

The development-related impacts of EU agricultural subsidies

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Abstract

The European Commission launched a process for the modernisation and simplification of the Common Agricultural Policy (CAP) in early 2017 which will lead to a Commission Communication on the future of the CAP post 2020 towards the end of 2017. The impact assessment for this Communication must consider the impact of future changes to the CAP on developing countries. This paper first provides an assessment of the development-related impact of important CAP instruments. It discusses some of the main proposals of stakeholders for the CAP post 2020 and draws conclusions on their implications especially for the poorest developing countries. Finally, the paper identifies key demands which development groups should consider raising in this debate. The paper concludes that the CAP (as distinct from accompanying trade policy) now has limited effects on the least developed countries and that potential changes to the policy post 2020 are unlikely to change this assessment. Campaigning groups have a role to play in helping to prevent any backsliding in the direction of CAP reform. However, they should assess whether devoting limited resources to attempting to influence the direction of changes in the CAP would give the greatest return in terms of poverty alleviation and meeting sustainable development goals in the poorest developing countries.

JEL Codes: F13, O13, Q17

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1. Introduction

The consequences of the EU's Common Agricultural Policy (CAP) for developing countries have long been controversial. It has been blamed for encouraging over-production and dumping EU surpluses on world markets, for destabilising world market prices, for undermining the livelihoods of poor farmers, and for contributing to deforestation and other environmentally damaging practices in developing countries. The CAP has been seen as perhaps the prime example of an EU policy domain most incoherent with the EU's development co-operation objectives for these reasons (Matthews 2008; Matthews 2015).

However, the CAP has undergone a long period of reform over the past 25 years which has removed many, though not all, of its trade-distorting features (Matthews, Salvatici, and Scoppola 2016). Variable import levies have been replaced by fixed import tariffs. The EU pushed for the elimination of export subsidies on agrifood exports at the 2015 WTO Nairobi Ministerial Council by 2020 at the latest, and has not itself made use of export subsidies since 2013. High administered market support prices have been either eliminated or reduced to safety-net levels. Compensatory direct payments intended to support farm incomes, which were originally partially coupled to production, have been replaced by mostly-decoupled direct payments which do not require production. Tariff protection for agro-food products remains high, but least developed countries (under the Everything But Arms agreement) and many African, Caribbean and Pacific (ACP) countries (under Economic Partnership Agreements) now enjoy duty-free access to the EU market. Nonetheless, expenditure under the CAP remains high and farm incomes, particularly for some enterprises and in some regions, are heavily dependent on the direct payments financed by the CAP.

The last reform of the CAP was agreed in 2013 and is being gradually implemented since 2015.² One of the main innovations in this reform was to allocate a significant proportion (30%) of the direct payments envelope for income support to a "greening payment", payable to farmers who follow certain practices beneficial to the climate and the environment. Another characteristic was the high degree of flexibility given to Member States (Member States had to make decisions on over 80 separate issues when deciding how they wished to implement the reform). This reform was the first CAP reform which was agreed under new legislative rules which give the EU Council of Ministers (representing the Member States) and the European Parliament (directly elected by EU citizens) equal status in decision-making. By common

² The legislative framework for the CAP is made up of four basic acts, or regulations:

- Regulation (EU) No 1307/2013 establishing rules for **direct payments** to farmers;
- Regulation (EU) No 1308/2013 establishing a **common organisation of the markets** in agricultural products;
- Regulation (EU) No 1305/2013 on support for **rural development**;
- Regulation (EU) No 1306/2013 on the **financing, management and monitoring** of the CAP (horizontal regulation).

In addition, important details setting out interpretations of the basic acts and adding specific policy details can be found in Commission delegated and implementing acts.

consent, the outcome of this reform has proved extremely complex, creating difficulties both for paying agencies in the Member States who have to interpret the regulations and for farmers who are required to follow them.

Thus, towards the end of 2016, the Commission announced that it intended to produce a Communication on modernising and simplifying the CAP towards the end of 2017. The Commissioner for Agriculture and Rural Development Phil Hogan has highlighted two rationales for re-opening the CAP regulations so soon after the completion of the 2013 CAP reform: the complexity of the CAP, in part due to the co-decision process in that reform, which gives rise to a need for simplification to reduce red tape; and changes in the policy environment for EU agriculture – from markets and trade to climate change and environmental challenges – which require a modernisation of the CAP.

In preparation for this Communication, the Directorate-General for Agriculture and Rural Development (DG AGRI) launched a public consultation which opened on 2 February 2017 for twelve weeks.³ The Commission has also published its inception impact assessment setting out the options for changes to the CAP which will be analysed in the preparation of the Communication.⁴ The Commissioner has indicated that the Communication may be followed by legislative proposals in the first half of 2018.

Even apart from this legislative process, further changes to the basic CAP regulations have either been signalled or are underway. The Commission included some amendments to the basic CAP acts in a so-called “Omnibus Regulation” following its mid-term review of the 2014-2020 Multi-annual Financial Framework intended to simplify some aspects of the CAP.⁵ This Regulation is currently (mid-April 2017) proceeding through the legislative process and there are signs that the Parliament, in particular, will try to widen the scope of some of these amendments. In addition, the report of the Agri Markets Task Force at the end of 2016 recommended a set of measures to strengthen the position of farmers in the supply chain which the Commissioner has indicated he will consider, some of which would require legislative action.⁶

Even without legislative change, the future of the CAP is likely to evolve under budgetary pressures. In the current 2014-2020 Multi-annual Financial Framework (MFF) the CAP still accounts for around 40% of EU expenditure. By the end of 2017 the Commission is required to propose an MFF for the years after 2020. The MFF sets out the maximum limits on EU expenditure as a whole as well as for the major headings, or categories, of expenditure, including Heading 2 *Sustainable management of natural resources* where the largest expenditure item is the CAP. It is well known that new priorities, such as security and addressing

³ <https://ec.europa.eu/agriculture/consultations/cap-modernising/2017>.

⁴ http://ec.europa.eu/smart-regulation/roadmaps/docs/2017_agri_001_cap_modernisation_en.pdf

⁵ http://eur-lex.europa.eu/resource.html?uri=cellar:a59b6beb-7a4f-11e6-b076-01aa75ed71a1.0001.02/DOC_1&format=PDF.

⁶ https://ec.europa.eu/agriculture/agri-markets-task-force_en.

immigration, as well as the continuing jobs crisis in Europe, are demanding greater attention. At the same time, the negotiations on the UK's withdrawal from the EU are expected to be completed by April 2019. Given the UK's status as the second largest net contributor to the EU budget, this will also have implications for the overall level of EU expenditure after 2020 and thus for the likely resources available for the CAP. It is thus possible that the Commission's legislative proposals for the CAP after 2020 will once again be negotiated in parallel with the budget envelope as was also the case with the 2013 CAP reform.

The purpose of this paper is to identify how the possible changes which might emerge from these overlapping and interacting processes to amend the CAP basic acts might impact on developing countries, and specifically the least developed countries (LDCs) and the countries of Sub-Saharan Africa (SSA). Specifically, the objectives for the paper are as follows:

- To provide an assessment of the development-related impact of important CAP instruments
- To draw conclusions for the future reform of the CAP regarding implications for SSA countries/LDCs
- To provide some suggestions what to tackle first within the CAP reform from a development/coherence perspective.

In addition to this Introduction, the paper has three sections responding in turn to each of these bullet points. Section 2 identifies some of the key policy instruments used, or proposed to be used, in the CAP and examines their development-related impact. Section 3 summarises some of the key issues which have been raised in the debate on amending the CAP regulations at this point in time. Section 4 assesses the development impacts of the proposals under discussion particularly from the point of view of the LDCs and SSA countries and concludes by making suggestions on how best development interests might be inserted into the debate on CAP reform which has now begun.

The precise impact of CAP policy instruments on poverty depends on the characteristics of individual developing countries: whether they are net exporters or imports of commodities protected by the CAP; whether they enjoy preferential access to the EU market or not; and whether poverty is primarily a rural or urban phenomenon. For this reason, it is difficult to make generalisations about the potential impact of further CAP changes on developing countries as a whole. However, the least developed/SSA countries share some common characteristics and concerns, and it is their interests which are in focus in the analysis which follows.

