.1
Feed	27 341	25.2	22 604	52.5
Labour	12 406	11.4	4524	10.5
Others	8083	7.5	4726	11.0
Total	**108 437**	**100**	**43 092**	**100**

Source: MAFF 2000, *Annual Livestock Statistics*.

steers, the main production cost is feed — dairy steers are far cheaper to buy than wagyu steers.

Beef consumption in Japan

Japanese people increased their consumption of beef rapidly after the liberalisation of beef imports in 1991. The removal of import quotas and reduction in tariffs have lowered domestic consumer prices and encouraged an increase in beef imports and consumption. Japan's imports of beef rose significantly in the first half of the 1990s. But demand for beef stagnated in the late 1990s: it dropped sharply in 2001 due to the incidence of bovine spongiform encephalopathy (BSE). Stagnant income growth due to economic recession since the early 1990s and unfounded health and safety concerns about imported beef (related to E. *coli* and BSE) appear to have contributed to recent static demand.

In 2000, beef consumption per person was 7.6 kg while consumption of pork and chicken was 10.6 kg and 10.2 kg respectively. Consumption of all three products was stagnant since the early 1990s (table 37). Lower consumption

37 Consumption of livestock products in Japan

	1985	*1990*	*1995*	*2000*
	kg per person	kg per person	kg per person	kg per person
Beef	3.9	5.5	7.5	7.6
Pork	9.3	10.3	10.3	10.6
Chicken	8.4	9.4	10.1	10.2
Eggs	14.5	16.1	17.2	17.0
Milk and milk products	70.6	83.2	91.2	94.3

Source: MAFF, *Food Balance Sheet*, various issues.

of beef relative to pork and chicken can partly be attributed to the higher price of beef relative to the other two products.

Reform of distribution required

To induce greater consumption of beef, the distribution system needs to be reformed to pass on to consumers the lower farmgate or port-of-import beef prices. Indeed, beef imports might have been substantially greater following liberalisation had the entire decline in wholesale prices been passed on to consumers. An apparent lack of competition in the Japanese retail sector, which allowed retailers to appropriate part of the gain of lower wholesale prices as increased margins, might have contributed to this.[64] The need to reduce distribution costs to make cheaper beef available to Japanese consumers is verified by the fact that 59 per cent of the retail beef price goes to distributors and retailers (table 38).

[64] ABARE 2001, *Agricultural trade policies in Japan: the need for reform*, Australian Bureau of Agricultural and Resource Economics, Canberra.

38 Composition of beef price in Japan and the US, 1995–97 average

	Japan		United States	
	¥/100 g	%	¥/100 g	%
Producer price	154	41	33	49
Middle margin	77	21	8	12
Retail margin	142	38	26	39
Retail price	373	100	67	100

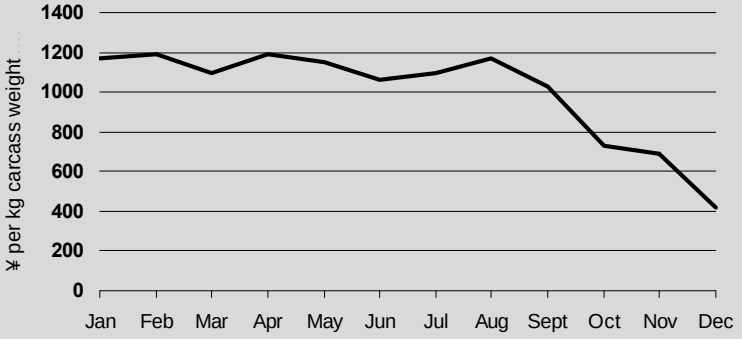
Sources: MAFF 2000 and 2001, *Statistical Appendix for the White Paper on Agriculture*.

Impact of BSE

In September 2001, the first case of BSE in Japan was confirmed in Chiba prefecture. The government established a system to immediately stop the spread of the disease: all beef processed before 18 October 2001 was incinerated; all carcasses of cattle slaughtered on or after 18 October were tested to remove the carcasses of cattle at risk of BSE; and the production, sale or use of all livestock feed containing meat and bone meal and similar products was prohibited. Despite the government's efforts, consumers rejected not only domestic beef, but also imported, disease-free beef. Prices of beef declined drastically in the latter months of 2001, as shown in chart 39. As at September 2002, four other BSE cases have since been detected.

After the implementation of the first program, in which the government bought and incinerated domestic beef, a series of meat-switching scandals have occurred. Several meat packers and processors, including two leading companies, disguised imported beef as domestic beef in attempts to obtain government subsidies under this program. The scandals seriously reduced consumers' trust in meat labeling — another reason why many consumers still refuse to eat beef.

39 Movement of beef prices in Japan 2001



[a] Farmgate prices are for wagyu steers. Wholesale prices are for grade B-3/B-2.
Source: MAFF 2002, *Annual Livestock Statistics*.

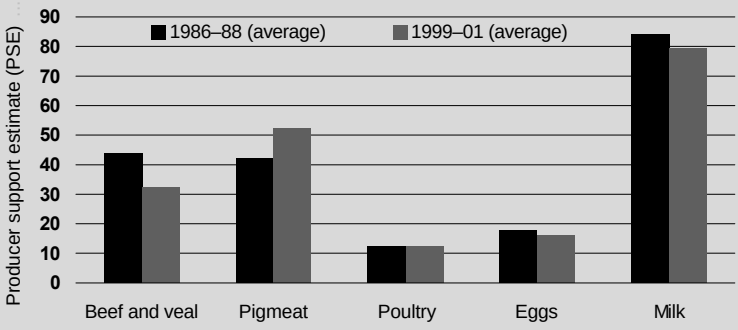
Support for beef in Japan

Japan's beef prices are still above world prices because of border measures and domestic policies. Chart 40 shows the level of producer support for Japanese livestock industries in terms of the producer support estimate (PSE). The PSE for beef and veal declined from 44 per cent in 1986–88 to 32 per cent in 1999–2001, reflecting the effect of import liberalisation in 1991.

Border protection is more important than domestic support measures to the Japanese beef industry. Table 41 compares the level of Japanese border protection for beef and veal with those of other OECD countries. The nominal rate of protection (NRP) is the price gap between domestic and world prices expressed as a percentage of world prices.

From 1995 to 1999, Japanese domestic prices of beef and veal were 44.3 per cent higher than the average world

40 Producer support estimates (PSE) for livestock industries in Japan



Source: OECD 2002, *Agricultural Policies in OECD Countries, Monitoring and Evaluation*, Paris.

41 Nominal rates of protection (NRP) for beef and veal in selected countries, per cent[a]

	1986–90	*1990–94*	*1995–99*
Japan	63.8	44.1	44.3
Canada	2.7	2.5	0.1
European Union	88.4	82.4	73.4
Iceland	108.8	92.3	67.2
Korea	165.7	219.1	174.9
Norway	136.1	112.6	92.7
Switzerland	242.9	194.8	127.4
United States	1.8	1.6	0.0
OECD average	55.0	48.3	38.8

Note: Price gap between domestic and world prices expressed as a percentage of world prices.

