EAAE Presidential Address

Redesigning the CAP to meet the challenges of EU enlargement and the WTO: what can agricultural economic research contribute?

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1. Introduction

Two major events will be shaping discussion on agricultural policy matters during the coming years: the upcoming EU enlargement involving preparations, negotiations of terms of entry, and perhaps membership for the first wave of applicants; and unfolding WTO negotiations. There is no shortage of proposals for CAP reform in response to these challenges and I am not going to launch another one here. Instead, I would like to address some of the underlying theoretical issues for which agricultural economic research could contribute to the discourse on the design of an efficient and equitable policy. The topic is huge. Fortunately, there are several common themes that are relevant to the discussion of both enlargement and trade relations. I will concentrate on three of those common themes. Even by keeping strictly to these three areas, time constraints will unavoidably create a bias in my remarks. For the same reasons, I will, moreover, concentrate on highlighting the research issues rather than on providing a ‘state-of-the-art’ assessment. The topics I will address are:

- Domestic or national policies and distortion of competition. The impact of domestic policies and compatibility of various domestic interventions with liberalisation of international trade is an old issue. Similar questions are, however, also likely to be raised in relation to the internal market, especially for the enlarged EU, as diversity of conditions and preferences is likely to increase, making it necessary to allow for more national discretion.

- Non-tariff barriers to trade. Rules and regulations (Sanitary and Phytosanitary Standards (SPS) and Technical Barriers to Trade (TBT)) are becoming more favoured as means of border protection since classical trade barriers have been disciplined. Adjustment to the acquis communautaire (especially as a large part of it is connected to the agricultural and food sector) raises fundamentally the same sets of issues as SPS in the context of international trade negotiations.

- Status of compensation payments. In terms of budget appropriations, direct payments have now emerged as the major policy instrument of the CAP.
Compensation payments are also likely to become a contentious issue both in WTO negotiations and EU enlargement.

2. Domestic policies and distortion of competition

2.1. Basic principles

It is often argued that agriculture is much more than food. Domestic policies are necessary, the argument goes, to address these related concerns, which tend to be non-trade, non-economic and/or multifunctional. Debate on non-trade concerns, or the multifunctionality of agriculture, revolves essentially around the same set of issues—food security, rural employment, rural amenities and environmental benefits—as did the discussion on the non-economic objectives of agriculture in the 1980s. This is not very encouraging. Have we not resolved at least some of those issues? Is the present debate only old wine in new bottles or have some new and relevant arguments been added? Have we failed to communicate our findings to the public or to decision-makers? The theoretical foundations for analysing the case have not changed (see Anderson, 1998). To achieve several policy objectives usually requires an equal number of policy instruments. Trade measures are rarely the most efficient instruments for addressing non-trade concerns. Instead, the most efficient instrument for overcoming a market failure is the one that addresses the objective most directly. Trade reform will be welfare-improving as long as optimal domestic interventions are in place to deal with non-trade concerns.

Thus, the literature offers the general prescription that non-trade concerns should be addressed by non-trade measures, or that measures should be designed in a non-distorting way. It should be observed, however, that some objectives cannot be addressed in a non-distorting way. Food security, interpreted as food self-sufficiency, can only be achieved by distorting trade. Sustaining non-competitive production to protect biodiversity affects trade as well. In such cases, the key issue is the validity of the specific formulation of agricultural policy objectives in terms of the overriding goals of the society rather than the impact on trade as such. The first part of my remarks will follow this line of reasoning. I will concentrate on three main issues: food security, environmental benefits and rural development.

Essentially, the argument that agricultural production is more than food and hence should not be exposed to the law of comparative advantage could also be applied to the internal market. This discussion relates to the question of whether there is a case for a common policy in certain areas or whether the principle of subsidiarity should be applied. I also have some comments on this issue.