2. The development-related impact of specific CAP instruments

2.1 The development impact of decoupled direct payments

EU agricultural income is heavily dependent on the direct payments received under the CAP. On average across the EU, Pillar 1 direct payments account for 28% of agricultural factor income;⁷ when Pillar 2 payments such as agri-environment payments and compensatory payments for farming in areas of natural constraints are added, the total rises to 33%.⁸ However, for individual countries the percentages can be higher, and for individual enterprises within countries (e.g. beef farming) the percentages can be higher still.⁹

Truly decoupled payments do not affect the marginal incentive to produce, which means they reduce the distortionary effects on production and trade compared to the same amount of agricultural policy support provided in non-decoupled forms. But there are still a number of mechanisms whereby even decoupled payments might be expected to encourage additional production compared to the absence of such payments, although there is controversy over the magnitude of these effects (Rude 2008; Moro and Sckokai 2013). Payments that are decoupled in a static and riskless world are no longer production neutral in a dynamic and risky world. The mechanisms include:

- Maintaining and improving farmer wealth, leading to higher investment and changing attitudes to risk (insurance and wealth effects).
- Increased access to credit where imperfect credit markets exist.
- Farmer expectations about future programme eligibility and payment basis affecting current production decisions.
- Slowing or accelerating farm consolidation.
- Conditional requirements on the receipt of direct payments such as cross-compliance which impinge on farmers' production decisions.

However, the production effects of decoupled payments will be smaller than those of coupled payments and much smaller than market price support. Because of the difficulties in imagining a fully

⁷ Agricultural factor income represents the income generated by farming which is used to remunerate borrowed/rented factors of production (capital, wages and land rents), and own production factors (own labour, capital and land). Agricultural entrepreneurial income (also called family farm income) in the EU agricultural accounts deducts the costs of paid labour, paid interest and paid rent. Both direct payments and total subsidies are a considerably larger share of agricultural entrepreneurial income.

⁸ Figures from DG AGRI, "Share of direct payments and total subsidies in agricultural factor income", available at http://ec.europa.eu/agriculture/cap-post-2013/graphs/graph5_en.pdf, accessed 13 March 2017.

⁹ See Matthews, A., "The dependence of EU farm income on public support", 20 April 2016, available at <http://capreform.eu/the-dependence-of-eu-farm-income-on-public-support/>, accessed 13 March 2017.

decoupled policy, the OECD suggests it makes more sense to discuss the production impacts of direct payments in terms of the 'degree of decoupling', compared to the production effects of a fully coupled policy usually taken to be market price support (OECD 2001). In his early review of the indirect production effects of the CAP's direct payments, Rude (2008) suggests that each of the above mentioned indirect effects appear to have only minimum potential to distort production decisions. "Collectively these indirect production effects may not be negligible but the impact will be nonetheless small" (p. 460).

The basic problem facing any empirical attempt to model the impact of the CAP and agricultural trade policy on production and trade is how to model the decoupled direct payments. Should they be modelled as a lump-sum transfer to farm households, as area payments, or as something else? If treated as a lump-sum payment to households, then CAP payments have no impact at all on farmers' production decisions, either in terms of input use (demand for land) or output supply (particularly yields). However, lump-sum payments are not capitalised into land prices which is not consistent with the empirical evidence. CAP Pillar 1 direct payments could also be modelled as area payments, i.e. a subsidy to land. In this case, if the land area is assumed to be fixed, all of the payment will be capitalised into land values, but there will still be no effect on overall agricultural output.¹⁰ For many analysts, this assumption is also too extreme bearing in mind the various ways in which even decoupled payments are expected to affect production incentives and the empirical evidence which shows that capitalisation of direct payments into land values is only partial and incomplete. Other analysts assume that some share of the decoupled payments accrues also to labour and capital employed in agriculture and thus affects production levels in the EU. The problem is that choosing the appropriate degree of decoupling is largely an ad hoc decision, given the lack of agreement in the literature as to what the correct value is. Most modelling studies simply make an assumption about the degree of decoupling and the empirical results reflect this assumption rather than providing evidence about it. One careful study (Mitzenzwei, Britz, and Wieck 2012) concluded that the elimination of EU direct payments would lead to a 5% reduction of land use of agriculture, with a consequent drop in agricultural output and net exports. In other words, there is a production response to decoupled direct payments, but it is relatively small.

This analysis of the possible production impacts of decoupled direct payments is based on stylised assumptions. Potential production effects also depend on the obligations farmers must follow for eligibility for these payments. In the EU, eligibility for direct payments depends on farmers observing cross-compliance conditions. While many of these are statutory obligations which farmers must follow in any

¹⁰ If the land area under cultivation can be increased in response to the extra demand for land created by the area-based subsidy, then output will also increase, with the extent of the increase determined by the extent to which non-land inputs can be substituted for land.

case, others go beyond legal requirements in restricting what farmers may do or oblige them to implement particular farming practices. Thus cross-compliance raises farmers' costs and offsets some of any production stimulus from decoupled payments. The greening payment introduced in the 2013 CAP reform might be viewed in this context as 'enhanced' cross-compliance as it requires farmers to observe additional requirements to be eligible for 30% of the CAP Pillar 1 payments. It is worth underlining how little growth in agricultural output has occurred in the EU since the introduction of decoupled direct payments since 2005. In 2016 EU agricultural output was just over 7% higher than in 2005, and some of this was catch up in the new Member States – in the EU-15 output was just 6% higher 11 years later.¹¹

2.2 Development impact of coupled direct payments

Most, but not all, CAP Pillar 1 payments are decoupled. The 2013 CAP reform altered the framework for coupled direct payments. The list of sectors eligible for coupled support payments is greatly expanded to cover nearly all agricultural production. Total coupled support is limited to 8% of each Member State's direct payments ceiling, or exceptionally to 13% in some countries. These percentages can be increased by up to 2 percentage points if this support is used for protein crops. Member States had to notify their decisions to the Commission by 1 August 2014. However, they can revise their decisions with effect from 2017, increasing, decreasing or ceasing the amount of coupled support they provide within the relevant limits.

All voluntary coupled payments within these ceilings should comply with a number of conditions, as follows:

- Coupled support may only be granted to those sectors or to those regions of a Member State where specific types of farming or specific agricultural sectors that are particularly important for economic, social or environmental reasons undergo certain difficulties.
- Coupled support may only be granted to the extent necessary to create an incentive to maintain current levels of production in the sectors or regions concerned.
- Coupled support shall take the form of an annual payment and shall be granted within defined quantitative limits and be based on fixed areas and yields or on a fixed number of animals. Limits should reflect the production levels in the targeted region or sector in at least one year in the period of 5 years that precedes the year of the decision about coupled support. This is intended to ensure that future

¹¹ For a more complete evaluation of the production effects of EU decoupled direct payments, also taking into account the potential impacts on technical efficiency, production growth and farm structures, see Matthews, Salvatici and Scoppola, 2016).

coupled payments would qualify as Blue Box payments under the WTO Agreement on Agriculture disciplines on domestic support.

The use of this voluntary option by Member States shows a very varied pattern. Nine Member States opted to use less than the standard 8% ceiling while eleven Member States have the maximum percentage of 13% with 9 of these also using all or part of the additional 2% available in case of support to the protein crops sector. Three old Member States (Belgium, Portugal and Finland) were given permission to exceed the 13% limit. Germany has maintained its position that it does not give coupled support and is the only Member State not to provide coupled support in 2015. In total, around 10% of CAP Pillar 1 direct payments are now coupled (excluding cotton payments) which is a small increase compared to the end of the Health Check period in 2012. Beef and dairy are the most supported sectors, with smaller amounts going to other sectors such as sheep and goats, protein crops and fruit and vegetables.

Coupled support provides a direct incentive to farmers to maintain and even increase production, and is thus classified as trade-distorting under the WTO Agreement on Agriculture. The impact on trade and developing countries may be limited by the requirement that support must be based on a fixed area and yields or on a fixed number of animals and can only be provided to maintain current levels of production, but it is not obvious how closely this latter constraint is policed.

2.3 Development impacts of market intervention measures

The CAP continues to make use of various instruments to support domestic prices during trough periods in the price cycle. These include intervention arrangements at safety net levels for some commodities, private storage aid, market withdrawal of fruits and vegetables undertaken by producer organisations, and temporary planning of supply during market crises. Intervention expenditure, which was at relatively low levels even by 2005, had virtually ceased by 2013. With difficult market conditions for fruits and vegetables, pigmeat and dairy products since the end of 2014 because of the Russian ban on imports of certain EU agricultural products and global market conditions, expenditure on intervention measures increased again in 2015 and 2016.

