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Working Paper WP02-11 October 2002

COMMON AGRICULTURAL POLICY:
A EUROPEAN JOURNEY – THEN, NOW AND THE FUTURE

by
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COMMON AGRICULTURAL POLICY:
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Mauro Poinelli

I. INTRODUCTION

Understanding the evolution of the Common Agricultural Policy (CAP) during the last decade would need a glimpse of the transformation of the political, economic and social landscape in which the European Union (EU) operates and in which, its agricultural policy is allocated. Since the Mac Sharry reform of 1992, the CAP went under a gradual reform process, conditioned by internal and external factors affecting the agricultural sector. As with other EU reforms, changes in the CAP revealed that for them to be successful, they must be anchored or built upon their past achievements. Fast or discontinuous changes often reveal a non-feasible option. These past achievements must, however, be reviewed in the context of newly emerging factors of influence shaping the Union and the CAP. The main factors that have been driving the EU reform process can be grouped in the following categories: external factors, such as the Monetary Union and the Enlargement; internal factors, such as societal concerns about food safety, environmental conditions and animal welfare; and such other factors as the need to review the financing mechanism, the influence of structural adjustments, the impact of multilateral commitments and the position that EU hopes to occupy in the future global world.

Only two years have passed since the take-off of the Agenda 2000's seven year program and, despite a good balance of the main domestic agricultural markets with the EU agricultural budget in order, reform of the CAP seems to be once again on top of the EU political agenda.

II. PRIMARY GUIDELINES SHAPING THE CAP

2.1 FROM MAASTRICHT TO AMSTERDAM TREATY

Financial limitations

Until the beginning of the nineties, the EU budget has known periods of great expansion. This expansion was mainly due to unrestricted agricultural spending and to the two "*Delors envelopes*" of the structural funds reforms in 1988 and 1992. At the onset of the Maastricht Treaty in 1993, particular events affected the EU spending capacity and brought about important repercussions for all EU policies.

The first event had something to do with the so-called *"German fatigue"* to keep up on its role as the main net contributor to the EU budget. Previously, Germany accepted to bear the biggest share of the cost of the "Delors envelopes" in exchange for the other EU Partners' commitments to accelerate the completion of the Common Market and to start the European Currency Union. It was also during this period that Germany sought the support of other Member States for its re-unification with the former German Democratic Republic. Having secured the needed commitments and support of other Member States and faced with new economic priorities at home, the German Government started to call for an important reduction in its own contribution to the EU financing. The subsequent deterioration of the country's economic growth, with its national budget coming

under heavy pressure for the Maastricht discipline, made the German's call more and more insistent.

The second important event was brought about by the Currency Union project, which forced all Member States desiring to participate to an austere fiscal policy and often, to undertake unpopular reforms. Most Member States raised taxes and reduced public spending in order to respect the budget deficit ceiling of 3% of GDP and the national debt limit of 60% of GDP. The Stability Pact ratified in 1997 fixed permanently these Maastritch criteria for every State within the Euro zone. As a result, the financial pressure on national budgets induced net contributor Member States to join Germany in its call for a more austere EU budget. The Financial Perspectives for the period 2000-2006, decided in Berlin in 1999, marked the beginning of this financial mood and in the medium term, marked the end of the expansion period of the EU budget. The Berlin Summit capped the EU budget at 1,27% of the aggregate GDP[1] and, as a consequence, agricultural spending, still heading the EU budget, was frozen in real terms[2] at the 1999 level.

The stabilization of the budget, gradually applied by the EU institutions, is another financial principle that in its own way forced the exercise of budget discipline. Pursuant to this principle, several reforms of the Common Market Organizations, aimed at bringing commitment and payment appropriations as close as possible, were made.

Subsidiarity

During the period covered by the two Treaties, factors other than those pertaining to financial imitations as discussed above, emerged to influence the evolution of the CAP. Foremost of these factors is *"subsidiarity"* which embodies the principle that governance should take place as close as possible to the level of the citizens. This principle has been enshrined in the Maastricht Treaty (Article 5) following a series of anti-centralization movement similar to the States' rights movement in the US. This movement was spearheaded by some national Governments, after some controversial rules on subsidiarity has been issued by the EU, and propounded by the German Landers and other local Authorities. The concept of subsidiarity has achieved relative success, especially during the period when the political mood of hostility and indifference by the European population to the central powers were prevalent. The Amsterdam Treaty reinforced the principle of subsidiarity as a legally binding protocol and subject the European institutions to a new set of procedural requirements designed to ensure that such principle is taken in consideration in EC legislation. If recent policies have been sensitively affected by subsidiarity, one can easily surmise its blueprint becoming more evident in the next foreseeable future. The CAP, traditionally centralized, may find itself part of this trend.

Environment and Food Safety

Other factors which influence the CAP are environmental and public health concerns. The Treaty of Maastricht already addressed public concerns of environmental deterioration. This was followed by the Amsterdam Treaty, which then introduced in every EU policy, compulsory environmental prescriptions. For all EU decisions involving environmental matters, the majority rule is mandated.

[1] The “own resources” ceiling was set at 1,27% of the aggregate Member States’ GDP. However, payment appropriations were set at a lower level for the whole period of 2000-2006, between 1,09% and 1,13% of GDP. A margin for unforeseen expenditure was set around 0,14% and 0,18%.
[2] The agricultural guideline remained unchanged and its ceiling will also include the agricultural pre-accession instrument and the part of the amount “available for accession” relating to agriculture expenditure.

Public health was another main concern interpreted by the Maastricht Treaty and which for the first time, became part of EU jurisdiction. The Amsterdam Treaty recognizes that *"a high level of human health protection shall be ensured in the definition and implementation of all Community policies and activities"*[3] and includes *"by way of derogation from art.37"* (CAP) *"measures in the veterinary and phytosanitary fields which have as their direct objective the protection of human health"*. These Treaty pronouncements are significant as they form the basis of the new EU food legislation and the institution of the European Food Safety Authority. It must also be noted that the institutional reform has been triggered in part by the BSE crisis and other food scandals. All these resulted in the creation of a new DG for consumer protection while the Treaty of Amsterdam granted to the European Parliament the co-decisional power in areas involving veterinary or plant health matters when previously under Article 37 (43) of the CAP, these areas are the object of direct EU regulation.

All the above events and factors will play an important role for the model of the future CAP.

2.2 From the Berlin Summit to the Nice Treaty

The austere discipline imposed by the Maastricht criteria on public finance drastically reduced the national spending margin. Additionally, the slowdown in economic growth had been putting more Countries under budget pressure. Countries such as France, Germany, Italy and Portugal were experiencing difficulties to meet their budget commitments. The enlargement of the EU, which will involve, directly or indirectly, a net transfer of resources from the group of fifteen member Countries, is another important source of additional financial stress. The Financial Perspectives decided in Berlin in 1999 foresaw a specific budget for this process, ring-fenced from the global budget of the EU-15, with two new lines for pre-accession aid and enlargement. Financial availability for the enlargement was calculated for six accession Countries from 2002 and granting them no direct payments. The part of the enlargement spending related to the agricultural sector was included in the ceiling of the agricultural guideline. A new heading for EU agriculture, rural development, veterinary and plant health measures, was created with a yearly average budget of 1999 spending in real terms over the period 2000-2006. Structural funds ceiling was reduced, although more concentrated in the lowest income regions (under request by Spain).

From Berlin, the perspectives on the enlargement have deeply changed. The Nice Council decided that ten candidate Countries may join the EU starting in the year 2004. The debate on direct payments seems, by now, to confirm the Commission's proposal of phasing in direct payments for the accession Countries. It must, however, be noted that the agreed timing of the enlargement may be undermined by the second referendum in Ireland on the Treaty of Nice and by some economic difficulties that the EU zone is facing.

