

Agricultural subsidies in the GCC

**Three principles for
maximum impact**



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EXECUTIVE SUMMARY

Governments in the Gulf Cooperation Council (GCC)¹ face a complex challenge in designing the right agricultural subsidy scheme. Strategy& analysis shows that output-based subsidies, in which governments reward farmers for finished agricultural products, are the prevalent form of subsidy in many countries. Output subsidies offer several benefits as they lead to increased efficiency and productivity for individual farmers and for the whole agricultural sector. They also support a more sustainable approach to natural resources, and they enable governments to track results more easily.

Each country's situation is unique, and output-based subsidies may not always be the most appropriate method. Regardless of which scheme an agriculture ministry chooses, it should use three principles for successful policy design:

- **Policy integration.** Integrate subsidies with other policies as part of a broader agenda to develop the agricultural sector, including a clear exit strategy so that subsidies foster self-sufficiency rather than permanent dependency.
- **Control and transparency.** Institute fraud controls and transparency to prevent misuse of subsidies and to increase the information available to government decision makers.
- **Environmental protection.** Include environmental considerations in subsidy design to ensure they support sustainable use of resources such as soil and water.

SUBSIDIES: A POWERFUL TOOL AND A COMPLEX DECISION

Governments seeking to develop the agricultural sector in their country have a powerful tool available: subsidies. Structured correctly, agricultural subsidies can accomplish a range of policy objectives. They can, for example, ensure food security and social protection, enhance farmers' productivity, stimulate exports, and speed disaster recovery. Each country's situation and needs are unique, and the best-suited subsidy scheme will vary by country. Selecting the most appropriate subsidy scheme, given certain objectives or the desired subsidy impact, is not easy.

The complexity of the decision process is amplified by a dearth of empirical evidence. Governments often lack precise data about the true impact of various subsidy schemes, the opportunity cost of alternative approaches, or even the administrative cost of running such programs. Moreover, any subsidy assessment needs to consider more than the initial financial implications. It must also consider the long-term sustainability of the program, its efficiency, and its fairness in allocating benefits among multiple stakeholders.

Broadly, the two main subsidy schemes are input-based (which lowers the purchasing cost of raw materials for farmers) and output-based (which pays farmers based on finished agricultural products).

The shift from input-based to output-based subsidies

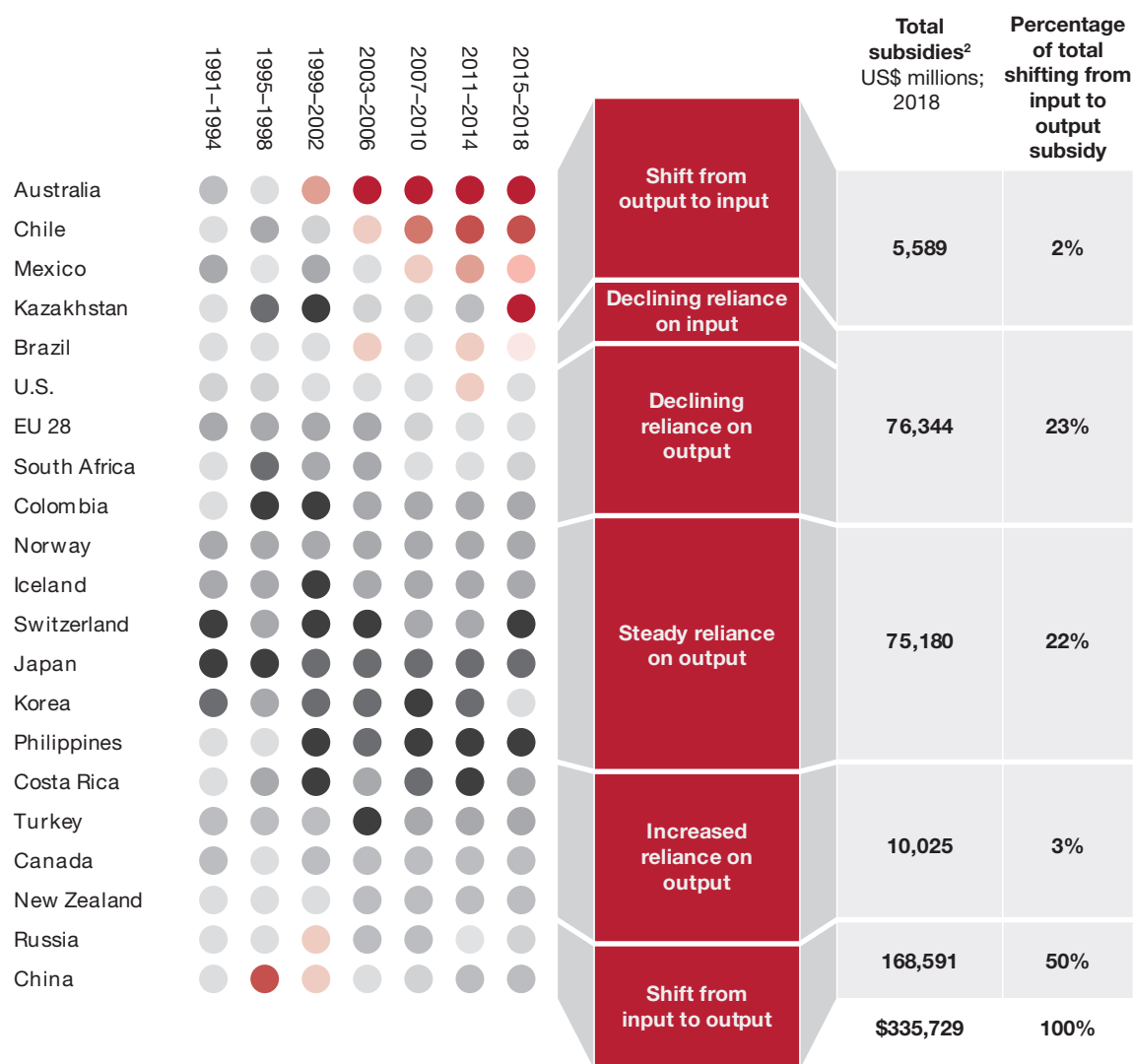
The global trend is toward output-based subsidies (see *Exhibit 1*). In recent decades, countries with large agricultural sectors, such as China and Russia, have shifted to output-based subsidies from input-based subsidies.² Indeed, China has introduced a number of output-based policies to benefit farmers directly and has phased out its taxes on farmers following its entry into the World Trade Organization. Previously, Chinese farmers had paid an agricultural tax based on the productive value of their land, an agricultural specialty product tax, and a myriad of additional local taxes and fees levied by village and township authorities.³