The conventional view is that domestic policies to stabilise agricultural markets destabilise international markets (Josling et al. 2010). This view developed on the basis of analysis of the variable import levy and export subsidy system used by the EU to stabilise domestic prices. Support provided through minimum support prices, intervention prices and other forms of administered prices usually relies for effectiveness on border measures, but the use of administered prices can by itself distort production

and trade. The WTO Agreement on Agriculture therefore includes support through administered prices in the sum of certain trade-distorting domestic support that is subject a limit.

However, genuine storage policies (a description which excludes market support policies masquerading as storage policies) can play a role in stabilising world market prices which may be welcomed by other agricultural exporters. For example, by removing skimmed milk powder from the market through storage in 2015 and 2016, the EU contributes to strengthening the world market price and provides a benefit to other dairy exporters. At the time when the purchases are made, storage also maintains the price for EU producers and thus keeps EU production higher than it otherwise would be. However, when the stored products are eventually put on the market again, prices for EU and third country producers will be reduced below what they otherwise would have been. If producers are risk-averse, then more stable prices will result in somewhat greater production than if prices had been more volatile, so even pure stabilisation policies may have a trade-distorting effect. However, the scale of the EU's intervention in domestic agricultural markets has been rather minor in recent years, although intervention measures were initiated for fruits and vegetables, pigmeat and skimmed milk powder in 2014 through 2016. For this reason, the size of any impact on global agricultural markets is also correspondingly small.

2.4 The development impact of measures to restrict production

For some commodities (milk, sugar, wine and arable crops and ruminant livestock in the past) the positive incentive on production of higher support prices and direct aids has been limited by the simultaneous use of supply control measures. In the case of milk and sugar, the production response to higher prices was limited by production quotas. In the case of milk, quotas were in force since 1984 and eliminated in 2015, while sugar quotas have been a part of the CAP since its inception but are planned to disappear in 2017. In the case of arable crops, the production response to CAP support was reduced by a land set-aside requirement implemented in 1994 and only finally removed in the context of high world grain prices in the 2008 Health Check. In the case of beef and sheep, the coupled premiums introduced in 1994 were limited to a fixed number of head by Member State and at farm level. In the case of vineyards, a system of planting right restrictions has been in place since 1976. This introduced a ban on new vineyard plantings in order to limit the production of table wines and prevent structural surpluses, with limited exceptions.

How effective were these measures in limiting supply? The impact study for the Commission in 2008 on the effects of eliminating the milk quota projected it would lead to an increase in EU milk production of 5.0% and a 10.3% decrease in the farm milk price (from the higher level it reaches under the baseline scenario) (Réquillart, Bouamra-Mechemache, and Jongeneel 2008). The Health Check reform

agreed on a gradual expansion of milk quotas in the years leading up to abolition in 2015. Nonetheless, because of the record high milk prices in the preceding year (2014), EU milk production surged in the first quarter of 2016 compared to the first quarter of 2015 (the last three months of the quota regime) by 7.2%.¹² The sugar quota regime remains in place until 2017. The most recent market analysis by the Commission expects the end of quotas to result in a significant increase both in sugar and isoglucose production. Imports (which almost entirely enter the EU market under preferential arrangements because of the high border tariff on sugar) are expected to fall because the EU market will become less attractive. The Commission analysis foresees that the EU could become a net sugar exporter in the post-quota period (European Commission, 2016a).

Since the 1990s, the CAP has encouraged the expansion of farm forestry through the provision of plantation grants and annual forest premiums (paid through the CAP Rural Development Pillar 2). The diversion of agricultural land to forestry lowers the supply response observed from the higher agricultural prices. Farm forestry grants were reformulated as one of the accompanying measures in the MacSharry 1992 CAP reform specifically with a view to taking land out of agricultural production and reducing EU agricultural supply.¹³ However, the most significant supply-reducing policy in recent years is EU renewable energy policy which encourages the production of biofuels.

The EU has had a policy to encourage biofuels since 2003. In that year, a new premium for energy crops grown outside set-aside land was implemented under the CAP (these payments were abolished together with compulsory land set aside at the end of 2008 as part of the CAP Health Check). At the same time, the EU set medium-run targets for the percentage of biofuels to be incorporated into conventional fuel (2% in 2005 and 5.75% in 2010 on an energy basis). A companion Directive on energy taxation allowed Member States to grant tax reductions and exemptions to encourage the use of biofuels. However, these targets were not mandatory and there was no penalty for noncompliance.

In the EU, biodiesel (produced mainly from rapeseed) plays a more important role than bioethanol (produced mainly from wheat and sugar beet). As part of the Energy and Climate Change Package in December 2008, EU leaders committed to a binding minimum target of 10% to be contributed by renewable fuels in total transport fuel in each Member State by 2020. One study suggested that eliminating the biofuel mandate in 2020 would result in freeing up 6% of EU wheat production, about 8% of other cereals production, and about 7% of EU sugar beet production (Hélaine, M'barek, and Gay 2013). More

¹² DG AGRI Dashboard – Dairy Products, available at http://ec.europa.eu/agriculture/milk-market-observatory/pdf/dashboard-dairy_en.pdf, accessed 15 June 2016.

¹³ Between 2000 and 2010, the wooded area in the EU increased through natural expansion and afforestation by a total of 3.5 million hectares, a rise of 2.0 % (Eurostat) although not all of this area would be suited to productive agriculture.

than half of EU vegetable oil production would be used for biofuels in 2020 under the mandate according to this study.

While biofuels may help the EU meet its greenhouse gas reductions targets, biofuel production typically takes place on cropland which was previously used for other agriculture such as growing food or feed. Since this agricultural production is still demanded, it may be partly displaced to previous non-cropland such as grasslands and forests. This process is known as indirect land use change (ILUC). In 2015 new rules came into force that amend the current legislation on biofuels – specifically the Renewable Energy Directive and the Fuel Quality Directive - to reduce the risk of indirect land use change and to prepare the transition towards advanced biofuels. Second-generation biofuels get a double credit, meaning that biofuels made out of ligno-cellulosic, non-food cellulosic, waste and residue materials will count double towards the goal. More importantly, the amendment limits the share of biofuels from crops grown on agricultural land that can be counted towards the 2020 renewable energy targets to a maximum of 7% of transport fuel in the light of concerns about the impact of increased biofuel demand on food prices.

The debate around biofuels (food versus fuel) illustrates some of the difficulties in interpreting the impact of the CAP on developing countries. The traditional critique of the CAP was that it led to over-production, depressed world market prices for developing country exporters and undermined livelihoods for small farmers in developing countries. The EU biofuels policy had the opposite effect; it reduced the availability of EU food supplies, raised world market prices for food products, and created new market opportunities for biofuel feedstocks, particularly palm oil and other vegetable oils. Yet these impacts were equally criticised by development organisations (Swinnen 2011). In part, this was because the palm oil was sourced in South-East Asia, encouraging large-scale deforestation of tropical rain forest and benefiting mainly larger companies, while EU biofuels policy was also alleged to lead to land-grabbing in other parts of the developing world. The potential for the production of renewable energy feedstocks to improve rural livelihoods was lost in the ensuing debate, while the fact that the premises on which the criticisms were based were at odds with those held previously by development organisations was often overlooked.

2.5 Development impacts of risk management measures

Risk management tools are designed to help farmers meet either production and/or price risks. Farmers normally try to mitigate normal risks themselves (weather fluctuations, pests and diseases, normal price volatility) through diversification, the use of technology, or use of market-based instruments such as forward selling or contracting. In the case of natural catastrophes, such as floods or drought, disaster assistance is often provided by EU Member State governments (the EU budget has a small Solidarity Fund

for disaster assistance but this is not specifically focused on agriculture). However, for well-known reasons, there is often inadequate provision of market-based risk management insurance instruments both for production and market risks. In other countries, such as the USA, Canada and Australia, significant government support is provided to subsidise either production (yield) insurance or income/revenue stabilisation schemes. The EU has begun to move cautiously in this direction.

Risk-related policies have the potential to distort production and trade. Where risk is reduced, farmers will tend to expand risky production activities at the expense of diversification and other risk management activities. Overall resources employed in agriculture are also likely to expand when policy measures make farming less susceptible to risk. Where governments reduce farmers' risks relative to other countries, global agricultural trade is likely to be distorted. Empirical evidence suggests that the production impacts of risk reduction measures are likely to be small. For example, the extensive farm safety net in the USA consisting of loan rates and counter-cyclical payments was estimated to be equivalent to an increase in average price support for US agriculture by mostly less than 0.5% (OECD 2011).¹⁴ Production impacts are enhanced if, for political economy reasons, risk-related policies are used as a politically convenient vehicle for farm income support (Tangermann 2011).