2.3 The Enlargement and the Outcome of the Convention

It is worthy to consider two essential elements presented by the enlargement and the Parliament's influence on agricultural issues that can have a critical importance for the future of the CAP. *Firstly,* the fact that the enlargement will strongly increase the influence of agricultural interests in the new enlarged EU as a higher weight of agricultural population is brought in from accession

[3] Article 152

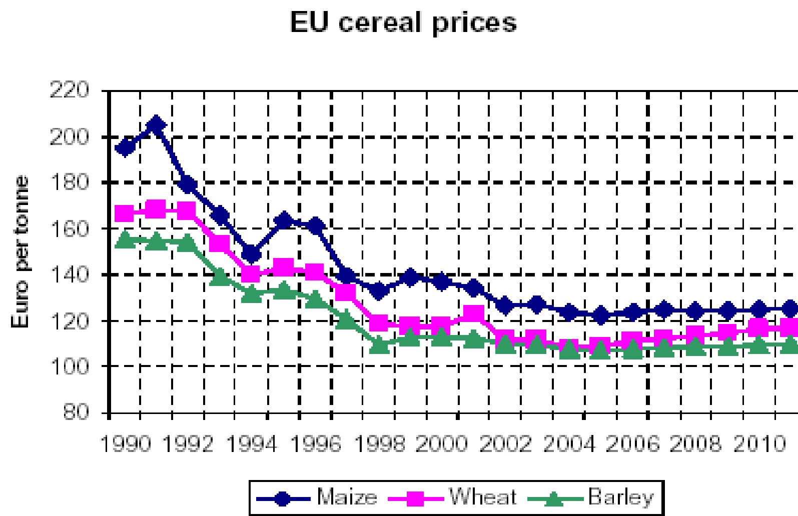
Countries. This would make decisions concerning future reforms more complex, especially the reduction of protection level. *Secondly,* the fact that in spite of the growing strength of the power of the European Parliament (EP) as granted by the Treaty of Nice, agriculture and the non-mandatory expenditures still do not fall within the ambit of the co-decision procedure. An eventual extension of the EP power to agriculture in the coming Treaties' review may cause an important change in the CAP line.

III. MAIN REFORMS OF THE CAP: ACHIEVEMENTS AND GAPS

3.1 AGENDA 2000: GOALS COMPARED TO PRELIMINARY OUTCOMES

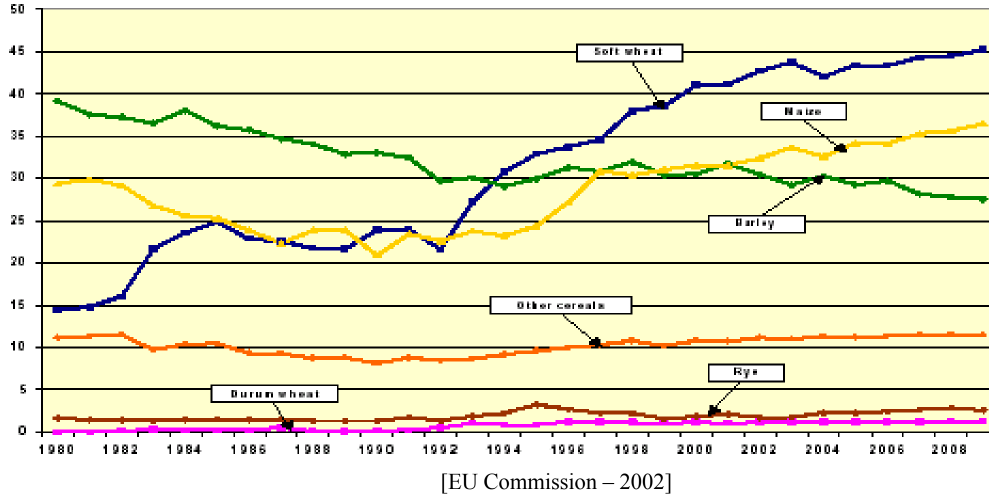
Hereunder is the analysis of the preliminary impact of Agenda 2000 reform vìs-a-vìs its main goals.

- ***A competitive agriculture:***
  Agenda 2000 reduced the support price in line with the reform of 1992. For cereals, this meant a reduction of the intervention price by 40%, from 170 €/ton in 1991/1992 to 101 €/ton in 2001/02, compensated by area payments. As a result, cereal domestic demand has continued to increase from 1992 in spite of a market slowdown in meat production growth, particularly for soft wheat (+95% in volume) and corn (+45%). The non-feed cereal demand trend shows the same development.



[FAPRI EU-baseline, May 2002]

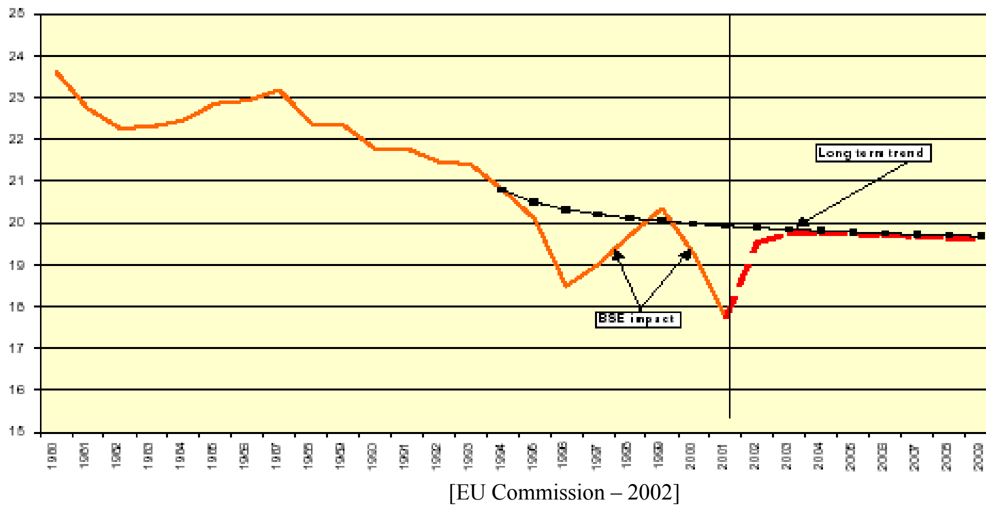
Development in cereal feed demand (Mio ton)



[EU Commission – 2002]

In the beef market, the intervention price has been suppressed since 2002/03 and replaced by a safety net of 54,4% lower than the intervention level of 1991/1992[4]. For this sector, however, the impact has been masked by the crisis of BSE and the dramatic break out of other diseases which have compromised consumers' confidence in beef products[5].