Other countries that have relied on output-based subsidies, such as Canada and Turkey, have increased their use of them relative to input-based subsidies. For example, Turkey's Ministry of Agriculture and Forestry uses output-based subsidies to increase farmers' revenues. The ministry pays farmers based on their production levels of certain crops, such as corn, cotton, rapeseed, and sunflower.⁴

EXHIBIT 1

Output subsidies have become more common

Based on Producer Support Estimate (PSE) Indicator¹ (1991–2018; %)



Shift from output to input

Declining reliance on input

Declining reliance on output

Steady reliance on output

Increased reliance on output

Shift from input to output

Countries that went from mostly output to mostly input subsidy schemes

Countries that relied more on output subsidies, but continued to use mostly input subsidy schemes

Countries that relied less on output subsidies, but continued to use mostly output subsidy schemes

Countries that consistently used mostly output subsidy schemes

Countries that used to rely on mostly output subsidy schemes, and relied more on output subsidies

Countries that went from mostly input to mostly output subsidy schemes



¹ PSE is an indicator of the annual monetary value of gross transfers from consumers and taxpayers to support agricultural producers, measured at farm gate level.

Input subsidies measured based on the values of the "Payments based on input use," a PSE sub-indicator. Output subsidies measured based on the values of the "Support based on commodity," a PSE sub-indicator.

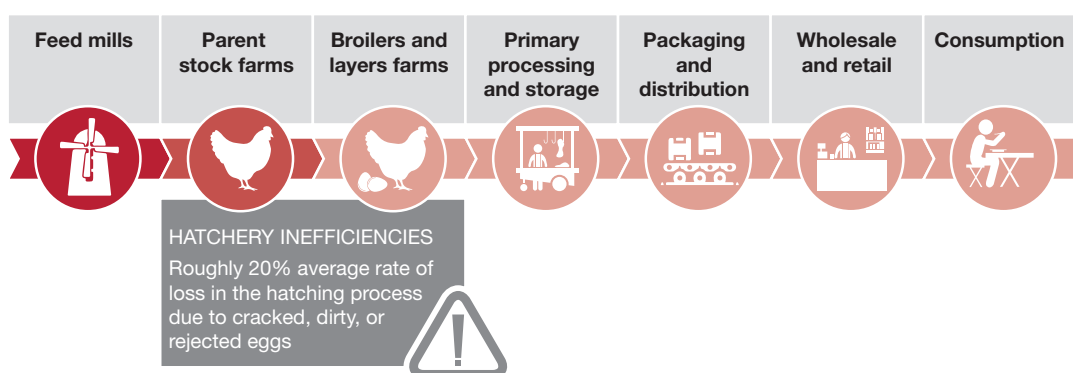
² Calculated based on the summation of input and output subsidies.

Source: Organisation for Economic Cooperation and Development 2019 database, "Producer Support Estimate (PSE)."