2.2. Food security

Invoking food security in defence of non-competitive production in industrialised countries is essentially an erroneous argument. From the seminal work

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1 For a discussion on the non-economic objectives of agriculture, see Winters (1988). Food security, environmental protection and viability of rural areas are also stressed in the preamble to the Uruguay Round's Agreement on Agriculture.
of Amartya Sen (Sen, 1981) we know that food security is primarily about the affordability, not the availability, of food. Those with enough money will never starve and rich countries can import food. In the unlikely event of trade embargoes and other disruptions, food security can only be guaranteed if a country also is self-sufficient in vital inputs, particularly energy. If those conditions are not fulfilled, food security is not credible as an argument for support. It could be argued, however, that long-term availability of food at the global level should not be taken for granted. Existing estimates suggest the need to double the global food supply within next 30 years (Thompson, 1998). This may not be a trivial matter. Application of the precautionary principle should, however, involve maintaining production capacity and, hence, avoiding the destruction of natural resources (such as land) rather than sustaining the present level of production in high-cost areas.

2.3. Environmental benefits

The impact of agriculture on the environment is potentially the most important non-trade concern. Agricultural production undoubtedly generates positive environmental effects, including landscape management and maintenance of biodiversity. Needless to say, agricultural production also entails a negative impact on the environment. Accordingly, the argument for support presupposes that there is a positive net benefit. Here I will focus on positive externalities because the underlying theoretical issues are more complicated. The analysis involves several steps: assessment of society’s willingness to pay for environmental benefits, determination of the most efficient policy instruments for encouraging farmers and others to provide that benefit, and deciding the optimal level of encouragement for them to do so (Anderson, 1998).

Valuation of environmental benefits is often complicated, especially in relation to biodiversity. At the same time, biodiversity is extensively invoked to justify support to agriculture. Preservation of biodiversity is, for instance, one of the major objectives of Swedish agro-environmental policy. In addition to the usual difficulties with valuation of non-marketable goods, preservation of biodiversity is also difficult to conceptualise, as argued by Metrick and Weitzman (1998). The authors raise the questions of what units should be used to measure biodiversity and what is to be optimised? Metrick and Weitzman conceptualise the issue of maintenance of biodiversity as a Noah’s Ark Problem in which species should be saved according to their contribution to utility plus diversity, weighted by the increase in their probability of survival. This includes such values as distinctiveness of a species and direct utility of a species per se. Application of this principle in practice may, however, be very difficult as species are disappearing faster than sufficient knowledge about them can be gathered. Moreover, natural scientists believe that what should be saved are habitats or ecosystems because of their intrinsic values and because they enhance species survival. For economists, this creates additional analytical difficulties. Valuing a complex combination of many species and their interactions in the context of an ecosystem is generally more difficult than valuing a single species (Gardner and Shogren, 1998). Close co-operation
between economists and biologists, with which agricultural economists have considerable experience, is an absolute precondition for being able to perform the task.

Most services provided by biological diversity are not priced on the market but consist of non-use values that are associated with benefits derived simply from the knowledge that an environmental asset is maintained. The primary tool used for assessing a monetary value for non-use values (as well as other non-marketable goods) is the contingent valuation method. This method is highly contentious because people are confronted with hypothetical questions rather than facing their own budget constraints and actually spending money. Critics claim that in responding to a hypothetical survey, an individual may fail to distinguish between the specific good under analysis and the wider group of goods. Accordingly, contingent valuation surveys often elicit surrogate preferences for environmental protection in general rather than specific species in question. Embedding a good within a more comprehensive good significantly lowers willingness to pay (Brouwer and Slangen, 1998). In the absence of pre-existing and stable preferences, information provided by the questionnaires may, furthermore, contribute to generating preferences instead of helping to discover existing preferences. An additional problem is the appearance of protest bidders. Protest bidders who have a negative attitude towards paying for the good but a positive attitude towards the good itself seem to perceive the preservation of biodiversity or other public goods through the eyes of citizens rather than consumers (Brouwer and Slangen, 1998).

Where does this discussion leave us? Positive environmental benefits are potentially the most relevant non-trade concern related to agriculture. Most of the environmental benefits of agriculture are public goods that cannot be bought on the market yet we lack a non-controversial method of assessing those benefits. Contingent Valuation (CV) surveys are likely to be challenged even in the future. Some critics argue that shortcomings of CV surveys are beyond repair (Diamond and Haussman, 1994). According to others (the National Oceanic and Atmospheric Administration panel), cautious use of the CV methodology can be accepted. Improving the CV methodology or designing uncontroversial or less controversial methods of putting monetary value on the environmental benefits of agriculture constitutes one the most challenging future tasks for agricultural economists.