Certain types of public support for risk management instruments may be notified in the WTO Green Box of domestic support provided that they meet the fundamental requirement "that they have no, or at most minimal, trade-distorting effects or effects on production" as well as policy-specific criteria income. For safety-net schemes, the criteria are that only income losses greater than 30% of average income in previous years can be covered, and that the indemnities should not compensate more than 70% of the income loss. For public support for disaster relief, including subsidies for crop insurance, eligibility for the Green Box depends on an official government recognition of a disaster plus a requirement that only production losses greater than 30% of average production in previous years can be compensated, and that compensation can only cover the cost of replacing such losses, including income loss.

Risk reduction has small effects, but if the accompanying income support (due to government subsidies) is taken into account, overall effects are potentially higher. In the EU, direct payments, which are largely fixed and known in advance, and which account for over one-quarter of factor income or 45% of entrepreneurial (family farm) income, provide a significant element of risk reduction for EU farmers. The relative importance of this characteristic of direct payments compared to the other possible channels through which they can affect production and trade is difficult to determine.

¹⁴ This is confirmed by the relatively few EU studies on the topic. For example, Garrido, Bielza, and Sumpsi (2003) in an econometric study estimated that a 35% increase in subsidies to yield insurance in Spain had about the same effect on cereal production as a 1% increase in cereal prices.

The 2013 CAP reform moved risk management into Pillar 2 of the CAP.¹⁵ The risk management toolkit in Pillar 2 now contains three instruments:

- financial contributions to premiums for crop, animal and plant insurance against economic losses to farmers caused by adverse climatic events, animal or plant diseases, pest infestation, or an environmental incident;
- financial contributions to mutual funds to pay financial compensations to farmers, for economic losses caused by adverse climatic events or by the outbreak of an animal or plant disease or pest infestation or an environmental incident;
- an income stabilisation tool, in the form of financial contributions to mutual funds, providing compensation to farmers for a severe drop in their income.

In each case, the Rural Development Regulation sets out conditions limiting the extent of support that can be provided which are based on the policy criteria for notification as Green Box measures under the WTO Agreement on Agriculture.

Although CAP support for agricultural risk management is increasing, the share of CAP funds being spent on crisis and prevention measures continues to be very low, less than 2% of the Pillar 2 funds and 0.4% of the total CAP budget in the 2014-2020 period (Bardají and Garrido 2016). In consequence, the distortion implications are limited. Furthermore, with a given overall amount of budgetary resources for rural development programmes, the farm income safety nets at the Member State level under Pillar 2 displace other Pillar 2 policies. Whether the measures displaced would have been more or less distortive than the new farm income safety nets is not clear as we cannot know how the individual Member State governments would have structured their rural development programmes in the absence of this option.

2.6 Development impacts of export promotion policy

The reduction in EU market price supports has slowly aligned EU market prices with world market prices for a growing number of agricultural products, thus improving the competitiveness of EU products on world markets. The EU is now the largest global agro-food exporter. Promoting agri-food exports and finding new markets has been an important objective of the Commissioner for Agriculture and Rural Development Phil Hogan since he took up the position, and he has led trade missions to a number of third countries, including in Asia and Latin America.

¹⁵ There are also risk management tools in the fruits and vegetables, and wine, sectors in the new Common Market Organisation Regulation.

A number of development groups have criticised EU agri-food exports to developing countries (even where they are not explicitly subsidised) on the grounds that they compete with products produced by smallholders and undermine their livelihoods.¹⁶ This debate is primarily about the benefits and costs of trade per se, rather than trade policy or specifically agricultural policy, and is not pursued further in this short paper.

However, the CAP does provide funding to support the promotion of agri-food exports. A new promotion policy came into force in December 2015.¹⁷ This increased the annual promotion budget from €61 million in 2013 to €200 million by 2019, introduced a greater focus on third countries as well as a number of measures to simplify and make the scheme more attractive for exporters. Whereas one-third of expenditure was earmarked for export markets under the previous policy, this share has now been increased to two-thirds of a larger budget.

The annual work programme sets out the total budget with specific allocations for different types of actions targeting different thematic priorities and geographical areas. For example, in the 2016 work programme which disbursed €111 million in promotion grants, €4.69 million was reserved for information and promotion campaigns targeting the Middle East and Africa. Four projects were approved under this heading, including Greek olives to Saudi Arabia and the United Arab Emirates, Croatian sheepmeat and cheese to Qatar and the United Arab Emirates, Lithuanian beer to South Africa, and Polish fruit to Algeria and Egypt. As the intention of this programme is to promote the export of high-quality and thus high-priced rather than bulk EU agri-food products, LDCs/SSA countries may be unlikely to figure as target countries for this promotion budget. If this were to happen, it would be appropriate to evaluate the impact of this expenditure through a policy coherence for development lens.

2.7 Development impacts of Pillar 2 payments

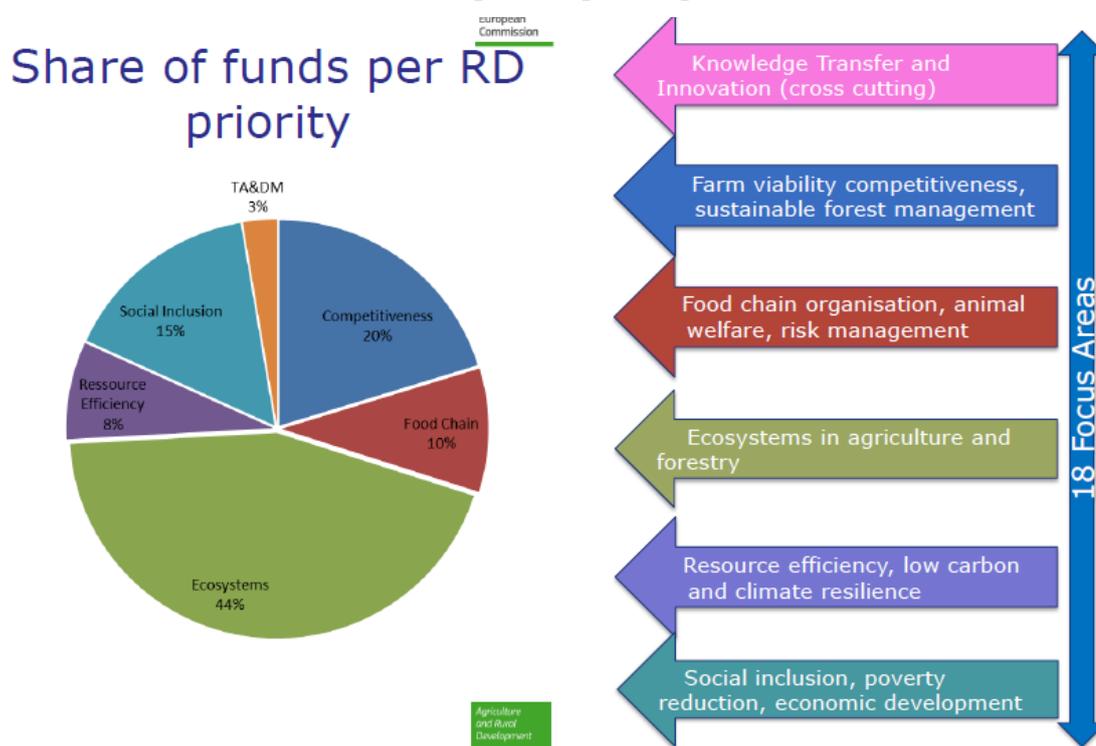
Most criticism of the CAP for distorting global agricultural markets focuses on its farm income support and market management measures financed by Pillar 1 (including the trade policy measures that are not formally part of the CAP). However, expenditure on Pillar 2 rural development measures has increased and now makes up almost one-quarter of CAP expenditure so it should not be overlooked. The measures

¹⁶ Some development groups argue that direct payments act as an indirect export subsidy for EU agricultural exports because they allow exports to take place at below the average cost of production in the EU. The production (and therefore trade) impacts of direct payments are discussed in Section 2.1 (see also Matthews, Salvatici and Scoppola, 2016).

