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Future Agricultural Policy in the European Union

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The crisis of the European Common Agricultural Policy (CAP) began in the mid-1980s. At that time, the CAP was the victim of its own success. Production had increased considerably, and stocks of commodities were accumulating. Conflicts with the United States over the General Agreement on Tariffs and Trade were increasing, and there were calls for reform. The 1992 CAP reform was a major turning point—intervention price levels were drastically reduced toward international market prices, and direct payments to farmers were established. The reform had mixed results, but it initiated a serious, broad debate about the role of agriculture in European society. This debate is still open.

This paper will explore the future of the CAP using three scenarios. First, the context of the debate is explained, including pressures from adding ten new countries and past World Trade Organization (WTO) commitments.

The Context

The 1992 reform focused on major crops (cereals, oil, and protein crops) and beef. The old high-price support system was replaced by a system combining low domestic prices, direct payments for cereals and beef cattle, set-aside of farmland, and premiums for reducing stocking rates in cattle farming.

Under the 1999 reform, farm prices continued to decrease, offset in part by greater direct aid. Greater decoupling of aid for cereals and the criteria for beef cattle payments were modified. States required cross-compliance, so that farmers who received direct aid used environmentally sound practices. Member states were also encouraged to limit the total amount of payments to the largest farms. The states could use the funds saved for "second pillar" actions. (The "first pillar"—market regulation and income support—accounts for 90% of the budget.)

The second pillar, called "accompanying measures" in the 1992 reform and "rural development regulation" in 1999, is mainly agri-environmental aid. Farmers' financial incentives cover the cost of changes in production that have desirable environmental effects. They consist of programs for input reduction, conversion to organic farming, and protection of biodiversity. Unlike the first pillar, the second pillar is financed equally by member states and the European Union (EU) budget.

These reforms led to a debate on the role of agriculture in European society. When prices were guaranteed, the scale of public support for agriculture was not a public issue. Only rural economists were aware of the negative side effects of this successful growth. The switch to direct aid heightened citizens' concerns. Citizens learned that farmers were subsidized—some of them heavily. Furthermore, the largest farmers received the most aid.

Disclosure of subsidy levels for agriculture coincided with public awareness of sanitary problems in food (e.g., BSE, dioxins) and environmental concerns about pollution of water by nitrates from intensive livestock or cereals farms and of the atmosphere by pesticides. A social debate then centered on the functions of agriculture and the role of agricultural policy. The European Commission speaks of a "European Model of Agriculture" that stresses and recognizes these new functions.

The enlargement of the EU also affects the future of the CAP. Among the 13 candidates, ten countries (Czech Republic, Poland, Hungary, Estonia, Lithuania, Latvia, Slovenia, Slovakia, Cyprus, and Malta) will join in 2004; three others (Romania, Bulgaria, and Turkey) are still negotiating.

Adding ten countries to the EU will bring political and economic advantages for more than 100 million new consumers. The great unknowns are how integration will affect the economies of the added countries and on how the European CAP will withstand the shock.

Two striking differences between the current 15-member EU and the added countries are the productivity of agricultural labor and the size of agricultural employment (Table 1).

Table 1. Comparison of agriculture in the current European Union (EU-15) and the ten applicant countries, 2000.

	EU-15	10 countries
Agricultural area (1000 ha)	130,443	38,381
Agricultural employment/total employment (%)	4.3	21.5
Agricultural GNP/GNP, 1999 (%)	1.7	7
Production of the agricultural sector, 1999 (million euros)	274,768	16,734
Agricultural foreign trade balance (million euros)	-122	-2,287

Source: European Commission

Poland strongly affects the overall equation, accounting for 63% of the labor and 70% of production. It has 27% of the working population in agriculture, and labor productivity is only 10% that of the EU. Apart from a few large former state farms, 90% of production is in small holdings. In Poland, and to a lesser extent in Hungary and the Czech Republic, entry into the EU could cause major social problems through the inability of small- and medium-sized farms to withstand competition from the West, especially in livestock. The decrease in agricultural population from integration could cause unemployment levels of up to 10% (European Commission, 1998). In the medium term, the potential for expanding cereal production, especially on large farms, worries EU-15 cereal growers, especially in France.

In general, the enlargement of the EU may have some negative social and commercial impacts for the current members. Currently, however, the focus is on the budget. Grain and meat are the main agricultural products in the applicant countries. Most of the farmers could thus receive direct CAP payments. The new regions are also eligible for the EU regional policy, which is aimed to support social and economic restructuring. For European policy, enlargement increases the risk of the breakup of the Union or the renationalization of policies. Expiration of the WTO "peace clause" in 2003 will likely end direct payments not fully decoupled and classified in the blue box.