Impact of the BSE on beef per capita consumption (Kg cwe)

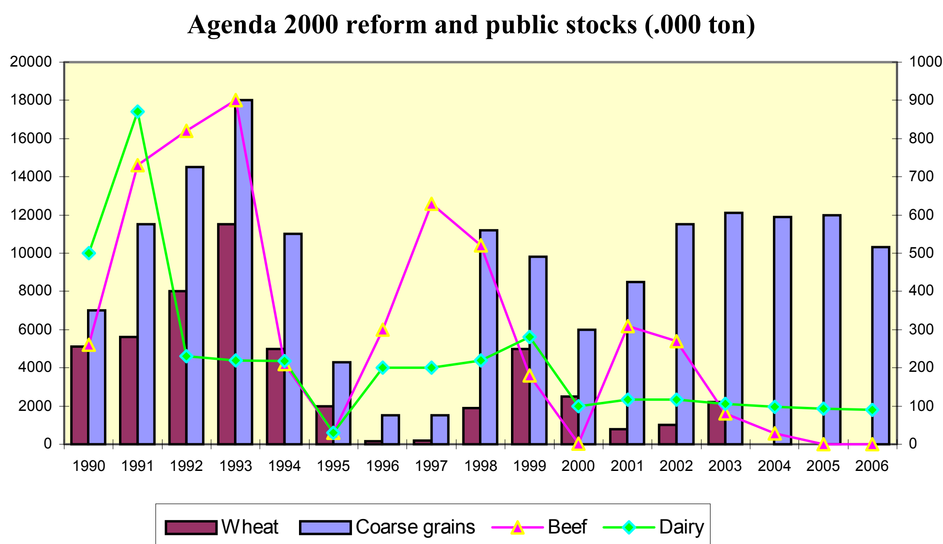


[EU Commission – 2002]

[4] Before to buy-in tender at safety net level (at 1560 €/ton), the private storing is triggered at 103% of the basic price (2224 €/ton). Considering the current basic price, the reduction of the 1991/92 intervention price is 35%

[5] Between 2001 and the beginning of 2002 supply-side measures like "purchase for destruction" and the "special purchase" schemes withdrew and destroyed meat of about 1,1 million of animals. In 2001, ending stock reached 309.000 ton cwe. Beef consumption dropped by 12% between 1999 and 2001. Consumption is expected to return to the decreasing long-term trend around 2003.

The stocks of the main products have been reduced at the minimum levels. This favorable trend should continue for the next years. Only rye is pushing up the stocks of coarse grains to excessive levels



The reduction of the feed costs, brought about by lower domestic prices of cereals, has facilitated the export of poultry and pig meat with lower subsidies needed. The share of export with no subsidies on the whole export is increased from 1991 to 2001, namely for pig meat, from 13% to 60%, and for poultry meat, from 10% to 71%. The full implementation of Agenda 2000 is expected to improve these figures, as confirmed by the forecast of the EU Commission until 2009[6]. Overall, Agenda 2000 reduced market intervention measures by 21% of CAP-Guarantee budget, from a share of 91% in 1991, while it increased the importance of rural development policy to a share of 11%.

- ***Farmers' revenue stability and fair standard of living***

  Successive reforms of the CAP have brought domestic prices closer to the world prices for several commodities. From 1992, the share of farm income coming from the market has decreased substantially while the related volatility has increased due to the higher exposure to the world market. In general, the large increase of relatively risk free resources, such as direct payments has effectively stabilized agricultural income in nominal term for the next 6-7 years[7], although this may bring political considerations to the fore.

  The Agenda 2000 goal of a more equal distribution of the support level across EU and among farmers has not been achieved[8]. The uneven distribution of the price support has been perpetrated by the 1992 and 1999 reforms, with no significant change. This is the consequence of the proportional link established between the average yield level and the

[6] *EU Commission, DG for Agriculture, Prospects for agricultural markets 2002-2009, 2002.* These estimates do not include the Farm Bill impact and the enlargement scenario. It is supposed that a steady $/€ exchange rate is set around parity. A strong €, even for a relatively short time can cause severe problems to some EU markets.
[7] From simulation by the *FAPRI-Ireland policy analysis model*
[8] *EU Commission, Report on Cohesion, The overall impact of the CAP across EU regions – Eurostat, 2000*

amount of direct payments, followed by the refusal of the Council to cap these direct payments per farm beyond a certain level[9].

- ***Diversity in form of agriculture, maintaining amenities and supporting rural communities*** Agenda 2000 created a new budget sub-category for rural development, called "II Pillar" of the CAP, with 11% of the entire agricultural budget. This sub-categorisation allows the splitting of the two Pillars of the CAP and to facilitate the decisional procedure to transfer funds from market support to rural development. Aside from redistributing payments among farmers, the modulation put in place by Agenda 2000 acts in such as way as to transfer resources from direct payments to rural development measures, albeit at a national level. This instrument, the implementation of which is voluntary on the part of member States, is currently observed in France, Germany, United Kingdom and Portugal[10].

- ***Provide public services requested by society*** Agenda 2000 strengthened the agri-environmental program and complemented it with rural development policy. This is the only compulsory program for Member States. No specific incentives concerning food safety or quality are foreseen. The worsening of the BSE crisis and other food scandals highlighted clearly the insufficiencies and limits of the CAP in promoting food quality or safety[11].

- ***Simplification and subsidiarity*** Although the principle of subsidiarity is more and more present in rural development policy, and even in some Common Market Organizations, simplification of farmers' obligations and reduction of administrative costs have been difficult to achieve in view of the complex mechanism of regulation currently in place.

- ***Justification of support vis-à-vis the society*** The Commission proposed in Agenda 2000 the compliance of direct payments to environmental standards. The Council reduced the scope of this principle, allowing Member States to set their own level of cross-compliance. The outcome is a scheme applied with a strong gap and disparity across the EU.

IV. SUBSEQUENT EVENTS TO SHAPE THE CAP

4.1 CAP AND ENLARGEMENT

The more direct effect of the enlargement on the CAP concerns the financial burden to be borned by the Member States. Other issues relating to the multilateral commitments will be analyzed later. The analysis, here under presented, is broken into two periods, before and after 2006, the year when the current Financial Perspectives will expire and the Agenda 2000 program will end.

[9] The Council did not accept the Commission's proposal to cap direct payments in the 1992 and 2000 reforms. During this last negotiation a compromise was reached on a non-mandatory modulation scheme. Each Member States can, therefore, decide to modulate direct payments - in function of their total amount, labour and prosperity of the farm concerned – and use the recovered funds to finance rural development measures.

[10] In France, modulation was suspended with the arrival of the new Government this year. Germany will start to implement it from the beginning of next year, if the new Government that will be elected in September this year will not repeal the law.

[11] A survey carried out by Eurobarometer, shows that only one-third of Europeans believes that CAP delivers safe food products and only a little more than one-third thinks that CAP is promoting enough traditional products. (*2001 Eurobarometer Survey*)

Impact on the EU budget until 2006

The enlargement of the CAP to the accession Countries implies additional costs to be shouldered by EU Members, proportionally to their share to the EU budget. In the current political situation, the enlargement costs can not go beyond the ceiling fixed in the Financial Perspectives 2000-2006 in spite of the fact that accession Countries are no longer six but ten and that area payments will likely be granted to their farmers[12].

The Nice Council has decided the possibility for ten candidate Countries to access from the year 2004: eight are CEECs (Romania and Bulgaria are not foreseen to access before the 2007), plus Cyprus and Malta. In order to respect the timing, the accession negotiation should be finished by the end of 2002. The final accession conditions are still to be negotiated, particularly the details on production quotas and direct payments. The Council has, by now, recognized direct payments as part of the *acquis communitaire*[13], even if they were not taken in account in the Financial Perspectives. The Commission proposed to phase in the area payments in two steps[14]. In the first step, direct payments will start in 2004 from the 25% of the current scheme level, increasing to 30% in 2005 and to 35% in 2006. After 2006, direct payments will increase in percentual steps to reach in 2013 at the same level of support then applied. These payments will be granted over the whole utilized agricultural area without regard to the activity done on it. They will not be under any production obligations although they have to comply with some environmental standards. This simplified scheme can be in place for a maximum period of three years, renewable for other two, after which it will have to comply with the regular scheme then applied in the EU. Accession Countries have the option of not complying but they will loose the incremental increase in the area payment rates. On the basis of its total envelope of direct payments and its utilized agricultural area, an average area payment would be calculated for each Country. The accession Countries must immediately implement the supply control tools. When reliable data are available, production quotas and maximum guaranteed areas will be calculated on the basis of the average of the production level from 1995 to 1999, without considering the lowest and highest values. A three-year rural development program will be applied with rules slightly adjusted to these Countries' needs and situations. The EU co-financing rate can reach up to 80%. Finally, a flat rate aid is granted to semi-subsistence farms.