Even countries that are reducing their reliance on output subsidies still tend to allocate more to that category than they do to input-based subsidies. For instance, the European Union (through its Common Agricultural Policy) and South Africa have reduced government support and subsidies to the agricultural sector overall, but still rely on output-based subsidies to develop the sector.⁵

The shift to output-based subsidies is also under way in the GCC. For example, Saudi Arabia has recently embarked on a large subsidy reallocation program that aims to lower the level of subsidy on animal feed and instead support finished agricultural products. In the poultry sector, for example, this shift of subsidies from raw materials toward subsequent parts of the value chain could reduce hatchery inefficiencies, which currently amount to an average loss rate of approximately 20 percent (see *Exhibit 2*).

EXHIBIT 2 In Saudi Arabia, subsidy reallocation away from feed mills can reduce inefficiencies



Source: Strategy&

The impact of output-based subsidies

The rationale for output-based subsidies is compelling. Output-based subsidies generally increase efficiency and productivity across the agricultural value chain because they reward performance. They achieve this through payments made for outputs that are agreed in advance, so that farmers know what they have to aim for. By contrast, input-based subsidies can lead to inefficiency and environmental damage because they simply incentivize the use of resources, rather than effective and sustainable consumption of these resources. In India, for example, input-based subsidies have led to the overutilization of some resources, resulting in degraded soil, an imbalance of nutrients in that soil, and depleted groundwater.

Output-based subsidies do, however, come with their own difficulties. Such subsidies typically entail higher administrative costs for governments, primarily because they require more active monitoring of outcomes when compared to input-based subsidies. Output-based subsidies still leave farmers exposed to financial risk and losses in the event of adverse agricultural conditions, such as unfavorable climate, pests, or other problems. Farmers still must pay for inputs and then, at the end of the growing season, receive their subsidies based on overall performance that can be negatively affected by factors beyond their control.

THREE PRINCIPLES FOR SUCCESSFUL POLICY DESIGN

Regardless of whether a country opts for input-based, output-based, a mixture of the two, or some other subsidy approach, it should use three principles for successful policy design.

- 1. Policy integration.** A ministry should integrate subsidies with other policies as part of a broader agenda to develop the agricultural sector, rather than applying them in isolation. Critically, subsidies should also be designed for eventual obsolescence. Rather than lasting indefinitely, they should offer temporary support to farmers and protect them until the sector can become self-sustaining.
- 2. Controls and transparency.** As with any government expenditure, subsidy programs are vulnerable to fraud and misreporting. For that reason, subsidy programs need to include mechanisms and systems to identify fraud and other types of misuse, such as unlicensed operation, or the use of illicit materials or equipment. Technology is making it easier to detect such misconduct. For example, governments can now use electronic systems to verify self-reporting by farmers. Such controls do more than mitigate misuse, they also generate positive effects. For example, subsidy controls provide ministries with more accurate and detailed information that empowers them to make better decisions about individual programs and overall agricultural development.
- 3. Environmental protection.** Agricultural subsidies need to take into account environmental and sustainability considerations, with the goal of protecting the environment and ensuring the most efficient use of water and other resources. Water is a particular concern in GCC countries, which have a chronic water shortage. Some subsidy schemes can have a deleterious effect on natural resources and the environment. By contrast, intelligently designed subsidies can reward the efficient, prudent use of resources, potentially through technology, to ensure the long-term sustainability of the agricultural sector and environmental protection.



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A ministry should integrate subsidies with other policies as part of a broader agenda to develop the agricultural sector, rather than applying them in isolation.

CONCLUSION

Agricultural subsidies are a powerful tool, but also a complex one. To design the right policies, GCC governments should focus on three principles: integration with other agricultural schemes and a predetermined exit strategy; controls and transparency; and environmental protection. Through this approach, governments can ensure that the subsidies they develop generate the maximum possible impact.

ENDNOTES

1. The GCC countries are Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, the United Arab Emirates.
2. Organisation for Economic Cooperation and Development 2019 database, “Producer Support Estimate (PSE)”
3. Fred Gale, Bryan Lohmar, and Francis Tuan, “China’s New Farm Subsidies,” USDA Economic Research Service, February 2005 (https://www.ers.usda.gov/webdocs/outlooks/40443/30113_wrs0501_002.pdf?v=8116.8).
4. Alper Demirdöğen, Emine Olhan, and Jean-Paul Chavas, “Food vs. fiber: An analysis of agricultural support policy in Turkey,” *Food Policy*, 2016, vol. 61, issue C, 1-8 (https://econpapers.repec.org/article/eeeejfpoli/v_3a61_3ay_3a2016_3ai_3ac_3ap_3a1-8.htm).
5. OECD, *Agricultural Policy Monitoring and Evaluation 2020* (<http://www.oecd.org/agriculture/topics/agricultural-policy-monitoring-and-evaluation/>).



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