Assuming that a willingness to pay for environmental goods has been established, the issue of how to design a proper policy emerges. Interactions between biodiversity maintenance, ecological processes, farming systems and agro-environmental policy are far from fully understood. Hence it is necessary to design environmental indicators to evaluate the usefulness of particular agricultural policies in securing sustainable development. The OECD has, among other things, developed such indicators. This is a challenging task for agricultural economists, but our profession really has comparative advantage.

A related research issue is connected to the design of efficient policies for delivery of environmental goods. It is widely recognised that price support to agriculture is not efficient for that purpose. Accordingly, the importance
of contracting between farmers and society for the provision of environmental benefits has increased. Many farmers receive several payments related to the environment. It is hardly surprising that such a system is costly (both for farmers and regulators). Obviously it should be possible to design environmental contracts in a more efficient way. How it should be done is, however, not a trivial matter. A trade-off between attainment of environmental objectives and control of administrative costs may easily be made. Contract design is, furthermore, plagued by information asymmetries, to the disadvantage of the regulator (Slangen, 1997). Farmers know much better than regulators what their opportunity costs are. Facing such a hidden-information agency problem, the government needs to provide a scheme with both participation and incentive constraints. However, the challenge is to design contracts that are not only incentive-compatible but also understandable, intuitively appealing, explainable and justifiable to farmers. A special challenge may be to design contracts that would be applicable in the CEECs (Central and East European Countries). Although the general level of education in the CEECs is high, this is not always the case among farmers.

Individual farmers are not the only possible providers of environmental benefits. Contracts between farmers and society could perhaps be arranged through intermediaries such as environmental or rural development groups. Such groups may have an information advantage with better local knowledge of the environmental impact of specific policies and opportunity costs. The penalty for defaulting on contracts with the local community is, furthermore, probably much higher than for cheating the bureaucracy. A group of farmers or an environmental co-operative could also contract for provision of environmental benefits. Some of the benefits, such as preservation of the landscape, could be preferably produced by a group of farmers rather than by an individual farmer. How such co-operative approaches could be conceptualised and designed is a challenging task for agricultural economists.

2.4. Rural development

Promotion of rural development is constantly invoked as a non-trade concern of agriculture. However, agriculture’s contribution to rural employment has declined considerably. In the OECD countries, rural employment is no longer identical to agricultural employment. Agriculture still plays an important role for rural areas, especially in the CEECs.

The issue is whether the present agricultural policies are addressing rural development efficiently or whether different policies are needed. Understanding the underlying economic processes that generate regional disparities is fundamental for proper policy design. In particular, proper identification of the trends affecting the future development of rural regions would make it easier to design suitable rural development policy. The future of rural areas depends on trends in the costs and benefits of urban compared with rural life. The picture is not clear and opposing forces are at work. Accordingly, the task of assessing the relative importance of the factors involved will be challenging. Scale economies are a major reason for clustering of economic
activities. Many activities display internal economies of scale over some range. In addition, firms may benefit from external economies of scale, i.e. achieve cost savings when operating in the context of a larger local economy by drawing upon common pools of space, labour, materials and services (Quigley, 1998). As a result, there are socially increasing returns as aggregate production rises, even if production from individual firms has constant returns. Could economies of scope that can be found in rural areas function as a substitute for economies of scale, as argued by Saraceno (1996)? Can rural regions compensate for the lack of economies of scale in other ways, such as by fostering small-scale business structure and a culture of entrepreneurship which may provide conditions for rapid economic adjustment? Or can they cultivate a work force that may prove attractive to certain types of firms (Blanc, 1997)?

Scale economies can be found in consumption as well. More differentiated consumer goods can be found in larger cities. Under reasonable assumptions, the utility of a household in a city will be positively related to the aggregate quantity of local goods it consumes and the number of different goods available in the economy (Quigley, 1998). The high cost of living and of commuting is, on the other hand, an obvious disadvantage of urban life, along with pollution, crime and urban anonymity. In numerous rural areas shifts in urban–rural migration patterns occurred in the 1970s. Migration toward the centres has been replaced by net migration towards peri-urban and rural areas. How will consumers value the advantages and disadvantages of rural life in the future? Will the new information technologies (internet shopping, access to services via telephone and fax, etc.) be able to remove some of the present disadvantages of rural life, particularly the narrow availability of high-quality goods and services?