Future Scenarios

In July 2002, European Commissioner Franz Fischler proposed a midterm reform for 2003 (European Commission, 2002). The reform would address the budget constraint, enlargement, pressure in WTO, and citizens' concerns. The key reforms are consistent with the previous ones but go further:

- Payments largely would be decoupled and entitled per farm, according to historical references. Milk policy reform would be postponed until 2008.
- Payments would decline by 5% over five years. Currently, member states can "modulate" direct payments and use the savings for rural development. The Commission proposal would require modulation and increased rural development funding for all member states.
- Environmental cross-compliance would be reinforced by requiring environmental audits of farms receiving more than EUR 5,000.
- The budget of the agri-environmental measures would increase progressively.
- The overall budget would remain constant.

In Brussels in October 2002, the French and German governments agreed to maintain a constant postenlargement budget until 2013. The 15-member council adopted this compromise. During 2004 to 2012, farmers in the added countries will receive only part of the direct payments received by their counterparts in the current 15 countries. The proportion will increase from 25% in 2004 to 100% in 2012; payments will be equal thereafter.

The main components of the Commission proposal are shown in Table 2.

With this proposal, the European Commission is seeking discussion about an in-depth reform. In January 2003, it presented a formal package of proposals, fully consistent with its July proposals but incorporating the agreement on the budget reached in October.

Table 2. Ten years of CAP reform.

	1992 reform	1999 reform	2002 midterm proposal
Decrease in prices	-35%	-15%	-5%
Payments	Total compensation for loss of income	Partial compensation	Payments covering 50% of total price decrease
Decoupling/ inputs	Partial: Payment per hectare or head of livestock	Partial: As in 1992	Single Payment: Calculated per farm and then conversion to per hectare
Decoupling/products	Weak: distinction between cereals/oilseeds dry farming/irrigated farming different types of livestock	Weak: little change in comparison with 1992	Almost total: Payment independent of the nature of production
Modulation of payments (limitation of payments to the largest farms)		At the initiative of states	Modulation set at the European level
Cross-compliance (ecoconditionality)		At the initiative of states	Following a common European framework
Agri-environmental measures	4% of the budget	10% of the budget	20% of the budget

Based on European Commission (1999, 2002)

The midterm reform proposal most likely will not be accepted as is. Many member states have raised serious objections. However, net contributor countries (Germany, the United Kingdom, the Netherlands, and Sweden) are pushing for a deep reform. The Commission proposal is one scenario that could form the next reform because, despite the outcry, the July 2002 proposal presents a viable compromise regarding the budget, enlargement, and WTO commitments.

A second scenario is renationalization of the CAP. The pressures in this direction are not negligible. Obtaining agreement between member countries with different interests is always difficult. The liberal view encourages the separation of market liberalization and agrifood competitiveness from rural development and environmental policies.

A third scenario could incorporate the new environmental and social issues into agricultural policy. The July 2002 proposal falls short of this outcome. The decoupling of aid does not specifically respond to citizens' concerns; this failure may be the weakest point of the proposal. The theoretical literature contains studies that show that direct payments will affect production through wealth and risk effects (Henessy, 1998; OECD, 2000). Empirical studies show that decoupling direct support could intensify production techniques and cause environment deterioration.

On the contrary, a "multifunctionality" policy should include creation of links between farm production and environmental services, payment for the environmental services supplied by farming households, payment per agricultural worker to support the territorial function, and support for quality product promotion. Specific policy measures remain to be developed.

CAP Opportunities

The Common Agricultural Policy has been under reform for ten years. Potential enlargement and financial pressures now suggest more radical reform. Three points are important for the future.

First, the CAP has become a "contract" between farmers and society, as illustrated by cross-compliance and the agri-environmental pillar. The CAP thus faces new issues: how to adapt farmers' production incentives with broader policy objectives addressing the new citizens' concerns and how to determine the best design and level of support system.

Second, decoupled farm payments often seem better. However, the agricultural products and environmental services provided by farmers are often what economists call *joint products*, which come together and cannot be dissociated. This connection could favor coupled payments.

Finally, issues of equity in payment distribution remain unresolved. The Commission's proposals would certainly impact those farmers who now receive large payments. But although politically difficult, agreeing on a distribution policy remains a challenge for the future.

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