For the Commission's financial assessment, this proposal respects the spending ceiling of the Financial Perspectives for enlargement from 2004 to 2006, without eroding the margin left for unforeseen expenditure[15]. The Commission estimates' outcomes are showed in the following table:

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[12] It must be noted that the wording used in paragraph 25 of the Inter-institutional Agreement made it clear that the ceiling of heading 8 of the Financial Perspectives (enlargement) has no binding character and therefore, can be increased in case of necessity *"by using the additional own resources resulting from the increased Community GDP after enlargement of the Union"*.

[13] This outcome has been reached at the end of a difficult debate between France and the main net contributor Countries willing to recognized direct payments under the condition of a significant reduction of the agricultural budget during the Mid Term Review.

[14] *EU Commission, Enlargement and agriculture: successfully integrating the new Member States into the CAP, 30 January 2002*

[15] This margin, from 2004 to 2006, is set between 0,16% and 0,18% of the EU's GDP.

Budgetary assessment of the CAP enlargement

Mio € - 1999 price	2004	2005	2006
Commitments			
Direct payments	p.m.	1.173	1.418
Market expenditure	516	749	734
Rural development	1.532	1.674	1.781
Total	**2.048**	**3.596**	**3.933**
Payments			
Total	**1.264**	**3.109**	**3.882**

Source: EU Commission

An access during 2004 will grant the right to area payments only during the succeeding financial year, in contrast to the market intervention and rural development policy wherein payments should be computed as of 2004[16].

In view therefore, it is possible to conclude that the eventual implementation of the Commission's negotiation proposal will not create particular financial problems that will demand a deep reform of the CAP before 2006.

Impact on the EU budget after 2006

The post-2006 spending ceiling will be fixed by a political decision during the new Financial Perspectives negotiation. A scenario at 2013 with a EU-27, without changes in the CAP and full area payments granted to all the farmers, foresees an additional EU spending estimated to be almost 12 billion € (price 1999)[17]. In terms of the EU's present farm budget that would represent higher borrowing requirements of around one-fifth. The new Countries will contribute fully to the "own resources" of the EU, at least from the financial year after accession. In the table next following, it is supposed that a part of the accession Countries' "own resources" will contribute to finance the agricultural heading, in proportion to agriculture's share for 2006 on the total budget. Adding this amount to the enlargement budget set aside for 2006, it is supposed to get the maximum of financial availability for the agricultural sector for the whole EU. As it may be observed, the system is in deficit already from 2008, the year in which Romania and Bulgaria are supposed to access. In this financial scenario, then, the CAP will not be sustainable by 2008. The reforms of sugar and rice would make the budget even tighter.

The increase of the farm budget to almost 20% in return of a EU GDP expansion of barely 5%, would be a very unlikely political decision. The net contributor Countries, which would thus have to bear the main share of the enlargement costs, will increase pressure to introduce some saving measures in agricultural spending, specifically targeted to area payments, which represents about half of the additional agricultural spending. The main possible options may include: (1) decreasing the level of EU-15's direct payments; or (2) introducing the co-financing of the direct payments by the Member States. This last option maintains similar farmers' direct support and addresses the problem of the net contribution imbalances among Countries.

[16] Most area payments are paid to farmers only after the 15 October. *Communication from the Commission: Common financial framework 2004-2006 for the accession negotiations, 30.1.2002*

[17] Other studies reached comparable results on enlargements costs. Simulation by IAMO (Institute of Agriculture Development in CEE) partial equilibrium model calculates an additional cost for the EU budget of 8 Billion € (1999 prices) in 2007, taking the 2007 as a year of accession of ten CEECs benefiting from full direct payments. Similarly, the Institute of Agro-Economy of Gottingen University estimates an additional cost for the EU budget of 11 billion € (1999 prices).

Financial needs and available resources in an extended EU

Mio euro (1999 prices)	2006 (1)	2007	2008 (6)	2009	2010	2011	2012	2013
Market regulation	734	2,180	2,771	2,795	2,822	2,900	2,946	2,992
Rural Development *(2)*	1,730	2,655	3,004	3,154	3,312	3,477	3,651	3,834
Direct payments *(3)*	1,418	1,794	2,570	3,027	3,483	4,008	4,532	5,057
Demand for payments	**3,882**	**6,629**	**8,345**	**8,976**	**9,617**	**10,385**	**11,130**	**11,883**
Enlargement agriculture *(4)*	3,933	3,920	3,920	3,920	3,920	3,920	3,920	3,920
Additional own resources *(5)*		3,651	4,130	4,337	4,554	4,782	5,021	5,272
Maximum available funds		**7,571**	**8,050**	**8,257**	**8,474**	**8,702**	**8,941**	**9,192**
Deficit			*(295)*	*(719)*	*(1,143)*	*(1,684)*	*(2,189)*	*(2,691)*

(1) from EU Commission proposal
(2) Estimates assumes that the same share of RD on the structural funds capped at 4% of GDP is maintained
(3) Increasing steps as the EU Commission is proposing. For the two last accession Countries, the same phasing in scheme is used
(4) Enlargement funds and pre-accession funds of 2006 level
(5) Share available for agricultural spending (42,5%), supposing that accessing Countries contribute by 1,1% of GDP (appropriation payments % GDP of 2006) to the EU budget
(6) Accession of Romania and Bulgaria under the same conditions

4.2 THE CAP AND THE WTO

The respect of multilateral trade agreements may constitute a conditioning factor for CAP development. Herein below is an evaluation of some impact of WTO commitments of the EU, in view of the status quo and considering near future events, such as the enlargement and the ongoing WTO Round. The main WTO commitments binding for the agricultural sector are: reduction of the domestic support; reduction of the export subsidies; and expanding market access.

Domestic support

Status quo

The URAA commits the developed Countries to reduce 20% of its Aggregate Measure of Support in six years (from 1995 to 2000), from the base period average level (1986-1988). The AMS involves support that causes distortion to trade, classified as "amber box". Other measures of support are exempted from reduction, classified in the "green box" and "blue box". While the green box measures are completely decoupled from production, the blue box measures are partially decoupled and only temporarily exempted from compulsory cut.

In line with the 1992 reform, Agenda 2000 transferred part of the domestic support from the amber box to the blue box, particularly decreasing the price support of cereals, beef, sheep meat, dairy and cheese products, and compensating by direct payments. With Agenda 2000 fully implemented and considering the steady price support of other products not directly included in Agenda 2000 (sugar, wine, fruits and vegetables, tobacco and olive oil), except rice, the AMS will be almost 35 billion of €, widely under the AMS ceiling fixed in the URAA of 61,2 billion of €. The reduction of the AMS has been achieved by increasing the blue box that, with Agenda 2000 fully implemented, will reach 25 billion of €.

In the URAA, there is no limit to the exemption of the measure included in the blue box. As a result, Agenda 2000 has recovered a big margin under the domestic support ceiling. The EU may

still be able to accept an important reduction of the amber box support without the need of changing its current support scheme. The safeguard of the blue box leaves a wide margin for the CAP.

Ongoing WTO Round

In the course of the current WTO negotiation, a wide alliance of Countries is calling for an end to partially decoupled payments (in other words the suppression of the blue box). The expiration of the "peace clause" in December 2003, to some extent, may also put under pressure the EU support system[18]. Owing to the last two reforms which reduced price support more than increased direct payments, the EU may, however, comply with the current AMS ceiling even without the blue box, particularly after reforms of some specific sectors such as sugar, tobacco and rice.