¹⁷ Regulation (EU) No 1144/2014 of the European Parliament and of the Council of 22 October 2014 on information provision and promotion measures concerning agricultural products implemented in the internal market and in third countries.

supported by Pillar 2 include support for knowledge transfer, investment aids, regional assistance programmes, environmental programmes, forestry, risk management support and locally-led job creation initiatives in rural areas. The breakdown between the six main thematic areas in the 2014-2020 rural development programmes is shown in Figure 1. Half of Pillar 2 spending goes on agri-environment and climate actions, with the remainder divided between competitiveness measures, general rural development and food chain actions. All expenditure on these measures is notified as Green Box expenditure in the EU's WTO notifications but they may still have some production and thus trade impacts.

Figure 1. Distribution of EU rural development spending, 2014-2020



Source: DG AGRI (2016), Rural development programmes state of play, Feb 2016.

In some cases (e.g. agri-environment measures) the impact is likely to reduce EU production relative to a non-policy benchmark.¹⁸ In other cases (support for knowledge transfer and innovation, measures to improve physical and human capital) the measures are likely to strengthen the EU's production capacity even if they are exempted from being counted as part of WTO trade-distorting domestic support. On balance, model estimates suggest that rural development expenditure reduces

¹⁸ See <http://capreform.eu/production-effects-of-agri-environmental-programmes/>. Note that in the non-policy benchmark EU agricultural production may still be higher than optimal to the extent that non-priced negative external effects are not fully reflected in farmers' decision-making.

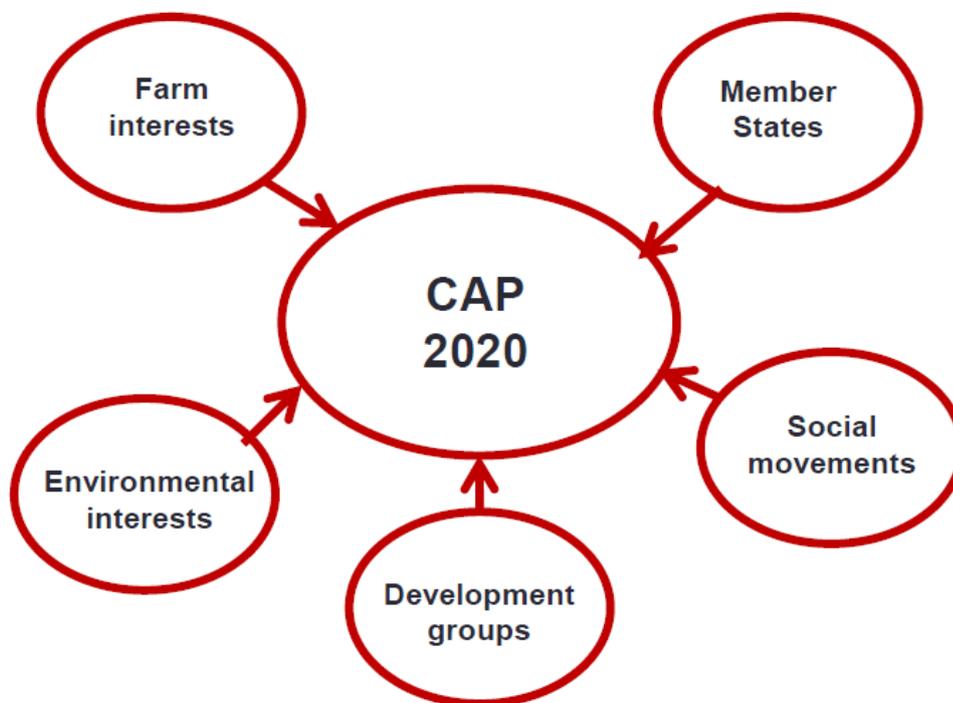
agricultural productivity (principally because the significance of the agri-environment measures outweighs measures such as investment aids and knowledge transfer which might be expected to increase productivity (Schroeder, Gocht, and Britz 2015)).

3. Issues in the CAP 2020 debate

3.1 Stakeholder views

The direction of EU agricultural policy is determined by the interplay of multiple interests, and with a heavy path dependency. We can distinguish five groups of players at this stage in the CAP 2020 debate, with varying degrees of influence. The major groups are those representing farm interests; the natural environment; Member States; social movements; and development interests. These groups represent stylized interests for the purposes of discussion; in practice, there can be overlaps and coalitions between these interests as well as conflicts (Figure 2).

Figure 2. Stylised representation of CAP 2020 stakeholder influences



Source: Own representation

Farm groups are the most important, and vocal, defenders of the CAP as its main beneficiaries. Their focus is primarily on measures which would safeguard and increase farm incomes. Farm groups want to see the size of the CAP budget maintained in real terms. They want the bulk of this budget to remain directed at financing Pillar 1 direct payments. Farmers have experienced some years with major price variability on some markets (particularly fruits and vegetables, pigmeat and dairy products). They would therefore like to see the market management instruments in the CAP strengthened and some of the reforms towards greater market orientation in the past reversed (higher intervention prices, more use of coupled direct payments, greater use of supply management, a stronger safety-net against periods of low market prices). Farmers are attracted by what they see as the more generous safety-nets and risk management instruments in the USA, which include counter-cyclical payments as well as a heavy emphasis on subsidised yield and revenue insurance. Farmers also campaign for measures to allow them to organize themselves collectively more effectively so as to increase their bargaining power in the food chain (for example, the power to agree prices and to control supplies through producer organisations). Finally, farmers criticise the increasing obligations they are required to undertake to receive their CAP payments. They complain about over-regulation and bureaucracy and would like to see a simpler CAP to deliver their payments.

Environmental groups have gained increasing influence over the direction of the CAP, given the evidence of the damage caused by intensive agricultural practices to the natural environment but also the importance of certain types of agricultural land management for the maintenance of habitats important for biodiversity and for the delivery of certain ecosystem services. There has been a growing integration of environmental priorities into the CAP over the years (Matthews 2013), and there was significant optimism among environmental groups that the 2013 CAP would see a step change in the importance attached to environmental policy objectives in the CAP. One of the key objectives of that reform was to further 'green' the CAP, which was pursued by allocating 30% of the Pillar 1 direct payments ceiling to a 'greening payment' to farmers who comply with a range of practices beneficial to agriculture and the environment. This payment is in addition to the continuation of cross-compliance conditions for receipt of EU payments generally as well voluntary agri-environmental schemes which are funded through CAP Pillar 2.

There has been huge disappointment among environmental groups with the way in which the greening payment was implemented. They accused the co-legislatures of hollowing out the obligations attached to the greening payment during the legislative process (which they referred to as 'green-washing'), although a strong case can be made that the fundamental problem lay more in the limitations of trying to influence management practices on farmland, with all of its diversity, heterogeneity and location-specific environmental pressures, through a simple set of uniform, annual practices. In any event, although

there has only been a short time in which to evaluate the impact of the greening payment, initial evaluations suggest the impact on the environmental performance of agriculture has been minimal (Pe'er et al. 2014; European Commission 2016b; Underwood and Tucker 2016). Thus, environmental groups debate what strategy to follow to secure a more effective outcome in the CAP post 2020. In addition, with the coming into force of the Paris Agreement and more ambitious greenhouse gas emission reduction targets up to 2030, a greater focus on reducing agricultural emissions and incentivising farmers to take up climate action is required.

The third important group of players is the Member States (MSs). MSs are interested in the budgetary impacts of the CAP as well as in the growing complexity of the policy which increases the costs, and risks, of administering it. While the traditional budgetary divide around the CAP has been between net contributors and net recipients, a secondary axis emerged in the CAP 2013 reform between those MSs with above-average direct payments per hectare (mostly among the older MSs) and those with below-average direct payments per hectare. Some progress was made in reducing these disparities (referred to as 'external convergence') in the 2013 CAP reform but the newer MSs seek further convergence in the next reform. The complexity of the CAP in part reflects the attempts to meet the individual interests and preferences of an increasingly heterogeneous European Union. The price of the unprecedented flexibility available to MSs after the 2013 CAP reform is that the policy has become considerably more complex. Also, MSs must now increasingly monitor the way farmland is managed and not just how much land farmers have at their disposal, and traditional audit-based approaches are not necessarily appropriate in this situation.