How will the shift to a service-based economy in which information- and knowledge-based industries play an increasing role affect the competitiveness of rural regions in attracting economic activities? Development of distance-independent service technology, such as telemarketing, booking agencies, etc., makes it possible to establish jobs in or move jobs to remote rural areas. However, recent innovations in production methods and organisations may also have increased the importance of skilled labour. The rise in returns to skill is a well-established feature of modern labour markets and this rise should increase the value of cities as centres of learning.

Could insights from agglomeration theories and New Economic Geography indicate how to design more efficient rural development policies? So far, rural development policies have tended to be reactive rather than proactive, and have concentrated on combating the forces that historically led to depopulation in rural regions. External economies of scale, which contribute to higher efficiency in urban areas, originate from a pool of common resources and ideas. Could modern information technology be used to enable smaller firms in rural areas to participate in such pools of resources by, for instance, improving access to high-quality services, thus improving the competitiveness of rural regions in attracting industries? However, if an
agglomeration mechanism is at work and is self-sustaining, then marginally improving the attractiveness of the periphery may have no impact on the location of firms (Martin, 1997). Moreover, there is a lack of convincing evidence that existing regional support policies are working. The work of Barro and Sala-i-Martin (1992) indicates that a pattern of convergence has been emerging across European regions. The speed of convergence is, however, low—around 2 per cent per year. Sala-i-Martin (1996) argues that the fact that the speed of convergence is surprisingly similar across data sets indicates that public policy plays a very small role.

2.5. Non-trade concerns and the case for a common agricultural policy after enlargement

The argument that agricultural production is more than food and hence should not be exposed to the principle of comparative advantage could be also applied to the internal market. It could be argued that, if non-trade concerns are valid, then they should be applied to the internal market as well. But should this kind of decision be made at national or central level? The issue is whether there is a case for a common policy in relevant areas or whether subsidiarity should be advocated. Essentially, this discussion boils down to the question of justification of a common environmental and rural policy for agriculture. This question could be asked with respect to the incumbent members of the EU; enlarging the union with several countries that are much poorer makes the issue of a common policy even more pertinent.

Having a common policy is not an aim in itself. On the contrary, the principle of subsidiarity implies that a decentralised solution should be preferred unless a good case for centralisation can be made. The major argument for centralisation is the possibility of achieving higher efficiency through a common policy. Such an efficiency gain may arise because external effects make uncoordinated national policies inefficient, from economies of scale or scope, from higher quality of decisions, etc. Additional aspects that can be considered are equity and accountability. Assessment of the relative merits of centralisation and decentralisation in agricultural policy-making is an essential task for agricultural economists, especially as recent and expected modifications of the CAP have implied fundamental changes of both priorities and instruments.

Environmental policy has two major components: punishment of negative environmental effects and rewards of environmental goods. The former is related to the application of the polluter pays principle (PPP) and environmental standards, the latter to payments for the provision of public goods. Discussion on common environmental standards is closely related to the issue of food safety and adjustment to the acquis, which will be discussed later. Here the focus will be on rewards.

As argued before, the main non-trade concern in the case of agriculture is the beneficial impact of agriculture on the environment, but this impact is not clear-cut. Promoting environmentally friendly production will in many cases result in lower intensity and hence lower production. However, sustaining
non-competitive production for the sake of biodiversity or landscape management will unavoidably affect production (see Lehmann, 1988), and therefore will have an impact on competitiveness. Willingness to pay for environmental benefits differs among countries. Poor consumers are, in particular, less likely to be willing to pay for such goods. Most environmental benefits, such as a beautiful landscape, are consumed locally, making the case for common policy (and common financing) relatively weak. However, there is an obvious danger that if payments to environmental goods were left to the discretion of the member states, a very uneven distribution of support could result. Designing a policy that could strike the proper balance between allowing richer consumers to enjoy more of the environmental amenities while avoiding serious distortion of competition is a challenging task for our profession.

If preservation of rural employment were a valid argument for agricultural protectionism, it would be more valid for the CEECs than for the EU because of their high share of farm employment. Designing workable rural development policies is one of the most pressing challenges facing the CEECs, especially those countries where more than 20 per cent of the labour force is in farming.