Source: OECD 2001, *The Uruguay Round Agreement on Agriculture: An Evaluation of its Implementation in OECD Countries*, Paris.

prices. In that period, Japan's NRP for beef and veal was much less than that of the European Union.

Beef is one of the few Japanese agricultural industries for which the government has significantly reduced producer support. The Japanese government still assists beef farmers,

but in less trade-distorting ways. Two domestic measures support the Japanese beef industry: a beef price stabilisation program and a deficiency payment program for calf-breeding farmers.

First, a price-stabilisation scheme under the *Livestock Products Price Stabilisation Act* is used to reduce volatility in the domestic price of beef. Under this scheme, the Ministry of Agriculture, Forestry and Fisheries (MAFF) announces the floor and ceiling beef prices in the early part of each year (usually March or April). Once the price band has been determined, the Agriculture and Livestock Industries Corporation (ALIC), a state trading body that runs subsidy programs on behalf of MAFF, intervenes in the market to keep the wholesale price in the price band. The ALIC buys and stores beef when the market price dips below the floor price and releases stock onto the market when the price rises above the ceiling price.

Second, a deficiency payment program for calf-breeding farmers was introduced in 1990. As discussed above, the prices of calves for fattening are crucial for beef production. Demand for feeder calves is a derived demand and so is influenced by the profitability of fattening. Therefore, a decrease in the price of beef reduces the demand for feeder calves and lowers the incomes of calf-breeding farmers. The feeder calf segment of the Japanese beef industry is important — developments in this segment have direct implications for total beef production.

The deficiency payment program was introduced to enable calf-raising farmers to continue to operate after beef import liberalisation. The program is based on the previous price stabilisation scheme for feeder calves. Under this program, the ALIC pays calf-raising farmers the difference between the guaranteed basic price and the market price if the market price is lower than the guaranteed basic price but higher than the target price for rationalisation. If the market

price falls below the target price, farmers are awarded 90 per cent of the difference between the target price and the market price. In this case, the national government contributes half of the payments, prefecture-level local governments contribute one-quarter, and the individual farmers contribute the remaining quarter.

How do the politics of beef protection differ from other industries?

Logic and reality of agricultural protection

It is common in developed countries for not only the beef sector but also agriculture in general to be protected by government policies. Agricultural policy is generally implemented regardless of its economic efficiency because it is a result of a political power struggle. In other words, agricultural policy has a strong political logic that reflects the state of equilibrium in the so-called 'political market'. Thus, to understand the logic of agricultural protection it is essential to investigate the political economy of government intervention in the agricultural sector.

The levels of agricultural protection in developed countries are not only high but also rising, despite the fact that agriculture is lessening in importance for economic growth. Two main political forces drive this observation. First, consumers become more tolerant to agricultural protection as their income increases. Second, agricultural producers obtain more political power as the number of farmers decreases, because they are able to avoid the so-called 'free rider problem' in organising political lobbying. Therefore, as an economy grows, with higher income per person and with a smaller share of agriculture in the economy, the level of agricultural protection tends to increase. Once in place, it

is difficult to break up the political equilibrium among farmers, consumers, taxpayers and politicians.

The above logic of the political economy of agricultural protection applies also to individual livestock industries. Table 42 shows the nominal rates of protection for livestock products and total agriculture in Japan from 1955 to 1990. The NRP of beef was increased during the period of Japan's rapid economic growth to reach 123 per cent in 1990. This increase is consistent with the above logic and the trend of NRP for agriculture in general. Protection of the dairy industry, although low until 1970, was increased rapidly thereafter.

Pork, poultry and eggs — in contrast to beef and milk — have not been protected as much, as shown by these products' low NRP during the observed period. The pork, poultry and egg industries are characterised by capital-intensive production and by affiliations with food processors and trading companies. Trade was also liberalised earlier for these industries — poultry and eggs in 1962 and pork in 1971. Therefore, pork, poultry and egg producers have a different influence in the political arena from the beef and dairy industries, although many family farms still produce pigs and poultry. This contrast also reflects the comparative advantage of Japanese agriculture. Japan has a

42 Nominal rates of protection (NRP) of livestock industries in Japan, 1955–90, per cent

	1955	*1960*	*1970*	*1980*	*1990*
Beef	39	84	108	100	123
Pork	2	97	-9	17	5
Poultry	-52	19	18	23	13
Eggs	-19	-7	-9	-1	15
Milk	4	5	212	186	160
Agriculture	18	41	74	85	116

Source: Honma, M. 1994, *The Political Economy of Agricultural Problems*.

scarce endowment of land relative to labour and capital. Production of beef and milk is land-intensive and these products are less competitive against imports from countries with rich endowments of land. Thus, it is difficult to reform the beef and dairy industries by raising productivity in a short period of time: these producers tend to lobby the government for protection.

However, the level of beef protection has declined since trade liberalisation in 1991 — the largest reform of any of Japan's agricultural industries. Beef is one of the few commodities for which Japan has significantly reduced production support. One of the reasons for the policy change was the decrease in the number of beef farm households below the critical number needed to maintain political power. Another reason was international pressure on Japan from beef exporters to liberalise imports, which resulted in further reductions of Japan's beef tariffs in the Uruguay Round Agreement on Agriculture.

What are the main pressures for change in agricultural protection?

The new Basic Law on Food, Agriculture, and Rural Areas

The fundamental philosophy and basic guidelines for Japanese agricultural policies had been based on the Agricultural Basic Law of 1961. The Agricultural Basic Law aimed to make per capita family-farm income equal to that of the non-farm sector through improving the agricultural structure. As the 'selective expansion' slogan indicates, this meant policies designed to raise agricultural production efficiency and agricultural income, by means of transferring resources from production of low income-elastic to high

income-elastic farm products and expanding the scale of operations.

Yet despite such policy efforts, it proved impossible to achieve income equalisation through agricultural restructuring alone. The government had to resort to protective policies, particularly price-support policies, primarily because rapid economic growth induced such rapid increases in non-agricultural income that agricultural restructuring and labour productivity improvements in agriculture could not keep pace. Despite the failure of the Agricultural Basic Law to achieve agricultural restructuring, it had remained unchanged since 1961.

However, it was apparent that Japan would need new agricultural and food policies to deal with new issues and to satisfy the country's needs in the 21st century. Therefore, on 12 July 1999, the Japanese parliament (the *Diet*) cleared the bill for a new Basic Law on Food, Agriculture, and Rural Areas (the new Basic Law). The objectives of the new Basic Law included securing a stable food supply, fulfilling agriculture's multi-functional role, developing sustainable agriculture and developing rural areas.

Before the bill on the new Basic Law was submitted, the ruling Liberal Democratic Party, MAFF and the agricultural cooperatives (Nokyo) agreed in December 1998 on the 'fundamental principles of agricultural policy reform'. The principles are specific guidelines for new policy making. Based on the principles, the agricultural policy reform started in advance of the implementation of the new Basic Law. This demonstrates MAFF's strong support for the policy reform — reform would have proceeded by means of the agreed principles even if the new Basic Law had not been introduced.