The fourth group of players is social movements which are a disparate group of voices with a primary focus on the way in which food is produced. Thus, under this heading are groups concerned with preventing further land consolidation and supporting small farms, supporters of agroecological farming practices, those interested in the relationship between food and health, opponents of genetically-modified crops, animal welfare advocates and others. These groups found a powerful voice at the heart of the Commission when Karl Falkenberg, one of President Juncker's special advisers with a specific remit to advance the UN Sustainable Development Goals, published a reflections paper setting out his vision for a sustainable future which goes into some detail about his views on the future of EU agricultural policy (Falkenberg 2016). In this paper, he advocated greater uptake of agroecological farming practices but, more controversially, also a return to smaller, more labour-intensive farm holdings which he argued would both offer increased employment opportunities as well as lower environmental pressures from agriculture.¹⁹ His call for greater emphasis on sustainability in the next CAP reform overlaps with the views of environmental

¹⁹ For a critical review of Mr Falkenberg's reflections, see <http://capreform.eu/karl-falkenbergs-reflections-on-the-cap/>.

groups, while his call to move away from area-based direct payments is welcomed by those who would like to see payments focused predominantly on smaller farms.

The views of development interests in this debate are not well articulated, and are further considered in the concluding section of this paper. In the remainder of this section, we identify the way in which these stakeholder views influence the key themes in the CAP 2020 debate.

3.2 The future of Pillar 1 direct payments

Pillar 1 direct payments continue to play a major role in the EU budget (70% of the CAP budget and 28% of the entire EU budget). They were introduced following the MacSharry CAP reform in 1992 as compensation for the reduction in intervention support prices at that time. This was an important and necessary step to help farmers adjust to a new economic situation. However, assistance for adjustment should only be temporary. As the years have passed, the argument that direct payments are intended as compensation payments has become less and less credible. As result, a number of alternative rationales for the continuation of Pillar 1 direct payments have been proposed. These payments are variously justified as addressing low farm incomes, as a necessary support for EU food security, as providing a safety net for farmers against unexpected market shocks, as compensating for higher regulatory standards and as ensuring more sustainable management of natural resources. These are all important policy objectives, but there is little evidence that decoupled area-based payments are an effective, efficient or equitable way of achieving these objectives (Matthews 2017). Proposals for reform include the suggestion that these payments should be gradually phased out, with savings as least partially redirected towards increasing the budgets for improved land management and, possibly, more extensive risk management instruments. Farm groups want to retain the decoupled area-based payments as a basic income safety-net, while some farm groups advocate an increasing recoupling of these payments to production.

3.3 The future for risk management

The gradual integration of EU market prices with world market prices over the past two decades as the CAP has moved in a more market-oriented direction (although, with high import barriers still in place, this integration remains incomplete) means that EU farm prices are now more variable than in the past. This has focused attention on the role of risk management instruments. There is general agreement that farmers need access to a broader range of measures and tools to manage risk, but less agreement on what is the appropriate role for public support. As noted above, the CAP currently provides limited support to

subsidise insurance premiums against production risk or to subsidise mutual funds which help to stabilise farmers' income over time. There is some interest in increasing the level of public support for insurance instruments to encourage their uptake, although the counter-argument is that the US experience shows that there is a considerable leakage of support to insurance companies in trying to support farmers' incomes in this way.

Another proposal under this heading would be to adopt a more active supply management policy. Currently, the Commission can make use of certain demand-side instruments (aids to private storage, public intervention) to support market prices when farm prices begin to fall to unacceptable levels. During the 2015-2016 milk price difficulties, the Commission for the first time operated a voluntary supply management scheme, under which farmers were paid to reduce production in an attempt to balance the market. Such measures aim to raise farm (and export) prices but their efficacy will depend on the ease with which imports can enter the EU market and the share of the EU in world export markets. Milk may be one of the very few commodities where EU action to reduce domestic supplies can be effective in raising domestic prices. Among some farm groups, there is interest in converting some or all of direct payments to counter-cyclical payments which would pay out to farmers whenever farm prices fell below some pre-determined levels, but would not be paid if farm prices were above these levels. Such a scheme would imply a return to product-specific support and would be highly trade-distorting. It is also difficult to see how such a volatile budgetary item could be managed within the confines of an EU budget with relatively fixed ceilings and which has to balance on an annual basis.

3.4 The future for environmental land management

There are some who would like to roll back the greening of EU agricultural policy but this is unlikely to happen. Instead, the debate is around whether the necessary greening of agricultural policy should be pursued by tweaking the greening payment regulations or by abandoning the greening payment and pursuing alternative strategies. Various options can be considered (Matthews 2016): the greening obligations could be incorporated into the cross-compliance standards which must be observed for eligibility for direct payments; the greening payment obligations might be developed into a menu-driven approach at MS level; the greening payment should be replaced by a requirement to enrol in a shallow agri-environmental-climate measure (AECM) in Pillar 2 (the 'conditional greening' or 'orange ticket' approach); or the greening payment could be transferred to Pillar 2 and improved environmental management pursued solely through voluntary AECMs as part of MS Rural Development Programmes. The arguments in

favour of pursuing greening through voluntary, contractual agreements with farmers are spelled out in Baldock (2017).

3.5 The future for rural development

The future of EU's rural development policy was discussed at a conference in Cork, Ireland in 2016, twenty years after the 1996 conference which helped to establish rural development policy as the second pillar of the CAP, and this resulted in the *Cork 2.0 Declaration on a Better Life in Rural Areas*.²⁰ Although half of the Pillar 2 budget is currently spent on land management issues (see Figure 1), the other half is devoted to supporting a range of other objectives, including on-farm investments, territorial balance and food chain organisation. Two issues with a particular focus in the CAP 2020 debate are whether more could be done with Pillar 2 funds to support the creation of jobs through agricultural employment, and to address generational renewal. The first issue follows on from the focus in the Juncker Commission on jobs and growth. While agricultural employment in the EU has steadily fallen and will continue to fall, it is possible to envisage policies which might bring about more jobs in agriculture than might otherwise be the case under a 'business as usual' policy. Some approaches, such as slowing down structural change and supporting small farms simply on the grounds that they are small and characterised by a higher intensity of labour use per hectare, would require substantial ongoing transfers and risk lowering aggregate employment because of the cost of these transfers.²¹ Trying to prevent the normal exodus of agricultural labour is also likely to exacerbate the unbalanced age structure in EU farming by making it less attractive for young people to enter farming. On the other hand, focused policies designed to overcome market imperfections and encourage higher value-added production which can earn premium prices from consumers (access to credit, quality schemes) can contribute to sustainable additional jobs in the farm sector.

3.6 Cross cutting issues

Finally, it is worth noting that there are a number of cross-cutting issues in the CAP 2020 debate. These include: whether to retain or abandon the two Pillar structure of the current CAP architecture; whether to require national co-financing for Pillar 1 CAP expenditure as well as for Pillar 2; and the overall size of the budget available for EU agricultural policy.

²⁰ Available at http://ec.europa.eu/agriculture/sites/agriculture/files/events/2016/rural-development/cork-declaration-2-0_en.pdf, accessed 3 April 2017.

²¹ See <http://capreform.eu/promoting-rural-jobs-through-the-cap/>.

4. Influencing the CAP 2020 debate from a development perspective

Some of the choices outlined in Section 3 will have implications for developing countries, which is the topic of this final section.

4.1 LDC/SSA interests in agricultural trade

Table 1 identifies those products which are projected to be particularly important for LDCs during the period 2015-2025, either because they are important in production in LDCs, or because they are important exports or imports. LDCs are overall significant net importers of agricultural and food commodities, and their import dependence is expected to increase over the coming decade. Ranked by value, their most important imports are vegetable oils, wheat, rice, sugar, poultrymeat and dairy products. However, some of these commodities are also important export items for a sub-set of LDCs, including cotton, rice, sugar and maize. Thus, LDCs and SSA countries will have the greatest interest in CAP policy changes affecting EU cereals markets (wheat, maize, rice), sugar, poultrymeat, cotton and dairy.