Justification of a common rural policy is similar to justification for structural funds, i.e. it relates mainly to equity. However, it could be argued that a proper response to equity considerations could simply be a monetary transfer and not necessarily a common policy. It may be difficult to design a common rural policy efficiently (compare criteria above). Efficient selection of projects requires detailed local knowledge that central authorities may not have. Lower tiers may, furthermore, have an incentive to misrepresent the local situation in order to manipulate resource allocation. Further arguments against centralisation relate to the possible mismatch in the preferences of the central authority and lower-level jurisdictions (CEPR, 1993). A good case for centralisation can be made, however. Willingness of net contributors and especially of the incumbent members of the EU to transfer money to rural development projects in the CEECs will be critically dependent on the quality of investments undertaken with EU money. The policy may fail for technical reasons such as lack of experience or political failure at the lower level resulting in misuse of funds. Both arguments suggest that the EU is likely to play an important role in the evaluation of development projects in its regions. Hence, the EU could act as a guarantor of the quality of investments (CEPR, 1993).

The arguments above speak in favour of a common framework for rural policies in the CEECs. It does not necessarily follow that precisely this approach should be taken. Weak administrative capacity in the CEECs will constitute a serious obstacle for them. Application of rural development policies is not entirely satisfactory in the present EU member countries. There is considerable criticism of the use of Structural Funds in the present member countries, despite their much higher level of administrative efficiency (von Urff, 1996). Moreover, those policies have taken a long time to evolve and have emerged when the countries where they are applied are at a higher level of economic development. This is particularly true for the institutions
that are instrumental in successful rural development activities, such as participatory approaches, in present EU countries. Designing special arrangements that would guarantee the quality of investment undertaken with common funds while avoiding penalising the CEECs for their weaker administrative and social structures is a challenging task.

3. Food safety and the acquis

3.1. Food safety and trade issues

Food safety means absence of germs, toxins and pathogenic chemical residues, and absence of risk of the spread of diseases or parasites. Food quality is a much broader concept that covers all the attributes included in the consumer utility function. New technologies, scientific discoveries, information about linkages between diet and health, and mass communication of this knowledge to consumers have resulted in increased demand for higher-quality foods, especially in high-income countries (Caswell and Mojduszka, 1996). This is likely to continue; trade in processed goods is growing faster than trade in raw farm commodities so standards and technical rules are bound to play an increasing role (Mahé and Ortalo-Magne, 1998). Demands for increased regulation and stricter enforcement of existing regulations have also gained momentum across OECD countries in recent years, as a result of a number of highly publicised outbreaks of food-borne diseases.

From the point of view of internal co-operation in the field of food safety, the issue is to find the balance between disguised protection and legitimate objectives of food safety (Mahé and Ortalo-Magne, 1998). Looking at this issue from the perspective of the enlargement, the question is how to accommodate the incumbent members’ genuine concerns for food quality without forcing poor consumers in the acceding countries to pay for regulation they do not desire and cannot afford.

Analysing the question of food safety and quality, it may be useful to distinguish between search, experience and credence attributes of goods. For search attributes consumers can determine a product’s quality before they buy by examining it; for experience attributes they determine quality only after they buy it and use it; for credence attributes they cannot determine the quality even after they have bought it (Caswell and Mojduszka, 1996). Attributes related to hedonism are in general of the experience type. In such a case, repeated purchases or labelling reduces information asymmetry. Market failures regarding food safety and quality attributes stem from asymmetry of information between buyers and sellers. All food-borne risk factors fall clearly into the experience and credence categories (Henson and Traill, 1993).

The credence character of food commodities constitutes a clear case for regulation. A more open question is whether consumer risk perception be taken into account when accessing the legitimacy of national food safety standards, especially when expert opinion and consumer perceptions differ (Henson, 1998). In many cases, consumer concerns are not based on scientific
facts. The fact that consumers misperceive risks to which they are exposed is well documented. There is a systematic primary bias in probability estimation with high risks tending to be underestimated and low risks overestimated. A pervasive fact about human judgement is that people disproportionately weight salient, memorable or vivid evidence even if they have better sources of information (Henson, 1998). Moreover, once strong hypotheses are formed, people are often inattentive to new information contradicting their hypotheses (Rabin, 1998). This belief perseverance and confirmatory bias suggests that if people are scared by sensational reports in the media it may be very difficult to persuade them to change their minds regardless of how much ‘dull’ scientific evidence is presented to them.