On the other hand, an agreement, which will result to a further reduction of the AMS, jointly with the suppression of the blue box, may create difficulties for EU to comply. It is likely that, whenever this hypothesis creates too many problems for the EU, a less extreme compromise will be reached; that is, eventual phasing out of the blue box and a further reduction of the amber box, along with a substantial revision of the green box. The EU, supported by other Countries, has called for an extension of the green box to other measures, such as animal welfare, food safety and quality, support for development and multifunctionality.

If the current situation and the next Round's outcome will not pose a serious concern for the EU-15, a different situation may be prospected in a bigger EU.

Enlargement

It is difficult to foresee right now the impact of the enlargement on the AMS ceiling. There are still the elements to be fixed by the accession negotiation. Added to this is the fact that under the GATT regulation, there are no precise rules for aggregating domestic support in case of a border merging. For a simple evaluation, however, it is supposed to sum up the domestic support commitments of the single merging Countries. The implementation of the Commission's proposal on the enlargement should not cause any problem until 2007-2009. All direct payments granted to the accessing Countries will be decoupled from production for the whole transitional period of 3, plus 2 years. Assuming that accession of the first ten Countries is completed by 2004, these payments will not be classified in the blue box (or amber box, depending on the outcome of the Round) until the 2007-2009, or when the new EU members do not fully comply with the *acquis communitaire*. By this time, therefore, the EU should not have any concern to overtake the domestic support ceiling then in force.

In the following table, the AMS and blue box levels of the EU-25 are calculated, supposing to grant full area payments to the candidate Countries. Although this scenario may well bear a reduction of the amber box, even by a third, an eventual suppression of the blue box should cause difficulties for the EU to comply with the domestic support ceiling. Likely, even the reforms of the sectors not included in Agenda 2000 (announced for the 2003 and not taken in account in the lower table calculation), would be not enough to reduce the EU's AMS under the WTO ceiling; similarly, the extension of the green box as it is asked for by the EU during the present Round. The EU, then,

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[18] Article 13 ("due restraint") of the Agriculture Agreement protects countries using subsidies and which comply with the agreement from being challenged under other WTO agreements. Without this "peace clause", countries would have greater freedom to take action against each others' subsidies, under the Subsidies and Countervailing Measures Agreement and related provisions. The peace clause is due to expire at the end of 2003.

would be obliged to reduce in a generalized way the direct payments and/or to decouple them from production, by 2007-2009.

Agriculture domestic support in an EU-25 with full CAP area payments

(Million of euro)	**EU-15** *(1)*	**Candidates** *(3)*	**EU-25**
AMS limit *(1)*	61.200	4.200	65.400
AMS value (2)	34.600	8.250	42.850
Margin	*26.600*	*- 4.050*	*22.550*
Blue box *(3)*	25.037	6.600	31.637

(1) Calculated on the basis of EU Commission market forecast 2002-2009 and other unpublished EU Commission estimates (2000)
(2) Include a hypothesis of reform of dairy and rice and not other announced reforms by 2003 (like sugar, olive oil, fruits and vegetables).
(3) Aggregation of country limits, converted in euro. Considering granting 100% of area payments to the candidate countries

Export subsidies

Status quo

About 90% of the world's export subsidy expenditures are attributable to the EU, which ranks as the second biggest exporter of food products in the world. As a result of the URAA, export subsidies were capped and reduced yearly for each of the 22 categories of products. By the end of 2000, export subsidies were to reach expenditure levels and quantity levels at 36% and 21% respectively, below those of the base period of 1986-1990.

Generally, quantity ceilings have been relatively more important than expenditure ceilings[19]. Until now, expenditure commitments constrained particularly the export of sugar, dairy products, pig meat and alcohol, while quantity commitments have been more restricting for rice, coarse grains, dairy products, pig and poultry meat, wine, fruits and vegetables. In the past, the use of the "roll over" has allowed certain flexibility for the management of the subsidies. The end of it in 2001, accrued the pressure in the markets which have not yet been completely reformed.

On the other hand, domestic price reductions made by Agenda 2000 should grant enough margins for main agricultural products. The situation may become tighter in the next years for dairy products (in spite of a certain release brought by the intervention price reduction decided by Agenda 2000, of the 15% over three years from 2006), rice, wine, sugar, fruits and fresh vegetables[20]. For the beef market, the situation much depends on the recovery of the demand after the BSE crisis. Generally, it can be foreseen that the volume ceiling will continue to be more constraining than expenditure ceiling, even if the latter can become more and more important in case of further reduction commitments.

Ongoing WTO Round

In the negotiation positions presented to Geneva for this Round, export subsidies represent a priority for most of the delegations. The Doha Declaration called for a phasing out, although subject to the clause of "*without prejudice to the outcome of the negotiation*". The EU declared that it is ready to reduce substantially export subsidies on the condition that all export incentive

[19] *OECD Report on export subsidy aspects of UR implementation*
[20] *WTO pressures for agricultural policy change, ERS, 1999*

tools are to be treated in the same way[21]. The United States seems to be open to this position. The strong pressure against the EU export subsidies will likely commit the EU to the subsidies' phasing out, although slowly and subject to certain exceptions. Such kind of commitments may not have a strong impact on the recently reformed sectors (considering a balance $/€ exchange rate) but may instead create a surplus in the dairy[22], sugar and rice markets[23]. It must be noted, however, that in general terms and considering the hypothesis of a EU commitment for substantial reduction of export subsidies, the main agricultural sectors should be under pressure not earlier than 2006 in a EU-25.

Enlargement

The enlargement will have an impact on ceiling commitments and amount of exportable products. The impact on export subsidy commitments in an enlarged EU is difficult to assess, as several details in the given scenario are wanting[24]. The difficulty in assessment is compounded by the fact that GATT does not fix precise rules on the aggregation of the ceilings. The conditions of the customs merger have to be negotiated with other WTO Members and the final outcome may be different from the simple sum of the ceilings commitments of individual Countries (less trade among the two merging parties). The enlargement will also alter the perspectives and the amount of exportable products in an extended market, which will particularly depend on price support and quotas production levels, the demand and yields growth in the accession zone. Generally, the increase in prices and subsidies' level of farm products during the enlargement in the newcomer Countries, may lead to an increase in supply and higher export. However, it can be argued that as a result of the adjustment process that has been going on, only few relevant price gaps will remain. Moreover, the introduction of production quotas will also contribute to contain the increase in production. The result of a simulation of supply and demand’s changes induced by enlargement in ten accession Countries (supposing access in 2007, the introduction of production quotas and full area payments) is shown in the following table:

Changes in CEECs resulting from EU accession in 2007

(Var. %)	**Supply**	**Demand**
Wheat	-7	4
Coarse grains	-1	-1
Potatoes	-3	4
Oilseeds	-1	1
Raw sugar	-4	-13
Vegetabiles	-14	4
Milk	-4	-17
Beef	22	-33
Pig meat	-6	8
Eggs	-1	14
Poultry meat	-11	30

Source: IAMO model

[21] Examples are "unfair" food aid practices, subsidized export credit and exporting STE

[22] *OECD A forward looking analysis of export subsidies in agriculture, 2002*

[23] The balance in these two sectors is even threatened by the recent EBA regulation that grants a phase in of a duty free scheme in favour of the LDCs’ imports. For this reason, the EU Commission has announced a reform proposal for 2003.

[24] Only some candidate countries, specifically Cyprus, Czech Republic, Hungary, Poland, Romania, Slovakia and Bulgaria, ratified agreements on export support reduction.