Table 1. Products of special interest to LDCs, ordered by value of imports in 2013-2015e

| | Production 2013- 2015e | Production 2025 | LDC imports 2013- 2015e | LDC imports 2025 | LDC exports 2013- 2015e | LDC exports 2025 |
|----------------|------------------------------|--------------------|----------------------------------|------------------------|----------------------------------|------------------------|
| | Quantities, '000t | | Value, USD million | | | |
| Vegetable oils | 2,720 | 3,319 | 5,117.2 | 8,796.0 | 278.5 | 270.3 |
| Wheat | 13,638 | 16,789 | 4,694.0 | 5,562.6 | 44.7 | 17.3 |
| Rice | 73,300 | 93,029 | 4,419.7 | 2,703.5 | 1,349.5 | 1,662.6 |
| Sugar | 4,312 | 7,628 | 2,365.0 | 3,826.9 | 641.8 | 930.7 |
| Poultrymeat | 2,494 | 3,061 | 1,984.1 | 2,668.8 | 7.5 | 6.3 |
| Cotton | 1,157 | 1,326 | 1,721.2 | 2,385.8 | 1,512.2 | 1,462.8 |
| Dairy | 32,624 | 42,481 | 1,386.9 | 1,822.6 | 65.0 | 43.5 |
| Beef and veal | 3,894 | 4,807 | 881.1 | 1,738.4 | 13.0 | 7.1 |
| Pigmeat | 1,554 | 1,954 | 624.6 | 1,271.7 | 3.0 | 2.7 |
| Maize | 42,503 | 55,610 | 337.7 | 602.3 | 597.6 | 476.3 |
| Protein meals | 2,837 | 3,391 | 323.4 | 653.0 | 100.9 | 68.5 |
| Soybean | 587 | 692 | 223.1 | 298.3 | 5.2ec | 4.7 |
| Other grains | 34,445 | 46,250 | 168.0 | 132.2 | 470.7 | 469.1 |
| Other oilseeds | 4,515 | 5,388 | 138.7 | 170.2 | 29.4 | 16.0 |
| Sheepmeat | 2,146 | 2,923 | 16.2 | 27.0 | 72.7 | 84.9 |

Note: Values are obtained by multiplying trade volumes by actual and projected world market prices in nominal terms, to give a proxy for the value of exports and imports.

Source: Own tabulation, based on OECD/FAO (2016), Statistical Annex.

4.2 Potential development impacts of CAP 2020 proposals

Section 3 reviewed the issues being discussed in the context of the next revision of the CAP basic acts. In broad terms, one group of proposals might be labelled a reversal of the direction towards greater market orientation observed in recent decades. There would be a return to greater market management and more use of trade-distorting payments, such as coupled payments, subsidised insurance and counter-cyclical payments. Such measures would be expected to encourage greater EU production than might otherwise be the case, with lower EU imports and greater EU exports of the supported production and with a lower level of world market prices, as a result. This might be seen as a return to the days of the 'old' CAP when the EU dumped its surplus production on world markets undermining prices and livelihoods of farmers in developing countries. However, such a characterisation would greatly exaggerate the likely significance of these moves.

First, the EU no longer uses export subsidies so any additional production must be sold at prevailing market prices; for exported commodities, these are world market prices although for commodities where the EU is not self-sufficient there is still the possibility to pay farmers higher than world market prices provided sufficiently high tariff protection continues. Second, the EU is likely to continue to restrict the use of coupled payments, even if the share of the CAP budget which can be used for these payments is increased. Because other EU farmers suffer from increased competition where a MS grants coupled support to its own farmers, there is an automatic countervailing political force which will help to keep these payments in check. Third, funding for these measures is not likely to be additional to current funding for decoupled direct payments but to substitute for it. The production effects of new policy measures must be compared to the production effects of the funding they replace (albeit I argued earlier that the latter are likely to be small in overall terms).

Farmers would also be protected more against price volatility in this scenario, with greater public support for risk insurance schemes, greater use of supply management schemes to limit over-supply, higher intervention prices leading to greater use of demand-side measures to take product off the market during periods of low prices, and even the introduction of counter-cyclical payments. The potential risk with such measures is that, if they smooth price volatility for EU farmers, they might exacerbate price volatility on world markets. This was precisely the criticism levied at the EU's use of variable import levies and export subsidies to stabilise prices for EU farmers in the past. For example, if the EU were to introduce counter-cyclical payments along US lines, such payments would eliminate the incentive for EU farmers to respond to world price troughs by reducing production, and would directly contribute to greater world market price volatility in the same way as variable import levies in the past.

However, apart from this instrument, it would be an exaggeration to compare these more recent proposals with the discredited instruments from the past. Subsidised insurance does not affect the market prices that EU farmers face and thus will not affect their incentive to reduce production when global prices are low (subsidised insurance may well attract additional resources into agriculture which will affect the level of world market prices as discussed above, but not their variability).²² While supply- and demand-management schemes to reduce EU product availability during periods of low market prices would raise the EU market price, this price would be raised for all producers and exporters of affected commodities and not only EU producers. The EU's export competitors would most likely welcome such interventions because of their positive effects on world market prices when prices are low. Low-income net-importing developing countries such as the LDCs would miss out on an opportunistic terms of trade gain because import prices would not fall as much as they might otherwise, but this would be offset by the greater predictability of the global market.

Even if the absolute magnitude of the likely effects of changes in the CAP in the directions discussed is likely to be relatively limited, this direction for the CAP post 2020 is not aligned with LDC/SSA country interests. LDCs and SSA countries need support to build their domestic food and agriculture production capacity. For this, they need to be able to depend on a reliable international trading system, which is also able to smooth out inevitable production fluctuations which may increase in amplitude as the effects of climate change become more apparent. The EU can best contribute to this outcome by minimising its interventions in agricultural markets and avoiding recourse to trade-distorting policy instruments.

The second group of proposals would continue the reform path of the CAP by converting the remaining decoupled direct payments, originally introduced as compensation for reform, into targeted payments to support environmental outcomes, sustainable innovation, generational renewal, rural job creation and climate action. As noted earlier, this mixed bag of initiatives could have contradictory and ambiguous effects on the overall level of EU production. Particularly the environmental and climate measures would be likely to lower the overall intensity of production and to lower the area of land used for agriculture in favour of land for forestry or nature purposes. On the other hand, measures to encourage the adoption of innovations (e.g. investment aids) or generational renewal might be expected to have a positive impact on the overall level of EU production. All of these policy measures would likely be notified in the WTO Green Box by the EU. This option for the future CAP would seem more in line with development interests than the first one.

²² One caveat is that, if insurance were to encourage EU farmers to expand cultivation in areas that are more prone to production risks, the resulting greater variability in EU production would lead to greater variability in world prices.

4.3 Commodity analysis

Sugar. The EU sugar market has been strictly regulated since its inception through a system of minimum support prices for beet sugar for production amounts limited by national quotas. Following agreement on a reform of the EU sugar regime in 2005, the EU gradually reduced the guaranteed support prices alongside an expansion in direct aid payments. The 2013 CAP reform confirmed that production quotas on beet sugar (and also isoglucose) and the minimum price for the purchase of sugar beet would be eliminated at the start of the 2017/18 production season in April 2017. A low reference (safety net) price can trigger aids for private storage of sugar should the market situation warrant. In addition, ten MSs provided voluntary coupled support payments to sugar beet production in 2015 amounting to €176 million.

African, Caribbean and Pacific (ACP) countries benefited since 1975 from the Sugar Protocol to the Cotonou Agreement which allowed ACP exporters to export specific amounts of cane sugar to the EU at the guaranteed EU minimum price. In October 2007, the EC announced the repudiation of the Sugar Protocol, which from October 2009 removed price guarantees for sugar imported from ACP countries. However, effective duty-free access was given to ACP exporters under Economic Partnership Agreements as well as to LDC exporters under the EBA arrangement (the safeguard ceiling was not implemented). Some ACP exporters ceased to export to the EU, but overall ACP/LDC sugar exports increased significantly by 2013/2014 to 2.193 million tonnes (a 37% increase over pre-reform levels), in part because EU sugar prices were unexpectedly buoyant during this period. However, EU sugar prices have fallen subsequently to the reference level. ACP/LDC exports in the 2016/2017 season are forecast at only 1.625 million tonnes, although this drop is blamed on climatic conditions.

The elimination of sugar quotas will likely see an expansion in EU beet sugar production, the diversion of previously 'out-of-quota' sugar (which could not normally be sold for food production within the EU) to the EU food market, increased competition from isoglucose production, a fall in EU sugar prices, and a squeeze on preferential imports. The prospect of UK exit from the EU adds to the uncertainty as the UK has been an important market for cane sugar imports from the ACP/LDC group. The consolidation of the EU sugar processing industry following the 2005 reform has also intensified competition on the EU market.

This new sugar market situation will be well established by the time of the next CAP reform. Although the adjustment has been painful for some ACP/LDC exporters, the previous highly-regulated system was not sustainable. Domestic sugar production in the EU is still protected by high tariffs, and ACP/LDC exporters continue to benefit from preferential duty-free access. Substantial adjustment assistance (over €1.2 billion) has been provided to the 18 ACP/LDC traditional sugar exporters. The EU market for imported sugar will be significantly squeezed (not least following Brexit) in the future. ACP/LDC

exporters will need continued support to diversify into higher-valued exports and to strengthen supply chains in the new market situation.