Also important is the growing number of consumers who are concerned about the possible adverse effects of their purchasing decisions on natural resources and the environment in other countries. Consumers are also concerned about the importation of goods that they reject for cultural or religious reasons. Ethical and environmental attributes are usually not verifiable as they relate to the history of the product, and its method of production, the so-called process and method of production (PMP) issue. This turns PMP into a credence attribute.

To what extent should the above-mentioned considerations be taken into account in restricting trade? A number of arguments can be made for including ethical and cultural values as grounds for trade restrictions. Trade is one of the most effective means for countries to exercise their beliefs regarding human rights or the protection of natural resources and endangered species. Socially aware consumers may find it hard to understand why international trade rules prevent this. Thus, ignoring consumer values may result in a loss of their support for the process of trade liberalisation (Bureau, 1998).

However, giving consideration to ethical or moral positions could permit potentially unlimited numbers of exemption to trade (Bureau, 1998). Moreover, consumer concerns about the way imported goods are produced are often used by pressure groups acting in their own interests. For example, is the concern voiced by US workers over working conditions in Mexico really an expression of international solidarity? Trade restriction is, furthermore, often a very inefficient measure for addressing such concerns. Consider a highly published case: will banning products produced by working children solve the problem of child labour? Depriving them of work will most probably make them even poorer. Children are not poor because they work; they work because they are poor.

Labelling and consumer information are policies usually seen as preferable alternatives to regulation because they are cheaper, and leave the choice to consumers, and are less likely to constitute trade barriers. However, labelling is not a satisfactory solution when consumers are not only concerned with products they themselves consume but with the PMP of the products available on the market. It seems that such concerns for collective rather than individual consumption only can be addressed by regulation (Mahé and Ortalo-Magne, 1998). The case of genetically modified organisms
(GMOs) illustrates this situation very well. Most consumers who reject GMOs do not fear the implication for their individual health arising from consuming such products. Rather people are worried that herbicide-tolerant plants may crossbreed with wild species growing next to them or that insect resistance may favour development of insects resistant to toxins, etc. Hence, labelling of products based on GMOs will not address such concerns. Labelling raises the issue, moreover, about the amount of information on a label that consumers are able to process in a useful way.

The underlying theoretical issue here is: what constitutes a legitimate source of comparative advantage? What criteria should be selected while judging what constitutes a technical barrier to trade? Baldwin suggested that non-tariff barriers should be defined as policies that reduce potential world revenue. Mahé (1997) has proposed that non-merchant effects should be included in the definition. Mahé suggests, furthermore, that measures that, if eliminated, would cause welfare losses in some countries that are greater than welfare gains in other countries should be classified as non-tariff barriers. This definition is in line with both economic theory and the idea of using cost–benefit analysis to arbitrate on disputes (Bureau, 1998). However, the implication from an equity point of view is highly questionable. This definition would legitimise restriction of imports (for whatever reason, including misperceived risks and false inference about causality among consumers) causing a welfare loss to a poor country provided that the welfare gain for a richer country is high enough. As an alternative view, it could be argued that products produced under normal working and social conditions and under regulations that are products of a democratic process in the exporting country should be allowed entry. This issue is likely to continue to be discussed in the future.

3.2. Food safety and the acquis communautaire

Extension of the acquis communautaire to new member countries raises a similar set of issues. The acquis defines the rights and obligations that EU members have under Union law. Candidates for membership are presented with the acquis as a rigid ‘take it or leave it’ offer. Application of all the requirements to the applicant countries from Eastern Europe will most probably generate a number of difficulties. The acquis originates from economies at a higher level of economic development. Agenda 2000 reflects the values and risk aversion of present members of the EU, which are much wealthier. It is possible to determine optimal quality standards for each country, reflecting a trade-off between cost and demand for quality. It depends on consumers’ willingness to pay and there is no reason why such an optimal standard should be the same for all countries (CEPR, 1993; Antle, 1995). Different tastes, incomes and willingness to pay may lead to differing regulations. Accordingly, enforcing higher standards than those the CEECs would have chosen on their own may result in a welfare loss. However, it is difficult to sell on the EU market if such standards are not enforced. Failure of the CEECs to take advantage of the quotas provided by the Association Agreements demonstrates this clearly. In the long run, imposing EU food quality
standards is in the best long-term interest of the CEECs, as it contributes to the positive image of the country’s products. The short-term solution is not entirely clear, especially if even production for local consumption must comply with the standards. Thus, we see that the issue of whether the politics and economics of the single market are compatible with allowing derogation from the regulation process for the CEECs is one of the central enlargement issues (Smith et al., 1996).