Under the new principles, the first step was reform of price-support policies, whereby domestic agricultural pro-

ducts were valued at market prices through tenders or similar market systems. For example, before the reform, the government purchased all wheat produced in Japan at a fixed price, which was much higher than the international market price. Following reform of the wheat policy, domestic wheat is now supposed to be marketed at prices determined by tender. Although farmers can still receive a guaranteed price for wheat, this price is gradually being lowered. One of the main characteristics of the new Basic Law or new agricultural policy is the restoration of the price mechanism in agricultural markets. Farmers are supported if necessary by the so-called decoupling policy.

Price-support policy reform

The core of Japan's agricultural policy reform — strongly emphasised in discussions about and proposals for the new Basic Law — was 'further introduction of market mechanisms and stabilisation of farm management'. The reasons why the current price-support policy should be changed are as follows. First, under the price-support policy, it is difficult to accurately convey to farmers the supply and demand situation and consumers' needs. This prevents farmers from cultivating good management ability. Second, because the policy affects all farmers, including small-scale farmers, it restricts the improvement of the agricultural structure. This is crucial for structural adjustment in the agricultural sector. Third, the price-support policy does not reduce the price gaps between domestic and international markets. This has caused increases in food imports and caused serious problems for Japan's food processing industries, leading to some relocation overseas.

Prices of agricultural products should exactly reflect the trends of demand and market value of quality, so that prices function as a signal to convey such trends promptly and accurately to farmers. In addition, it is essential that

farmers can demonstrate their originality and get more profit from the market through this process. If the reform of price-support policy is successful, it is expected to lead directly to overall agricultural reform in Japan.

Where does the main resistance to change come from?

Interest groups

The livestock sector in Japan has been well represented by a number of different organisations. The groups involved in promoting and protecting livestock (including dairy) farming interests within Nokyo alone include the following:

- Zenchu — the national leadership organisation of the agricultural cooperatives — makes budgetary requests in relation to livestock farming, makes requests for government price support for livestock products, and sponsors mass-mobilisation activities of farmers against liberalisation of livestock products;
- Zenno — the national trading arm of the Nokyo organisation — is involved in all aspects of marketing and input supply for livestock farmers as well as being an end-user and distributor of imported beef;
- Zenchikuren and Zenrakuren — the National Livestock and Dairy Nokyo Federations and their regional federations — conduct economic and other functions for their specialist cooperative members, and channel policy demands relating to livestock farmers; and
- Kaitakuren — the national Nokyo specialist federation of reclamation cooperatives — also weighs in on livestock matters, particularly in relation to beef farming.[65]

[65] George-Mulgan, A. 2000, *The Politics of Agriculture in Japan*, Routledge, London.

Other prominent livestock-related organizations are *gaikaku dantai* (government-affiliated agencies) such as the ALIC and the National Association of Beef Cattle Price Stabilisation Fund. These organisations are primarily administrating agencies of government and not lobby groups. Nevertheless, they play an important role by relating to MAFF on livestock matters, whether it be in connection with their own funding, disbursement of subsidies, managing the beef import trade or administering price-support schemes. These activities indirectly assist the ultimate beneficiaries of these programs — livestock farmers, livestock production groups and other agricultural organisations such as agricultural cooperatives.[66]

In 1970, there were 902 000 farms raising beef cattle. By 1980 the number had sunk to 364 000; by 1990, to 232 000; and by 2002, to 104 000. The drop in the number of farm households raising beef cattle in the 1990s has been attributed to the ageing of farmers and a shortage of their successors, pressure to rationalise production for efficiency gains, and low prices for dressed carcasses of domestic beef because of increased imports. Domestic dairy beef producers were the most affected by the increased competition from beef imports in the 1990s — the biggest price falls were registered in this industry.

Political influence, however, is not purely a function of the absolute number of advocates. One factor sustaining the effective electoral representation of livestock interests is the existence of regional concentrations of livestock producers. Certain districts have strong and clearly identified livestock interests, particularly the beef cattle-raising regions of Kyushu and Tohoku, where livestock voters still comprise an important component of overall voter interests. Product specialisation is another important factor because it

[66] George-Mulgan, A. 2000.

increases the vulnerability of farmers to price trends in the market and other factors affecting producer returns. This is particularly the case if they run small numbers of cattle, as they do for example in Kyushu.[67]

Current WTO negotiations on agriculture and Japan's proposal

New WTO negotiations on agriculture, which commenced in March 2000, are supposed to produce numerical targets, formulas and other 'modalities' for countries' commitments by the end of March 2003. In phases one and two of the negotiations, member countries submitted proposals on the subjects to be negotiated. Japan submitted its proposal on agricultural negotiations to the WTO in December 2000.

Japan's proposal emphasised three points that it wanted to have included in any set of rules or disciplines established in the agricultural negotiations:

a. the importance of the multi-functionality of agriculture;
b. the importance of food security; and
c. the imbalance between importing and exporting countries with regard to rules and disciplines.[68]

Japan's proposal is based on a fundamental philosophy of coexistence of various types of agriculture among the member countries. The proposal indicates that Japan is reluctant to reduce barriers to agricultural trade. It may be useful to investigate the first two of the Japanese proposal's points from the viewpoint of protection.

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[67] George-Mulgan, A. 2000, *The Politics of Agriculture in Japan*, Routledge, London, pp. 324–325.

[68] MAFF, 2000, *Negotiating proposal by Japan on WTO agricultural negotiations,* Minister for Agriculture, Forestry and Fisheries, Tokyo.

Multi-functionality of agriculture

The meaning of the term 'multi-functionality of agriculture' varies according to the history and situation of each country. Japan considers the following functions to be the major elements:

- land conservation, including preventing floods, soil erosion and landslides;
- fostering of water resources;
- preservation of the natural environment, including management of organic waste, resolution and removal of polluted substances, air purification, and maintenance of biodiversity and preservation of wildlife habit;
- formation of scenic landscapes;
- transmission of culture;
- rural amenity;
- maintaining and revitalising the rural community; and
- food security.

Most functions are the so-called 'externalities' created by agricultural activities. Food security is not an externality; it is discussed separately.

Recognition of the multi-functionality of agriculture is an important step in evaluating agricultural activities, especially from an environmental viewpoint. But what has to be asked is how to maximise the net benefits of the multiple functions of agriculture while considering the costs of maintaining agricultural operations. MAFF estimated the value of paddy fields and upland fields (according to a substitutive cost method) to be 4.6 trillion and 2.0 trillion yen respectively.[69]

[69] These data are available in the following web sites: http://www.maff.go.jp/soshiki/kambou/Environment/env1.html and http://www.maff.go.jp/soshiki/kambou/Environment/env8.html

Even if the value of multi-functionality is recognised, the fundamental point is not the *total* value, but the *marginal* value of multi-functionality as agricultural production changes. The total value of agricultural externalities does not have any implications for efficiency and agricultural policy decisions. What we need to know is the marginal loss (gain) of the value of the multi-functionality as agricultural production shrinks (expands). In other words, we need to know the social demand curve for the multiple functions and how they are related to agricultural production.