Cotton. Cotton is grown in Greece, Spain and, to a tiny extent, in Bulgaria (cotton is no longer grown in Portugal). The area under cotton has been falling gradually, from 349,000 ha in 2012/13 to a projected 291,000ha in 2017/18 with a corresponding fall in production from 313,000t to 287,000t over the same period. The EU is a small net exporter of cotton, amounting to around 150,000t in 2016. Cotton is mainly imported from Turkey (21%), India (9%), Kazakhstan (8%) and Brazil (8%), with 12% of imports coming from West Africa (Burkina Faso, Mali and Chad). EU cotton exports go mostly to Turkey (41%), Egypt (13%) and Indonesia (12%).²³

The EU reformed its cotton regime in 2008. The reform decoupled 65% of the previous cotton aid, while 35% continues to be linked to cotton production as a cotton-specific area payment. When Greece acceded to the EU, it requested that support should be given for cotton, given its importance in the agricultural economy of some regions. As cotton was not considered an agricultural product (and therefore not listed in Annex I of the EU Treaty), a specific support regime for cotton was written into the Greek Treaty of Accession as Protocol No 4. This was later extended to Spain and Portugal when they joined the EU. The cotton-specific payments are linked to a maximum base area in each country, and the total subsidy paid to cotton growers is also fixed.

In the 2013 CAP reform the base areas and yields are maintained but the hectare aid amounts were slightly reduced. This reduction in the value of support has further reduced the incentive for cotton production in the EU, although the remaining support continues to unbalance the playing field for developing country cotton exporters, particularly in West Africa. However, the EU is a small player in the global cotton market; its gross exports account for around 3% of total global exports. Development groups could try to further reduce the value of the cotton-specific payment in the next reform, although the legal obligation to support cotton production in the Treaty Protocol will set a limit on what can be achieved.

Rice. With a production of less than 3 million tonnes of paddy per year (less than 2 million tonnes in milled equivalent), the EU-28 represents around 0.4% of global rice production. Five countries account for the bulk of EU rice production: Italy, Greece, Spain, Portugal and France. EU consumption has been growing while EU production has been rather flat. The EU tends to produce *japonica* (round or medium-grain) rice while consuming mainly *indica* (long-grain) rice, so despite only covering around two-thirds of its consumption, it is both an exporter and importer of rice. Most rice is imported under preferential agreements with India,

²³ Trade statistics averaged over the years 2012-2016, source DG AGRI.

Thailand, Pakistan and the US. As the EU is not self-sufficient in rice, EU rice production is supported by high tariffs, but there is limited support for rice production in terms of domestic agricultural policy (rice producers benefit from decoupled direct payments, public intervention can be opened for rice when prices are below the safety-net intervention levels, and 6 MSs provide voluntary coupled support payments for rice amounting to around €55 million annually). Development groups could seek to eliminate the possibility to provide coupled support to EU rice production but the market impacts would be small.

Dairy. The EU is the second global dairy exporter after New Zealand and SSA/LDC countries are significant net importers of dairy products. Since the elimination of quotas in 2015 there has been rapid expansion of EU milk production, in part also stimulated by high dairy product prices during the previous two years. World dairy product prices have been low since 2015, which has benefited importers, but are now recovering. The most likely change to dairy policy in the CAP post 2020 might be greater use of voluntary supply management to limit EU production when milk prices are falling. This would not seem to be in the interests of countries which are structural net importers of dairy products. There has been controversy around the role of EU dairy product exports in Africa and elsewhere undermining markets and livelihoods for local producers, although there is also a case that dairy product imports help to expand the local market for milk products and thus benefit local producers.²⁴ Whichever approach development groups might support, the market impacts are not likely to be great.

4.4 Sustainability issues around EU agricultural imports from developing countries

There is increased interest in the development impacts of agricultural and food exports from developing countries to the EU, including their impact on rural livelihoods and environmental sustainability issues. The traditional critique of EU agricultural policy by development groups was that trade barriers and production support lowered world market prices and limited the possibility for developing countries to expand their agricultural exports and market share. With the extension of EU preferential market access arrangements, especially to SSA/LDC countries, the trade-distorting impact of EU trade and agricultural policies for these countries has been eliminated (any residual production support impacts from direct payments and market intervention support are likely outweighed by the positive protective impact of high EU tariffs in privileging preferential imports from these countries relative to their developed and developing country competitors). There still remain obstacles which limit the ability of SSA/LDC countries to exploit fully their preferential

²⁴ Duteurtre, G. and Corniaux, C., Are investments of milk corporations in developing countries likely to promote socially sustainable business? Lessons learnt from West Africa and South-East Asia, CIRAD, <http://agritrop.cirad.fr/583052/1/P36.pdf>.

market access. These obstacles, relating for example, to port delays, customs costs, difficulties in meeting and certifying food safety standards, are largely the responsibility of SSA/LDC countries themselves. The EU can and is assisting these countries to overcome these barriers through 'aid for trade' initiatives.

As a result, the interest of development groups has now turned to ensuring that market access arrangements deliver the benefits in terms of poverty reduction and sustainable development which they promise. The need to pay attention to these issues has been shown by various case studies which have documented examples where export market access has facilitated land alienation and consolidation at the expense of local populations, resulted in deforestation or other environmental damage, or been accompanied by poor working conditions or other human rights abuses. Both public initiatives (e.g. sustainability certification) as well as private campaigns (putting pressure on importing companies including processors and supermarkets to raise standards in their supply chains) have been important instruments to combat these abuses. Reforms to EU agricultural policy cannot directly address these issues. However, the EU can use human rights and sustainability clauses in its free trade agreements to raise these issues with the exporting countries. In such situations, the desire to defend universal human rights and sustainable development goals should trump the traditional position of development groups that donor countries should not dictate the development paths of partner countries.

4.5 Concluding remarks

This paper has identified the main issues which will be discussed as part of the debate on the CAP post 2020. It has also identified some key demands which development groups should consider raising in this debate. Pillar 1 direct payments still make up the bulk of CAP expenditure and make an important contribution to EU farm incomes. Any trade-distorting effects arising from these payments should be minimised by converting these payments into more targeted payments which pay farmers to deliver public goods, to support research and innovation, and possibly to kick-start participation in risk management schemes. Development groups should also be active in preventing any back-sliding in CAP reforms, such as coupling direct payments to production or introducing counter-cyclical payments. Following the improved guidelines introduced in 2015 on implementing policy coherence for development perspectives into Commission impact assessments (European Commission 2015), it will be expected that the impact assessment of proposals for the modernisation and simplification of the CAP (see footnote 4) will include an evaluation of these proposals on developing countries. Development groups have a role to ensure that this impact assessment is more than a *pro forma* exercise and undertakes an inclusive and complete evaluation of the likely impacts of different reform paths on developing countries.

A final consideration: during the 1980 and 1990s development groups were an important voice in influencing the path of CAP reform. In part because of their efforts, the CAP today is a much less trade-distorting policy than it was. High tariff barriers remain, but these require changes in EU trade policy and not agricultural policy. In any event, LDCs enjoy the benefits of duty-free quota-free access to the EU market and their access is protected against more competitive developing country exporters because of these high tariffs. Thus, reducing EU agricultural tariffs is not necessarily a priority for LDCs and SSA countries.²⁵ EU farming remains heavily dependent on transfers from both EU taxpayers and consumers. However, it is likely that this support primarily affects the structure of production in the EU rather than the level of protection. If the EU were to unilaterally remove all taxpayer-funded support to EU agriculture, there would be a considerable need for structural adjustment and a reduction in the number of farms, overall production levels on these restructured holdings might not be very different to the level of production today.²⁶ Given limited campaigning resources, the benefits to LDCs from a successful campaign by development groups to lower public transfers to EU farmers needs to be assessed against the potential gains from allocating those campaigning resources to other issues with potentially greater returns in terms of poverty alleviation and meeting sustainable development goals.

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²⁵ Each country would need to weigh up for itself whether the direct benefits of preferential market access for its agrifood exports are outweighed by the indirect impacts of greater competition on world markets because of EU tariff protection. EU tariff protection may also have a systemic effect if it discourages other countries from lowering agricultural tariffs.

²⁶ This statement refers to aggregate production; there could be more significant variations in the production of specific commodities.

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