It could be argued that harmonisation of regulation is not necessary to the functioning of the single market and premature harmonisation could damage the competitiveness of the CEECs (Smith et al., 1996). Moreover, lobbies of EU producer interests can hijack the decision making with respect to application of common standards as well as manipulating environmental and social concerns raised in relation to external trade.

4. Direct payments: implications for WTO and enlargement

Direct payments that are paid as compensation for lower prices (previously called compensation payments) will undoubtedly play an important role in the next WTO negotiations. The key issue will be whether the direct payments can be seen as decoupled. Fixed payments per hectare, which are based on historical yields, are less production-enhancing than price supporting because application of inputs such as fertilisers can be expected to be lower. As long as involvement in agricultural activity is required for receiving the payments, however, they may have an impact on production. This will be the case for production that would be unprofitable in the absence of direct payments. This, in turn, will depend on cost levels, yields, etc. In the case of marginal land in Sweden, direct payments have a decisive impact on production if cultivation is required. In the absence of such a requirement, production of relevant commodities would shrink considerably. If 100 per cent set-aside were allowed, the share of voluntary set-aside in Sweden would more than triple (Ministry of Agriculture, Sweden, 1998). A similar indication has been seen for Germany; calculations with the RAUMIS model indicate that when higher set-asides were allowed, their attractiveness to producers increased considerably (Henrichsmeyer and Löhe, 1998). These results have been obtained in models where set-aside is endogenous and production is regionally differentiated. An interesting question is whether the result applies to other countries as well.

US direct payments, Production Flexibility Contracts (PFCs), are notified in the WTO as green measures. Comparisons between PFC payments and direct payments in the EU made for Swedish conditions (Ministry of Agriculture, Sweden, 1998) under the assumption that 100 per cent set-aside is allowed, indicate that, depending on conditions, the PFC payment may be more production-enhancing. If all direct payments are distributed by acreage and harvesting is required, the difference between the basic version of Agenda 2000 and PFCs is very small. Allowing for 100 per cent set-aside, EU payments become more decoupled than PFCs. Translating US policies to EU conditions
is not a trivial matter. Hence more research on this issue seems needed, as the relative merits of the European and US payments are likely to be scrutinised during the next round of negotiations.

Allowing for 100 per cent set-aside would seem, according to the analysis above, to turn direct payments into truly decoupled support. Several issues emerge, though. First, could agricultural politicians credibly commit to decoupled payments? All justifications for agricultural policy are related to production, environmental qualities, employment, rural development and rural amenities. Accordingly, decoupling threatens the legitimacy of the policy. Thus, farmers may find it hard to believe that society will continue to extend support to them if they stop production, especially as they are no poorer than other groups. Second, are direct payments desirable? Implicit in the recommendation to decouple the payments from production is the assumption about the specificity of agriculture that necessitates support of farm income through sectoral measures rather than through social measures directed at particular individuals. Can such specificity still be justified?

The situation where farmers derive most of their income from direct payments of various kinds constitutes a fundamentally new circumstance. This raises a number of research issues: Do we know enough about farmers’ behaviour in such conditions? How will farmers react to a multiplicity of payments for different targets? It has been often argued that lower price supports will make farmers more market-oriented. This will not necessarily be the case if income from product sales constitutes only a small share of total income, the rest being direct payments of different kinds. The food-processing industry in Sweden (slaughterhouses) has already started voicing concerns about the quality of meat supplied to it. Will farmers bother to produce high-quality meat when income from meat production constitutes a very minor share of their total income? In such circumstances, might sensitivity to meat price changes be fairly low?

Past enlargements have resulted in amendments for newcomers and a novel use of existing instruments. The CAP for the incumbents has hardly changed. It is questionable whether the same approach can be followed in the next enlargement. What role should the CAP play in the process of European integration? Should we aim for still closer integration, as stipulated in EU treaties, or should we retreat in some areas where the benefits of a joint policy are lower than the costs?