Furthermore, the relationship between multi-functionality and agricultural production is not straightforward. Many alternative levels of agricultural production and many combinations of products can achieve a certain level of social value. WTO negotiations are to discuss the levels of support and protection that affect trade and production. Thus, the quantitative assessment of multi-functionality in terms of agricultural production is necessary. However, the multiple functions of agriculture are not the targets that agricultural production directly aims to hit. Therefore, they are not necessarily efficient to fulfill the social needs.

Food security

In Japan's WTO proposal, food security is considered as one aspect of multi-functionality; however, this confuses the definition of multi-functionality. It is better to limit the multi-functionality of agriculture to the external effects, particularly effects on the environment. Food security is defined as a situation in which all households have both physical and economic access to adequate food for all members and where households are not at risk of losing such access.[70]

[70] FAO, 1966, 'Food and international trade', Technical background document 12 for World Food Summit, FAO, Rome.

A country has two options to achieve food security at the national level: to pursue either food self-sufficiency or food self-reliance. Food self-sufficiency means meeting food needs from domestic supplies as far as possible and minimising food imports. Food self-reliance means maintaining a level of domestic production, but relying also on international trade to meet the food needs of the population. Which strategy a county should take depends on the benefits and risks of relying on international trade.

Food security is an important issue in countries with low food self-sufficiency ratios. In Japan, the food self-sufficiency ratio has dropped to 40 per cent on a calorie basis, which is the lowest among the developed countries. Some people are very concerned about this low level of self-sufficiency from the food security viewpoint. Achieving food security is one of the basic roles that the government should fulfil. MAFF has set a food self-sufficiency ratio of 45 per cent as a target level for 2010.

Policies for food security are counter-productive

Policy measures for food security differ according to which types of crisis are considered. Predictions about future world market conditions depend on assumptions and forecasts about exogenous variables. It is important to devise policy measures that have minimum social costs for possible different food security risks.[71] In addition, the volatility of world food market prices comes from government interventions that aim to insulate domestic markets from international trade — which makes the world market smaller than it would be without intervention. If all domestic markets are integrated to international trade, poor or rich harvests in some areas can be easily absorbed into

[71] Hayami, Y. 1988, *Japanese Agriculture under Siege*, Macmillan Press, Hampshire.

the world market. Therefore, limiting trade for food security purposes is a counter-effective policy measure.

The Japanese government should prepare a blueprint for unpredictable emergencies in which a food security measure is one of many national security measures. According to MAFF estimates of availability of food energy using only domestic agricultural resources, in 2010, Japan could provide 1890 to 2030 kilocalories of food per day per person without any food imports. This is roughly equivalent to the per capita calorie intake in the early 1950s. This kind of information is important, though the production composition is of course different from the current dietary composition. However, there is no plan for how to shift from the current regular farm operations to emergency ones and how to realise these emergency food supplies for the general public. It is necessary to establish a system to supply food efficiently in emergencies as part of a national security plan, rather than increasing the food self-sufficiency ratio at a cost to consumers and taxpayers in peacetime.

Conclusion

As far as Japan seeks economic development based on international cooperation, it will be necessary to further liberalise agricultural trade — including beef. Although the applied tariff on beef has been lowered to 38.5 per cent, beef prices in Japan are still much higher than world market prices. Beef is a highly differentiated product, particularly in Japan's market. This may be verified by the experience of domestic beef production, which was scarcely reduced after beef trade was liberalised in 1991 and even increased up to 1994. This means that Japan can foster a beef industry capable of competing with imported beef.

Japan's beef policy reform is indicative of what might be achieved in other agricultural sectors. Tariffication of former non-tariff barriers and the subsequent reductions in tariffs increased imports and reduced prices of beef, which increased consumer welfare and promoted product differentiation. To survive, domestic beef production sought non trade-distorting government assistance mechanisms. This direction is supported by the new Agricultural Basic Law. The Guideline for Modernising Dairy Farming and Beef Cattle Raising (the fourth edition of which was issued in April 2000) outlines necessary programs for cattle farming advancement. Such programs include development of recycling of resources in farm management, adoption of improved technologies, and provision of infrastructure for information exchange.

However, there is a concern about the political shift toward a new agricultural protectionism based on the multi-functionality of agriculture, such as Japan proposed to the current WTO agricultural negotiations. As discussed in this paper, multi-functional goals can be achieved together with the expansion of trade and it is necessary to avoid multi-functionality becoming a disguised non-tariff barrier.

The only way for Japanese agriculture to survive in an open trading system is to seek its own comparative advantage and shift resources in that direction. Technology and capital-intensive sectors like the livestock industry seem promising. Non-agricultural joint-stock companies should be encouraged to take advantage of their human capital potential for agricultural management, which would increase the variety of agricultural products and types of farm management. Promotion of domestic reforms and deregulation based on the new Basic Law on Food, Agriculture and Rural Areas are urgent to achieve the survival of Japanese agriculture.

5 KOREA: SHIFTING TO MARKET-ORIENTED PRINCIPLES

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Beef is an important part of the Korean diet and the Korean agricultural sector. The beef industry has undergone a great deal of change over the last decade. Some liberalisation has occurred, but the industry is largely still protected, principally through barriers to imports. The type of border restriction has changed markedly, however, from quotas to tariffs. This has exposed the industry to market forces. The special place of beef in Korea, the changing nature and the political economy of the beef industry — including the forces blocking and promoting changes in industry protection — are reviewed in this paper.

Production and consumption of beef

The number of cattle in Korea peaked in 1996 at 2.84 million. Cattle numbers have since declined because of a decrease in Korean beef consumption and an increase in the price of feed since the 1997 financial crisis. Also, interest in raising cattle has declined since the Korean beef

market opened to permit the importation of live cattle. Only 1.41 million cattle were raised in 2001 — 12 per cent fewer than in 2000. Of the reasons for abandoning cattle raising, the most common reasons given are the liberalisation of the market and the financial crisis (table 43).

The number of farm households raising cattle also fell dramatically — by 55 per cent — from 513 000 in 1996 to 235 000 in 2001. However, the average number of cattle raised per farm household increased from 5.5 in 1996 to 6.0 in 2001 (table 44).

One point to take into consideration is that the number of cows older than two years of age decreased more drastically, from 1.2 million in 1996 to 532 000 in 2001 (table 45). This means that the base of local beef production has weakened.

The proportion of farm households that raise more than thirty head of cattle has increased, indicating that Korean cattle farmers have begun to specialise (table 46).

Due to higher incomes, the consumption of beef continued to increase until 2000. However, the outbreak of bovine spongiform encephalopathy (BSE) or 'mad cow' disease in

43 Abandoning Hanwoo raising: time and reason

Year abandoned	(%)	*Reason for abandoning*	(%)
1993–1994	4.2	Liberalisation	34.6
1995–1996	14.1	Financial crisis	48.0
1997–1998	51.3	FMD	3.1
1999–2000	30.6	Others	14.2
Total	**100.0**	**Total**	**100.0**

FMD: Foot-and-mouth disease.