The impact of the merger between the EU-15 and CEECs' agricultural markets may, however, be very different from the simple sum of individual changes in supply and demand. For some products, an increase in supply in CEECs may be balanced by an increase of the demand in the EU-15, or vice-versa. The EU Commission has analyzed the impact of the extension of the CAP considering the entire EU-27 single market. The results of this scenario, with full direct payments, show no particular heavy market situation[25]. Marketable surplus may specially occur in wheat market, exported without need of subsidies, barley market, in which the support is sensitively related to the $/€ exchange rate; beef market, with enough flexibility when the long term trend of demand has been restored, and in the dairy market, where only standard products will face a heavy situation. Similar conclusions are reached by other analysis. A simulation applied in the case of accession of Poland, Hungary and Czech Republic (summing up the single export subsidy ceilings) shows tighter margin for dairy products and beef[26]. Vice-versa, fruits, vegetables, some cereals and eggs can enjoy a more flexible position. Another simulation of a EU-27 scenario shows insufficient volume ceilings for cereals, dairy products and pig meat. The expenditure ceilings may be restrictive for sugar, dairy products and pig meat. A supposed increase in world prices by 25%, although with reduction of global spending in subsidies, will not sidestep the problems for these products. An increase of the CEECs production level by 10%, will not affect much the position of individual products in relation to export subsidy ceilings[27]. Given all these, it can be concluded that the enlargement should affect those markets with already foreseeable tight margin in the current EU-15.

Market access

Status Quo

As a consequence of URAA, variable import levies were replaced by tariffs, which were then gradually reduced from 1995 to 2000 by an average of 36%, with a minimum of 15%. The level of these rates was based on the average difference between the world market price and the intervention price in the reference period 1986-1988, plus 10%. For certain products, additional rates were agreed, on the basis of a special clause (special warranty clause). Beyond these commitments, it was also agreed to reach a market access of at least 5% of domestic consumption by year 2000, by opening quotas with lower import tariffs or through other ways.

It seems that the above commitments have not substantially affected the EU market protection[28]. The new rates, fully reduced for different reasons, have been set high enough to guarantee a good market protection[29]. Similarly, market access commitments entailed few problems for the EU market. The average bound tariff rates for over-quota imports are still higher than 87% for beef and sheep meat, dairy products and processed rice, while it is around 76% for sugar[30]. For cereals and rice, duties were calculated based on the intervention price level[31]. In the case of fruits and

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[25] *EU Commission, DG Agri, Analysis of the impact on agricultural markets and incomes of the EU enlargement to the CEECs, March 2002*

[26] *WTO pressures for agricultural policy change, ERS, 1999*

[27] *Silvis and Van Rijswick, EU agricultural expenditure for various accession scenarios, 2001*

[28] *Silvis and Van Rijswick, Tussen interventie en vrijhandel: WTO en de Nederlandse agrosector. Agr. Ec. Res. Inst., 1999*

[29] *Swinbank, Alan, CAP reform and the WTO: compatibility and developments, Eur. Rev. of Agr. Ec., 1999*

[30] General protection not reflecting trade bilateral agreements

[31] The current system to calculate EU import duties for cereals takes US Commodity Exchange quotations as representative for world cereal market prices. These quotations, by adding both commercial premiums applied on the US market and transport costs, are then converted into theoretical CIF-Rotterdam prices, which are compared to 155% of the EU Intervention price. The EU Commission just proposed to change the protection system because during the last year, new exporters have started to sell grain at prices well below other world market prices.

vegetables, the new custom duty system is not very different in terms of protection assured by the previous reference price system.

Market access commitments are easily met only by the implementation of trade agreements granted unilaterally by EU to third Countries. Two thirds of EU's agricultural imports come from Countries with preferential agreements[32]. These non-reciprocal trade agreements or preferences include such instruments as the Generalized System of Preferences, LDC preferences, Europe agreements, Euro-Mediterranean agreements and other bilateral agreements[33]. It is also worth noting that for several reasons, most of the Tariff Reduced Quotas (TRQs) consolidated in the URAA have not been fully exploited. An analysis undertaken by the WTO shows how only 38 TRQs on 87 of the EU, have been fully filled and 11 have been exploited at less than 10%[34]. On the other hand, what have been particularly well exploited are the quotas which are open to dairy products, high quality beef, sheep meat, sugar, bananas and corn, and wheat during the years of high world prices. The *safeguard clause*, though not often utilized, has guaranteed domestic market against excessive fall in the prices. On this basis, it can be concluded that the current WTO commitments on market access will not imply particular problems for the European agricultural market.

Ongoing WTO Round

Given the WTO Members' positions presented to Geneva on this issue, it can be foreseen that the final compromise of the present Round may contain a mix of the following: discreet reduction in the average of the tariffs; substantial reduction of tariff peaks; and increase in the scope of the TRQs. The first and the second option should not result in an important decrease of domestic market protection. This consequence is also due to the lower intervention level set by the recent reforms. In contrast, an increase of the TRQs may deliver a stronger impact, particularly in the most protected sectors (e.g. dairy products, sugar and rice). However, it is expected that the major impact on the EU market protection will come from enlargement and bilateral agreements. The EBA regulation is an example of great impact for sugar and rice markets, starting from 2007-2009[35].

Enlargement

During the negotiation of the import tariffs, the CEECs were granted a special treatment. Each CEEC sets its own rates, with no obligation to be based on historical levels[36]. The average rates were set at a fairly higher level than previous levels. In any case, these rates were generally lower than those applied at the Common Customs Union, particularly for cereals, sugar, dairy products and beef.

The customs merger implies the creation of common customs tariffs, which must be negotiated with other WTO members. The simple extension of the present common customs tariff, would cause the compensation (e.g. granting extra tariff-quotas) to third countries to be penalized. Conversely, the reduction of the current import rates to the accession Countries' level, will give the EU the right to ask for compensation from the beneficiary Countries.

[32] *World Trade Atlas, data for 1998-2000*

[33] In particular, GSP reduced tariffs (from 15% to 100%) for selected products are provided to 146 developing Countries; LDC preferences were replaced by EBA which provides 49 LDCs duty free access to EU market with no quota for all agricultural and processed products.

[34] *WTO, Tariff quota administration methods and tariff quota fill, 2000*

[35] EBA provides duty free and quota free access to the UE market for all the commodities and processed products from LDCs, from March 2001. For banana, rice and sugar, a transitional period is foreseen. As for the last two products, the duties phasing out follow this scale: 20% in 2006, 50% in 2007, 80% in 2008 and complete suppression in 2009.

[36] *Tangermann, S., Widening the EU to CEECs: WTO and the perspectives of the new Member States. Wagen., 2000*

The negotiation of the common customs tariffs will have a more important impact on the domestic market protection as compared to the last enlargement. The average tariff level for Austria, Finland and Sweden was far higher than the EU's. Although it is difficult to predict the extent of the impact, as the details of accession have not yet been agreed, it can be expected that such impact on the domestic market protection may become evident shortly after the completion of the single enlarged market.

V. COMMISSION'S NEW PROPOSAL FOR THE MID TERM REVIEW

5.1 GAPS TO BRIDGED

The decision of the Berlin Summit on the Mid Term Review

The conclusion of the Berlin Summit states that the "*Commission and the Council are requested to pursue additional saving to ensure that total expenditure, excluding rural development and veterinary measures, in 2000-2006 period will not overshoot an average annual expenditure of 40,5 billion euro*". The Summit also recommended for market imbalance to be addressed as well.