Source: Huh, D. et al. 2000, *Liberalisation of the Beef Market and the Method of Developing Hanwoo Industry*, Korea Rural Economics Institute.

44 Beef and dairy cattle, number of farms and head of cattle

	1996	*1997*	*1998*	*1999*	*2000*	*2001*
Farm households						
Beef	513 319	464 785	427 005	350 222	289 714	235 415
Dairy	21 129	17 419	15 671	14 392	13 348	12 827
Number of cattle						
Beef	2843 535	2735 432	2383 133	1951 989	1590 020	1405 849
Dairy	551 493	544 417	538 913	534 560	543 708	548 176

Source: Ministry of Agriculture and Forestry 2000. *Agricultural and Forestry Statistical Yearbook*.

45 Age and sex of beef cattle herd, number of cattle

	1996	*1997*	*1998*	*1999*	*2000*	*2001*
Under 2 years						
Total	**1619 191**	**1637 361**	**1451 057**	**1206 223**	**979 382**	**856 761**
Female	733 835	746 091	689 768	558 024	424 659	362 380
Male	885 366	891 270	761 289	648 199	554 723	494 381
2 years and over						
Total	**1224 344**	**1098 071**	**932 075**	**745 766**	**610 638**	**549 088**
Female	1209 245	1081 833	913 028	725 900	592 774	531 862
Male	15 099	16 238	19 048	19 866	17 864	17 226
All ages						
Total	**2843 535**	**2735 432**	**2383 133**	**1951 989**	**1590 020**	**1405 849**
Female	1943 080	1827 924	1602 796	1209 924	1017 433	894 242
Male	900 455	907 508	780 337	668 065	572 587	511 607

Source: Ministry of Agriculture and Forestry 2002, *Agricultural and Forestry Statistical Yearbook*.

Europe and Japan and foot-and-mouth disease (FMD) in Korea caused a decrease in the consumption of beef in 2001 (table 47).

Beef cattle farming is very important to Korean farmers. In 2001, the sector contributed 5.2 per cent of agricultural income and 25.6 per cent of farm livestock income, as shown in table 48.

46 Beef cattle farms by herd size

Number of beef cattle	*Number of farms*					
	1996	*1997*	*1998*	*1999*	*2000*	*2001*
1–2	223 372	212 768	427 005	350 222	289 714	141 017
3–4	117 638	101 127	86 690	49 273	49 273	38 170
5–6	58 507	48 337	36 020	25 282	19 959	15 900
7–9	41 875	34 949	25 172	16 637	13 843	11 771
10–14	32 949	28 022	19 908	15 359	11 708	9261
15–19	14 349	13 513	10 198	7367	5769	4856
20–29	13 993	12 981	10 271	7864	6487	5784
30–39	5659	6020	5239	4116	3148	3025
40–49	2181	3015	2729	2720	1745	1749
Over 50	2796	4053	5015	4810	4061	3882
Total	**513 319**	**464 785**	**427 005**	**350 222**	**289 714**	**235 415**

Source: Ministry of Agriculture and Forestry 2002, *Agricultural and Forestry Statistical Yearbook*.

47 Supply and consumption of beef

	1995	*1998*	*1999*	*2000*	*2001*
	kt	kt	kt	kt	kt
Domestic beef					
Production	154.7	264.1	226.9	214.1	159.9
Consumption	154.7	260.1	239.7	212.4	161.7
Stock	0.0	12.8	126.6	222.8	0.0
Imported beef					
Import	148.1	77.0	153.0	190.0	161.7
Consumption	146.5	85.4	39.0	71.7	213.4
Stock	5.7	29.4	431.7	475.9	20.0
Total supply	**306.9**	**387.7**	**392.7**	**402.4**	**395.1**
Total consumption	**301.2**	**345.5**	**392.7**	**402.4**	**375.1**
Consumption per person (kg)	6.7	7.4	8.4	8.5	7.9

Source: Korea Rural Economics Institute 2002, *Agricultural Outlook 2002*.

48 Value of agricultural products

	Agriculture (A)	*Farming livestock (B)*	*Beef cattle (C)*	*C/A*	*C/B*
	Wm	Wm	Wm	%	%
1997	29 258	6903	2107	7.2	30.5
1998	29 639	7515	1836	6.2	24.4
1999	31 857	7937	1778	5.6	22.4
2000	31 829	8082	1879	5.9	23.2
2001	32 447	8312	1700	5.2	25.6

Wm: Won (million)

Source: Ministry of Agriculture and Forestry 2002, *Agricultural and Forestry Statistical Yearbook*.

The price of Korean beef has increased significantly since 1997; however, the price of imported beef has remained relatively stable during the same period. The price gap between Korean and imported beef has widened — from W3958 per 500 grams in 1997 to W9730 per 500 grams in 2002 (table 49).

According to OECD estimates, Korea has a high level of support for beef and veal with a producer support estimate (PSE) for 2001 of 60 per cent (table 50). Korea uses few policy measures to support beef production. One measure is the Calf Breeding Stabilisation Scheme. The scheme's purpose is to promote a stable business environment for the breeding of Korean native cattle (Hanwoo). Under this scheme, farmers who have contracted with the local livestock cooperative receive a payment equivalent to the difference between the average price of calves in the market and the stabilisation price. As of 2002, the stabilisation price level is W1.2 million and the ceiling of the deficiency payment is W250 000.

49 Price (won per 500 gms)

	1997	*1998*	*1999*	*2000*	*2001*	*July 2002*
Korean beef, Grade A			9614	11 284	12 073	17 839
Korean beef, Grade B	7539	6915	7232	8673	9807	14 384
Imported beef, Grade B	3581	3969	3984	3974	3838	3723
Pork, Grade B	2554	2805	3723	3888	4051	4654
Ratio of imported beef price to Korean beef, Grade B, price (%)	47.5	57.4	55.1	45.8	39.1	25.9
Ratio of imported beef price to Korean beef, Grade A, price (%)	na	na	41.4	35.2	31.8	20.9

Source: Agriculture and Fishery Marketing Corporation.

50 Level of support for beef and veal in Korea

	1986–1988	*1999–2001*	*1999*	*2000*	*2001[p]*
PSE (%)	54	63	66	63	60
Producer NAC	2.26	2.70	2.95	2.69	2.48
CSE (%)	-52	-62	-65	-62	-58
Consumer NAC	2.17	2.62	2.89	2.62	2.35

p Provisional.

PSE: Producer support estimate. NAC: nominal assistance coefficient CSE: Consumer support estimate.
Source: OECD 2002, *Agricultural Policies in OECD Countries*, Paris.