Market prospective recently elaborated by the EU Commission[37] shows that only the rye market has a serious surplus problem for the next coming years. Other markets are substantially balanced, with the lowest stocks among those in the last decade. Furthermore, agriculture spending respects the ceiling, even taking in account the enlargement from 2004 to ten accession Countries, against the six countries foreseen in 1999.

One clear mandate the Berlin Summit conferred to the Commission concerns the evaluation of the opportunity for a further 5% cut in cereal intervention price. In the last year, most of the cereal exports were made without subsidies[38]. The intervention cut will cause the same decrease in import levy. Given the increases of wheat imports during the year 2002, assessment of the potential net benefit for a further reduction becomes more controversial with no change in the import levy system. The beef market situation is improving, as a consequence of the demand recovery. So there is no need of immediate reform. For the milk quota scheme, the Commission is called to issue an evaluation study on different policy options after the year 2008[39].

New societal needs to be addressed

During the elaboration of Agenda 2000, serious events drastically worsened the consumers' and citizens' image of and confidence in the agricultural sector. The need to justify support of the agricultural sector became, therefore, a priority for the EU agenda. Decision makers tried to find ways and means to deliver a higher level of food safety, protection of the environment and countryside. In a recent Eurobarometer survey, it is found that 90% of Europeans believes that the first policy objective of the CAP should be the promotion of safety and healthy food; 88% are strongly in favor of environmental protection. Furthermore, most of the Europeans think that the CAP does not do enough to address these issues[40].

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[37] *EU Commission, DG agriculture, Prospects of agricultural markets 2002-2009, 2002*

[38] Export certificates delivered, in ton, decreased by 41% during the period June 2000- June 2002 for wheat and by 70% for barley.

[39] The EU Commission has just issued the recommended study wherein four scenarios are evaluated. The conclusion is slightly in favor of a quota scheme, although a more flexible scheme than the current one.

[40] *Last Eurobarometer poll of mid-2001*

Developing a more market-oriented farming sector

Recent market developments suggest that competitiveness of the agricultural sector and the stabilization of the farmers' income in the long term can be improved not only by reducing price support but better still, by increasing the quality level and differentiation of production. Progressing from commodities - which characterizes the model of mass production and undifferentiated demand - to highly differentiated products - such as typical, organic, OGM-free products, and to a certain extent, certified products – the EU sector gains both added value and the citizens' confidence.

Building on public's enthusiasm for locally-produced food, "environmental friendly" or other special crafted processed products, is a great opportunity for farmers to add value and gain a bigger slice of the price mark-up. Local foods are seen by retailers as one of the main force for the next development in food market. The boom of organic demand in Europe proves these phenomena. In several European regions, local food has created a niche in the market above expectations. Lack of technical knowledge, particularly in quality, marketing, information and training areas is, however, the main barrier to the development of these products. Investment facilities in the rural development programs are often, with difficulty, beyond the reach of small farms which are more involved in the production of such products, and local food network's operators. A successful sale and marketing of these products, especially those which are geographically indicated needs to be undertaken as a group initiative, with enough volume to warrant investments. Incentives for farms producing local foods to group together are in this respect important. Quality tools, such as certifications and traceability, make farmers more aware of the consumers' demand, as well as retailers' and processors' requirements. They are powerful tools that can improve the food channel functionality and efficiency, thereby, forcing farmers to coordinate closely with downstream operators and at the same time, push the processors and traders to restructure themselves.

Agenda 2000, despite its commitment, did not assure enough resources and tools for the issues above discussed, issues that stand at the core of the multi-functionality concept that was first introduced by Agenda 2000. The Mid Term Review may be an opportunity to improve the market capability of European farms along with providing an effective response to these societal needs.

Agenda 2000's objectives not successfully achieved and other market issues

Aside from societal demands, Agenda 2000 was not able to achieve some of its other goals, such as the redistribution of public resources, particularly of direct aids, the simplification of the CAP mechanisms and the cutting of red tape as previously discussed. Moreover, the implementation of the EBA regulation necessitated the reform of the rice market so as to avoid severe problems for the domestic market. The same goes for the sugar market. Other CMOs are facing problems and would need to be reviewed, such as fruits, vegetables and wine.

5.2 PROPOSAL CONTENT

The EU Commission's proposal emphasizes issues which were not addressed sufficiently by Agenda 2000. A careful reading of the proposal would, however, reveal other issues particularly related to enlargement preparation.

Emphasized Issues

Emerging societal needs

New accompanying measures will be introduced in the rural policy, encompassing a new *compulsory chapter* on food safety, quality, hygiene, animal welfare and environment. The specific measures are:

- A five year flat rate payments for farmers setting up quality assurance and certification schemes, including organic farming and geographical indication of origin;
- Support of producer groups in promotional activities related to agricultural products designed under quality assurance and certification schemes;
- Temporary and declining support to farmers implementing required standards in the areas of food safety, animal welfare, environment, employment safety, which will be included in the new "good farming practice".

In order to finance these wider policy objectives, a transfer mechanism of funds from direct payments to rural development measures is proposed. This so-called "dynamic modulation" will be compulsory for all the Member States and will involve an increasing cut of 3% a year, up to 20%, from the year 2004. The modulated funds will flow to the EU budget (rural development sub-heading) and then redistributed to Member States to be used for strengthening rural development in widely different ways, including among others, new compulsory quality chapter.

Redistribution of funds

A franchise of 5.000 € of direct payments up to 2 full time working units is foreseen, plus additional franchises of 3.000 € for each additional working unit, will exempt small farmers. Furthermore, direct payments are capped at 300.000 € per farm after applying modulation and franchise. The amount saved by modulation will flow to the EU budget and will be re-distributed to Member States based on certain "cohesion criteria" (agricultural area, farm employment, farm prosperity and other specific rural needs), while the saving from capping will be delivered accordingly with the amount capped in each Member States. Through this mechanism, the Commission intends to redistribute funds among farmers, States and products.

Simplification

The Commission proposed to replace as many as possible current direct payments with a single decoupled income payment per farm. This single payment will be calculated on the basis of historical records of payments received by the farm. Under this scheme, payments will not be subject to production obligation. Farmers will be able to farm all products in their land, with only few exceptions specifically identified. Only fruit and vegetable crops would not be eligible for support. However, the same rules of the coupled systems will still apply. This scheme will cover cereal, oilseeds, protein crops, starch potatoes, beef, sheep and dairy (when implemented by Agenda 2000 program). Payments for rice, durum wheat and dried fodder will follow once reformed. Payments for sugar, olive oil and some fruits and vegetables may be included as well, after reform.
On the other side, specific payments will be left out, such as quality premia for durum wheat, crop specific aid for rice, nuts and new protein crop supplement.

Justification support

Aside from wider rural development measures, a more rigid cross-compliance is introduced for the single income payments per farm. Conditions relating to statutory food safety, environment and animal welfare standards are required. The current scheme of *compulsory set aside* will be

transformed to an environmental compulsory scheme, lasting 10 years on a non-rotational basis. Non-food crops cultivation will be excluded from this new scheme.

Increase competitiveness

To increase competitiveness, three salient areas were tackled.

(1) The new compulsory "chapter on quality" which is aimed at improving the global quality level of the EU agricultural and food production.
A rural development package with more financial availability can be an opportunity to develop farms' activities which are more consumer oriented and with higher value added. For instance, the development of local and regional food markets, boosting farms' investments and initiatives for promotion and advertising aimed at building the public's enthusiasm for food with regional origin or at acquiring environmental friendly practices or special craft practices, and so on. Rural development funds and food safety tools can even encourage and improve marketing channels connection between producers and consumers, as well as cooperation between farmers and food processors and/or retailers. The development of new markets and diversified activities, such as tourisms, land management, etc., can substantially contribute at improving and stabilizing farm income.
(2) The on-going reduction of domestic prices.
(3) The introduction, as a first step, of a bio-energy development policy.
Biomass production may provide a real long-term solution for the agricultural sector and at the same time, respond to public concerns on environment and energy production. The main obstacles to the development of the biomass market pertain to the reduction in duties on bio-fuels[41], the lack of start up public support for processors and absence of a more flexible and clear regulation for planting crop energy uses. The Mid Term Review seems to tackle the last two obstacles, proposing more freedom to farm energy crops and more financial availability for investments.

Mid Term Review: Main Market Reforms

Cereals	Intervention price cut of 5 %, down to 95,35 €/t. Compensation at a rate of 50%
Rye	Abolition of rye intervention
Durum Wheat	Reduction in three years of the supplementary payment in "traditional areas" of 27%. Abolition of the supplement in "established areas". New quality premium of 15 €/t.
Oilseeds	No specific measures foreseen – increase in payments, the same as for cereal payments
Rice	50% reduction of intervention price to a basic price of 150 €/t, triggering private storage. Safety net intervention at 120 €/t. Compensation payments of 177 €/t of which a smaller part (75 €/t) will be granted as a crop-specific payment in wetland. Reduction of the MGAs to the 1999-2001 average or the current MGA, whichever is lower.
Energy crops	45 €/ha for energy crops. Guaranteed area up to 1,5 Mio ha

[41] Waiting for the decision of the European Parliament and Council on two Commission directive proposals concerning alternative fuels. The first intends to impose by 2005 compulsory minimum contents of "green" fuels in conventional mineral fuels. The second forces Member States to apply a 50% excise duty reduction for bio-fuels.

Other Issues

In the Commission's proposal, we can glean other issues relating to certain constraints that may occur in the post-2006:

- Going beyond the compensation concept of direct payments and transforming such direct payments to farm income payments. The policy implications and consequences that this change will entail are evident;
- Reduction of direct payments level: the dynamic modulation in the enlarged EU and/or a likely consolidation of the two sub-headings level after modulation may, slightly, reduce the enlargement costs;
- For CEECs, the reduction of direct payments level under the system post-2006, may reduce discrimination against other categories as the average level of revenue will still be very low compared to the direct payments received by farmers. Furthermore, a stronger "II Pillar" can foster more investment side than consumption side (income support).
- Harmonization of the two CAP schemes towards the simplest one proposed for the accession Countries. This avoids problems associated in the implementation of the complex system of the current CAP in Countries with still limited administrative capability as well as strong dislocation of production;
- Transfer of direct payments from the blue box to the green box;
- Conditions for a further reduction of export subsidies. The reduction of the cereal domestic prices slows down demand in export subsidies of cereals and meat. The abolition of the premia scheme for beef should reduce the incentive to produce and therefore, reduce the surplus in the long term. Only the dairy market may remain constrained;
- More capability to face eventual reduction of domestic market protection. The cut in the intervention strength and the increase of the quality standards level of the domestic production, lead to extend this ability;
- The introduction of certification schemes and *traceability* systems all along the food chain can assure a higher protection level of health among EU citizens, even with a more open custom system. A complete food chain system of *traceability* and certification can effectively guarantee EU consumers a free choice of food products (e.g. between GMOs, GMO-free or organic food).

5.3 OBSTACLES FACING THE MID TERM REVIEW

The complexities and ambiguities in some points of the Commission's proposal can encounter several obstacles in the EU decision process, specifically:

- The aims pursued by the dynamic modulation, rural development extension and redistribution of funds can be diminished by Council negotiation. This scenario is likely, considering that modulation affects a wide range of interests and as a tool, it links together these two goals. The complexity of the mechanism proposed also risks to add administrative burden and costs for farms contrary to what is promised;
- The proposed decoupling scheme makes a number of exceptions in comparison to the scheme applied to accession Countries. These exceptions risk to require severe rules and constraints, thereby, undermining the expected simplification and red tape cuts;
- The measures proposed to meet societal needs, risk to be costly for taxpayers and farmers and too slow to deliver the expected outcome;

- From the financial point of view, the proposal does not reduce EU agricultural spending. There is also the risk of a worsening financial position in the current main net contributor Countries, thereby, paving the way for national co-financing option of direct payments;
- There is no evident link between the reform and the accession Countries' integration strategy. This is not good for the negotiation process as it can, to a certain extent, generate uncertainties in the CEECs and in the EU-15;
- The continued reform process approach can undermine economic confidence and investment capacity of farmers. The Mid Term Review will be decided at the time that the contextual elements of the post 2006 scenario are not yet known. These main elements pertain to the negotiable conditions of the accession Countries, the WTO commitments of the extended EU, the impact of Agenda 2000 reform, the new Financial Perspectives and finally, the new institutional arrangement that will be designed by the Convention. Therefore, a new reform may likely be necessary to align the CAP with the new domestic and international scenarios.

VI. CONCLUSION

MID TERM REVIEW - IN SEARCH OF A EUROPEAN AGRICULTURAL MODEL

The reform process of the CAP has been, till now, driven by market and financial factors. The Mid Term Review, however, shows that these factors are not anymore the sole considerations in driving the reform process. Another important factor that is related to public concerns has strongly emerged. As shown by the above analysis, we can deduce that the Mid Term Review is mainly inspired by an attempt to deliver a prompt political response to the concerns of EU citizens. On the market side, however, it goes beyond the line drawn by Agenda 2000. It anticipates part of the reform supposed to be needed after 2006 in preparation of the CAP for the enlarged EU, consistent with the Commission's approach of gradual reform.

The Mid Term Review appears, therefore, to be a step towards a precise model of agriculture, that can better serve the role entrusted to it by the European society to undertake. This is the role of a "multifunctional" agriculture, as it is called in several EU Commission documents, that can carry out jointly functions and tasks relating to rural space and land/territory management, environmental resources and biodiversity protection, production of high level safe and healthy foods, which generally belong to "public goods", as well as the production of other "tradable goods". In this perspective, the CAP is called to integrate the public good goals, for which the achievement of the optimal production level market fails, and trade goals, for which market signals has to be delivered. The necessary policy instruments will then be those able to drive, in as much efficient and effective as possible way, both, production of tradable goods on a competitive world basis, and production of public goods as demanded by society. Concretely, this EU model has to prefigure a decoupled market/income support measures from production, incentives linked to specific public good production and tools of short-term farmers' income stabilization.

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The decoupling and reduction of area payments, as well as lower intervention levels introduced by the MTR may be seen to contribute at restoring market conditions in the EU agricultural sector and reducing distortion of farmer's production decisions. This is even more evident if the sector reforms in sugar, olive oil and tobacco as announced by MTR for 2003 will be pursued. On the other hand, stronger and wider cross-compliance, environmental set-aside and the extended rural development policy, proposed in the Mid Term Review, may be seen as measures which generate a higher level

of positive externalities by encouraging farmers to accomplish “good” practices/activities. There are, however, questions that need to be explored concerning the policy instruments in use, such as the efficiency and effectiveness of the applied measures promoting positive externalities, their impact on trade and production decisions.

Regarding market policies, a more complete framework of safety net and farmers’ revenue stabilization tools are necessary. The liberalization process of the EU farming sector has been proceeding by removing and loosening the policy instruments in place for more than 40 years, projected and implemented to be effective in a closed economic system. No new instruments, more effective in stabilizing farmers’ income in an open economy and affordable for taxpayers, are however, introduced or experimented (e.g. the recent discussion on risk management tools at EU level did not bring any concrete results). This may weaken the competitiveness and soundness of the European agri-business sector, in a situation of growing price volatility and lower production public support, or may represent a serious obstacle for further reform towards the market.