Another policy measure is the Incentive Payment for Keeping Mature Cows for Additional Calves. As its name suggests, this payment was introduced to ensure an ample supply of calves by discouraging the slaughter of cows. Farmers are eligible to receive W200 000 for each cow that has given birth three or four times and W300 000 for each cow that has given birth five times or more. The Incentive Payment for Castration is a similar payment, intended to improve the quality of beef by promoting castration of Hanwoo bulls. Farmers receive W200 000 per steer that has been castrated (table 51).

51 Measures to support beef production

	Calf breeding scheme	*Incentive payment for castration*	*Incentive payment for keeping mature cows*
2000			
Head	417 000	530 000	309 000
Value (W)	62 379	72 920	60 097
2001			
Head	51 000	109 000	84 000
Value (W)	9 586	21 900	16 800
2002			
Head	60 000	136 000	118 000
Value (W)	6 630	32 330	27 175

Source: Ministry of Agriculture and Forestry of Korea 2001, *Agricultural and Forestry Statistical Yearbook 2001.*

History of protection in the Korean beef market

After the mid-1970s, rising incomes led to an increase in the demand for beef. However, production could not meet the increased level of demand. Therefore, in 1976, the Korean government started to allow the importation of beef. As well as beef, live cattle were imported to establish the foundation of beef production. The objective of maintaining a stable supply of beef was achieved, but the price of beef declined drastically as the supply of beef began to outgrow demand. In response, the Korean government prohibited the importation of beef and live cattle in 1985. This triggered a trade dispute, and a General Agreement on Tariffs and Trade (GATT) panel was established at the request of the United States, Australia and New Zealand. Korea accepted the panel's recommendation and bilateral negotiations were held from 1989 to 1993. At these negotiations, the participating countries agreed upon a quota and a Simultaneous Buy and Sell (SBS) system, as specified in table 52.

52 Uruguay Round commitments: quota and SBS

	Quota	*SBS*
	tonne	%
1990	58 000	7
1991	62 000	7
1992	66 000	7
1993	99 000	10
1994	106 000	20
1995	123 000	30

Source: Huh, D. et al. 2000, *Liberalization of the Beef Market and the Method of Developing Hanwoo Industry*, Korea Rural Economics Institute.

53 Quota, SBS and tariff

	Quota	*SBS*	*Mark up*	*Tariff*
	kt	kt	%	%
1994	106	20	95	20.0
1995	123	37	70	43.6
1996	147	59	60	43.2
1997	167	84	40	42.8
1998	187	112	20	42.4
1999	206	124	10	42.0
2000	225	158	0	41.6

Source: Huh, D. et al. 2000, *Liberalization of the Beef Market and the Method of Developing Hanwoo Industry*, Korea Rural Economics Institute.

Korea's Uruguay Round commitment also scheduled the opening of the beef market. From 2001, a tariff only was applied to beef and quotas were disallowed (table 53). The final bound tariff rate has been set at 40 per cent in 2004. The tariff rate after 2004 will be decided following the result of the Doha Development Agenda negotiation.

The Korean beef market was further liberalised in January 2001. The Livestock Products Marketing Organisation, which formerly had the sole right to import beef, was no longer active in this area — anyone who wanted to import

beef could do so, subject to a tariff. Live cattle can also now be imported. The United States is the largest beef exporter to Korea, following by Australia (table 54).

What is beef's role in the political economy of agriculture?

Beef is an important agricultural product in Korea. Long before machines were introduced in rural areas, cattle were a major source of labour and were even regarded as family members. During the period of industrialisation, cattle were raised as a source of income to pay children's school fees — a practice some farmers still continue today. Because of such personal connection to cattle, many college graduates from rural areas support the protection of the beef industry. The close ties many Koreans still have to cattle is one of the reasons why beef is more politically important than other agricultural products.

Beef is regarded as a superior good compared to pork and poultry. The average price of beef is much higher than other meat products due to its particular historical background in Korea. Because cattle were a source of labour and there were no refrigeration facilities, cattle would be

54 Beef imports by country of origin

	1998		1999		2000		2001[a]	
	tonnes	%[b]	tonnes	%[b]	tonnes	%[b]	tonnes	%[b]
US	48 995	56	97 709	49	131 505	55	81 106	56
Australia	30 166	35	79 625	40	70 271	30	45 573	32
Canada	3 995	5	11 616	6	1 615	8	4 839	3
Others	3 962	5	8 535	4	17 405	8	12 333	9
Total	**87 078**	**100**	**197 489**	**100**	**237 841**	**100**	**143 851**	**100**

[a] b1–11. [b] Country share (column may not add due to rounding).

Source: Huh, D. et al. 2000, *Liberalization of the Beef Market and the Method of Developing Hanwoo Industry*, Korea Rural Economics Institute.

slaughtered only when there was enough demand, such as for a festival or wedding in the village. This scarcity of beef made it a superior good. Even though consumers' increased health concerns have recently encouraged the consumption of white meat, beef is still the most preferred type of meat.

Fewer Korean farming households raise pigs or chickens than cattle. In 2002, the number of households that raised pigs was 23 841. Although 217 963 households raised chickens, over 90 per cent of these households raised less than 20 chickens. Therefore, the economic importance of chicken to farmers' income is less important than that of cattle. The political power of farmers raising pigs and chicken is less than that of beef cattle farmers.

Beef has been one of the main subjects of trade disputes between Korea and other countries. Many policy makers and farmers think that the beef sector should be protected against outside pressures and competitors. Even consumers think that the external pressures to open the beef market are a threat to domestic sovereignty. Therefore, policy makers and consumers do not oppose the protection of beef. In addition, many beef cattle farmers believe that the beef market was opened at the Uruguay Round as a trade-off to keep the rice market closed to competition. Essentially, beef farmers believe their interests were sacrificed to protect rice growers' interests and they are strongly opposed to further liberalisation. They suspect that the Korean government will again sacrifice the beef market to protect the rice market in the current Doha Round of trade talks, strengthening their opposition to further liberalisation.

Another reason for beef farmers' strong opposition to liberalisation is their belief that imported beef will destroy domestic beef production. However, the price of Korean beef is currently more than 400 per cent higher than

imported beef. This price discrepancy has shown signs of widening recently, indicating that price divergence will be likely to continue even after liberalisation.

How do the politics of beef protection differ from other highly assisted industries?

The reasons for protecting the beef industry differ from the reasons for protecting other Korean industries. Heavily assisted industries in the non-agricultural sector were protected because policy makers believed these industries needed time to develop competitiveness in the domestic and world market — the 'infant industry' theory of protection. However, in the case of the beef industry, the objectives underlying the protective measures were different. The Korean government protected beef in order to protect the foundation of domestic production and farmers' incomes. The income discrepancy between rural and urban areas widened during the industrialisation of Korea's economy. As beef is the major source of a farmer's income, this sector was protected to prevent the income gap between rural and urban workers widening.

Korea has 273 parliamentary members, 227 of whom are elected by direct election. About half of those elected are from electoral districts that have some relationship to agriculture. The other half have their electoral districts in urban areas, but many also consider the interests of rural areas because they and many of their voters are from rural areas. Therefore, most elected members of parliament strongly support protecting the agricultural sector and this has resulted in the perpetuation of a bipartisan approach to protecting beef farmers.

Other highly assisted industries have employed fewer workers than the beef industry and they are not as well

organised as the beef farmers. Therefore, they have not been as politically powerful as beef farmers.

'*Nong ja chun ha ji dae bon*' (farmers are the foundation of the nation) was the main theme of the ruling classes for many centuries in Korea. Farmers were ranked second only after aristocrats, followed by artisans and tradesmen, in the social hierarchy. Their traditionally high status made it easier for farmers to gain the political support from policy makers and consumers than could any other industry.

There is another reason underlying the protection of the domestic beef industry in Korea that is neither economically nor politically motivated. This is the concept of 'Hanwoo'. To Koreans, Hanwoo is a symbol of their hometown villages where they spent their childhood and where their parents still live. Koreans' sense of duty and obligation towards their hometown is difficult for non-Koreans to comprehend. Tens of millions of Koreans travel back to their hometowns for Lunar New Year or Chusok (the full moon festival), even though the drive may involve more than 10 hours of extreme traffic congestion. These types of cultural factors need to be considered when examining the issue of protection for the Korean beef industry.

Such cultural issues also help explain why Korean consumers prefer domestically produced beef and are willing to pay a higher price for it. However, this is changing. Results from a survey conducted by the Korea Rural Economics Institute show that the number of consumers who consider quality and price to be more important than country of origin has increased significantly.[72]

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[72] Huh, D. et al. 2001, *The Forecast of Hanwoo Industry and Policy Measures*, Korea Rural Economics Institute, pp. 5-6.

Where do the main pressures for reducing protection come from?

All agriculture

The main pressure for reducing protection of Korea's agricultural products comes from abroad — such as the Uruguay Round and bilateral negotiations. The Doha Development Agenda will play a role in opening the Korean agricultural market, as one of the main objectives of the negotiation is to improve market access. Bilateral pressure will be the other vehicle for opening the agricultural market.

To date, Korea has not opened its sensitive agricultural markets voluntarily. However, Korea will need to do so of its own accord in the near future because the average age of Korean farmers is 55 years or over and more than half of them do not have successors. (That is, there will not be enough labour to produce sufficient food for the population and Korea will have to depend on foreign agricultural products to achieve food security.) Diverting farmland to factories and residential areas will promote the opening of Korea's agricultural market in order to ensure a sufficient supply of food for Korean consumers.

After the implementation of the Uruguay Round Agreement on Agriculture, the Korean government increased the budget for agriculture (table 55). However, due to the particular characteristics of the agricultural sector, significant short-run improvements from the spending on this sector were not visible, since most of the budget went into improving agricultural infrastructure. Therefore, there was some opposition to increasing the budget for agriculture. Some policy makers also thought that protection caused inefficiency in the agricultural sector and government spending should be reviewed based on the criteria of

55 National and agricultural budget

	National budget (A)	*Budget for agriculture & forestry (B)*	*GDP (C)*	*Value-added in agriculture (D)*	*B/A*	*D/C*
	Wb	Wb	Wb	Wb	%	%
1993	42 184	4 386	277 497	18 598	10.4	6.7
1995	59 401	7 615	377 350	23 354	12.8	6.2
1997	75 999	7 980	453 276	24 258	10.5	5.4
1998	84 875	7 807	444 367	21 979	9.2	4.9
1999	92 194	7 608	482 744	24 482	8.3	5.1
2000	99 130	8 365	521 959	24 518	8.4	4.6
2001	106 486	8 810	545 013	24 127	8.3	4.4

Wb: Won (billion).

Source: Ministry of Agriculture and Forestry, *Agricultural and Forestry Statistical Yearbook*, various years.

effectiveness and efficiency. Consequently, although the total budget for agriculture and forestry was increased, its ratio to the total national budget fell.

Korean consumers have long supported the protection of agriculture. Many Koreans left rural areas during the rapid industrialisation period after the late 1960s. With relatives still living in the rural areas, these new 'urbanites' regarded farmers as family and opposed opening the agricultural market — and actually supported paying subsidies to the agricultural sector. However, the first generation urbanites from rural areas have now passed away and the second and the third generations' ties to the rural areas are not as strong as the first's. Thus, consumers' concerns about protecting agriculture are weakening while their preferences for less expensive and high quality food regardless of its origin are strengthening. Although the change is not yet striking, the trend is likely to increase as time passes.

Livestock and beef industries

It is difficult to identify the source of domestic pressures to reduce the protection of the livestock and beef industries in particular. As in the case of other agricultural products, the main pressure for change comes from abroad. The main force for liberalisation of the Korean beef market came from bilateral negotiations and the Uruguay Round Agreement on Agriculture.

The same process can be used to achieve further liberalisation of the beef market. Korea might reduce its tariff rate on beef following the results of the Doha Development Agenda negotiation now underway.[73]

Strong bilateral pressure can also have negative effects, such as costly delays in the WTO dispute settlement body. Meanwhile, Korea can use other discriminatory measures against the countries that raise the issue. For example, Korean inspectors can delay the inspection procedure for imports from such countries.

Another influence was the FMD outbreak in early 2000, which caused a serious disruption to the livestock industry and a huge fall in the consumption of beef and pork. To prevent another outbreak, quarantine procedures were strengthened making it more difficult to import beef.

Animal welfare is not a major concern in Korea because Korea is not at the stage of economic development in which animal welfare is important to the population. However, intensive farming methods raise concerns among some environmental groups because the sewage and wastewaters produced by such intense methods cannot be properly disposed and therefore damage the environment.

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[72] If the Uruguay Round method for liberalisation is used again, Korea will not lower the tariff on beef below the minimum requirement because it is a sensitive item.

Where does resistance to change come from?

Consumers

Korean consumers support the protection of the agricultural sector. They believe that agricultural products cultivated and produced in Korea are safer and better for their health than imported food. Consumers adhere to the idea of '*sin tow bul e*': to enhance their health, people should consume food that has been produced domestically, because the human body needs the power of the land that is contained in the foods grown in their own land. Mass media reinforces consumers' health concerns by emphasising violations of food safety regulations by imported food. For example, the media has a contradictory viewpoint on genetically modified organisms (GMOs): they support the development of GMOs by Korean scientists and companies, but criticise the importation of GMOs on food safety grounds.

Farmers

Korean farmers — including beef farmers — maintain the opinion that they have been hurt by industrialisation and export policies: that they have been victims of the fast growth of the Korean economy. They strongly oppose agricultural liberalisation because they believe it is merely a trade-off for access to the industrial goods markets of other countries. The difficulties in negotiating the Korea–Chile Free Trade Agreement (FTA) are an example of this situation. Farmers wanted to exclude the agricultural sector from the FTA now in force. Since the FTA includes agriculture, farmers demand compensation from the industrial sector, which they believe to be the beneficiary. Farmers maintain the same position in the ongoing agricultural

negotiations in the WTO and they strongly oppose the further opening of the agricultural market.

Farmers' organisations

Farmers' organisations — such as the National Union of Farmers' Associations (NUFA), Korean Advanced Farmers' Federation (KAFF), and Korean Dairy and Beef Farmers' Association (KDBFA) — have a very strong voice on the issue of agricultural market opening. The main purpose of NUFA is to prevent the liberalisation of agricultural imports, including beef products, and to achieve national self-sufficiency in food. The organisation was established in 1990 and has 97 branches nationwide. It is the most active farmers' organisation and it has led major demonstrations during the last decade. KAFF is an organisation of farmers engaged in larger scale production of a smaller variety of agricultural products. It has about 47 000 members. The KDBFA is the specialised farmers' organisation, which aims to promote the rights of dairy and beef farmers. It consists of 12 regional branches and 253 sub-regional branches.

These groups are the main engine behind the movement to protect the agricultural sector, and they organise many demonstrations and petitions to maintain and promote protection.

Food processors

Food processors in Korea have different positions with regard to raw materials and processed foods. Processors want to open the market for raw materials, even though the tariff level on raw materials is low compared to other agricultural products. For processed foods, they support the continuation of protection. However, processors are not

influential and are largely ignored by policy makers because they are not well organised.

Distributors

Distributors in Korea are indifferent as to whether they sell local or imported beef and thus do not exert influence on liberalisation. Their main concern is to earn profits from distributing and selling beef, regardless of its origin. If they could gain greater benefits from distributing imported beef, they would support the opening of the beef market. However, given the severe price fluctuations for domestic beef, it is difficult to estimate which type of beef would be more profitable for distributors.

Government

The Korean government has been protecting the agricultural sector for decades. Because every political party strongly seeks political support from rural industries, the Korean government's policy orientation regarding the import of agricultural products has not changed much, even though there were changes in the ruling party. However, there are some differences on the issue of agricultural import protection among the various ministries. The Ministry of Agriculture and Forestry has maintained a position supporting the protection and minimum market opening of the agricultural sector. However, the Ministry of Foreign Affairs and Trade and the Ministry of Commerce, Industry and Energy are in favour of opening the agricultural sector.

Options for building pressure for change

As mentioned in the preceding paragraphs, the main pressure for change comes from outside Korea; however, the attitude of Korean consumers, government officials and non-government organisations (NGOs) are also changing. Until now, environmental groups have not focused on the effects of the livestock industry on the environment. Their concerns have mainly been focused on food safety issues such as genetically modified organisms and hormone use in animal rearing. However, there are environmental problems associated with the intensive farming techniques used by Korean beef and dairy farmers. A stronger environmental lobby that raises issues about the environmental harmfulness of the Korean livestock industry would provide a source of pressure for reducing the protectionism in this sector. Importing livestock products can lessen the environmental damage caused by the continuation of Korea's intensive livestock farming methods.

Some consumer organisations including the Korean Federation of Housewives Clubs and Citizens' Alliance for Consumer Protection of Korea still oppose an open market. They are strongly allied with agricultural non-government organisations such as NUFA and the key members of the Korean NGOs Coalition for the WTO Round Concerning Agriculture, Environment and Livelihood, which emphasises the non-trade concern of agriculture and multi-functionality. The main reason these consumer organisations oppose liberalisation, even though cheap imported agricultural products may help consumers, is their concern about the food safety of imported agricultural products. They question the quality and safety of imported beef. Because no case of BSE has been reported in Korea, consumers believe Korean beef is safer than imported beef.

However, as consumers gain access to more information on the food safety of imported beef (for example, Australia also has no cases of BSE), their attitudes are changing, though the differentiation of the beef market is likely to continue. Many consumers will buy imported beef if they have confidence in the product's quality: for these consumers, the lower price of imported beef will be the most important factor. Other consumers who can afford the higher priced domestically produced beef, will continue to consume it. To penetrate into the market, importers should ensure the high quality and safety of their products.

Exporters of manufactured goods can also influence the importation of beef. Because they have a strong interest in opening export markets, they will be willing to participate in compensation programs if the benefits to them outweigh the costs. For example, when China prohibited the import of Korean mobile phones as a counteraction to Korea's introduction of safeguards on Chinese garlic in 2000, Korean mobile phone makers raised funds to import Chinese garlic after the Korean government increased the quota.

After the 1997 financial crisis, budgetary pressure on agriculture increased because the Korean government had to support other sectors to assist economic recovery. Budget pressure continues; as a result, the budget allocated to agriculture, and support for beef production, will not be greatly increased. To motivate change, it is necessary to emphasize that the gain in consumer surplus from the liberalisation of the beef market is much greater than the loss in producer surplus because it is easier to create change if the majority of the people understand the benefits of market liberalisation.

The most effective strategy for further opening of the beef market is to educate and persuade farmers and farmers' organisations about the positive effects of a liberalised beef

market. To change the attitude of farmers — which is the main obstacle to bringing about liberalisation — it should be emphasised that further liberalisation will not destroy the Hanwoo beef industry. Farmers need to be shown that the beef market can be differentiated — that domestic beef and imported beef can be sold to different groups of consumers.

Conclusion

Korean consumers and some policy makers are now changing their stances on beef protection as they become accustomed to market-oriented principles. However, prejudice still exists about the quality of imported beef (a direct result of poor quality beef being imported in previous decades). To repair the image of imported beef and increase its consumption in Korea, high-quality beef should be imported and a strict quality control mechanism should be maintained. Korean consumers are very sensitive about food safety issues. They do not consume a food if there is any doubt about its safety. Therefore, a single mistake can have serious repercussions on the importation of agricultural products. Continuous and careful attention to food safety is therefore critical.

It will be very difficult to gain the support of Korean farmers for importing beef. However, many farmers are changing their attitudes too. They believe that market liberalisation in the agricultural sector is inevitable and show a willingness to accept market opening if they are adequately compensated. Therefore, market mechanisms in the agricultural sector will be best received if accompanied by policy measures that compensate farmers for losses incurred during liberalisation. However, this should be done by direct payment and not by price support because

price support only distorts the market and is against WTO rules.

Another significant measure would be to provide farmers with correct information about the effects of opening markets. Many farmers are opposed to importing live cattle because they believe that the domestic beef market will be destroyed. However, if farmers realise that raising imported live cattle can be more profitable than raising domestically bred cattle, they will not oppose importing live cattle. Also, the schedule for market liberalisation should be made public. If it is not, there is the risk of a backlash.

The objective of opening the market is to provide safe and high-quality food at reasonable prices to consumers without deleterious effects on the Korean beef industry. To meet this objective, foreign and domestic producers in the beef trade should cooperate. This cooperation will lead to the co-existence of domestic beef and imported beef in the long run without damaging the close relationship between trading countries. For domestic beef to co-exist profitably alongside liberalised imported beef implies greater product differentiation of the local product and structural change. In the long run, both Korean farmers and exporters can benefit from the liberalisation of the beef market if it is accompanied by structural adjustments in the Hanwoo industry.