New priorities, especially for environmental protection and rural development, have been gaining momentum. Direct payments have replaced price support for some commodities. These changes of priorities and instruments have fundamental ramifications for the justification of a common policy for agriculture. In the previous section I have discussed the justification for a common approach with respect to rural and environmental policy. The same issue can be raised with respect to direct payments. Especially in relation to direct payments, the justification for a common policy is weak. Direct payments originated to replace price support, which resulted from the pursuit
of a farm income objective. Accordingly, the payments should be seen as permanent direct income support. As such, those payments could be argued to fall under social policy, especially if demands on decoupling are made. There is no common social policy in the EU. A case for a common social policy is weak (CEPR, 1993). Even weaker is the case for a common social policy in a single sector.

Direct payments are likely to be highly controversial in the accession negotiations. At the end of 2006, direct payments are expected to account for three-quarters of the EU’s agricultural budget (if Agenda 2000 proposals are fully implemented). Moreover, because of the low level of prices that will result from the reform, direct payments will be more ‘coupled’ than before the reform and hence further disturb the competition between receivers and non-receivers.

Three major options are possible with respect to direct payments in the context of the enlargement agreement. The two obvious options are the opening bids of the Commission and the incumbents: no payments and full payments, respectively. The third option is a compromise involving a stronger reliance on subsidiarity and decentralisation (Rabinowicz, 1999).

There has been extensive research comparing the full payment and non-payment options (Banse et al., 1998; Frandsen et al., 1998). Conclusions that emerge from this research state that full payment would probably be welfare-decreasing for the EU. The overall level of transfers implied is simply too large to constitute a mutually beneficial solution for both the incumbents and the applicants. Moreover, incompatibility of this option with WTO commitments, even if Agenda 2000 is implemented, would threaten the next round of trade negotiations. No payment would be an unstable and discriminatory solution. Denying direct payments to the CEECs would eventually undermine the very foundation of the CAP for the incumbents. A common policy of supporting farm incomes cannot be credible if the poorest farmers are excluded.

There has been considerably less research on how to design a suitable compromise on enlargement. This is could be a challenging task for agricultural economists. Such a compromise should allow for more flexibility and rely on subsidiarity. How to reconcile a more decentralised approach with a need to avoid distortions to competition is, however, no simple matter.

5. Role of agricultural economists

5.1. Research agenda

In several of the issues identified, the focus is on consumers, taxpayers or the general public and their willingness to pay, their perception of food safety, etc. This constitutes a slightly new orientation of the research agenda for agricultural economics, which has traditionally focused more on farmers and their behaviour. Moreover, many of these issues also attract environmental or general (applied) economists. As economists, we should welcome competition. Do we have comparative advantage to pursue research in these areas?
I would argue that this is the case. Good knowledge of theory and methodology is, of course, an absolute precondition for being able to compete in the field, but the tradition of applied work at the interface between economics, biology and technology that has long been a hallmark of agricultural economics should provide for success in these new areas.

5.2. Policy advising

I have identified a number of research issues where results could contribute to an efficient design of agricultural policy. This is, of course, an optimistic and, some would claim, naive view of the role of agricultural economists in the design of agricultural policies. Even those of us who do not fully subscribe to the theories that public policies are solely driven by self-interested politicians wanting nothing other than re-election, agree that political constraints are a reality not to be ignored. Should economists be involved in designing suitable compromises taking both political and economic considerations into account? This sounds very tempting. Some economists have even suggested that the policy problem should be solved as a joint optimisation of the political and economic problems. Designing first-best solutions that will never be followed because they can be blocked by those who would lose on them is very frustrating. A colleague of mine, a general economist I should add, said once that listening to an agricultural policy debate was like watching a performance of Swan Lake at the opera house. The story is not an issue. Everybody knows what will happen. What is interesting is only how well the ballerinas perform their pirouettes. Hence, looking for politically acceptable improvements may seems reasonable even if the improvements only constitute a second- or third-best solution. Tempting as it may be, this option nevertheless may turn out to be a slippery slope. Political realism implies that the interests of some groups are weighted more than those of other groups not necessarily because the supported groups are more deserving, but because the group is better at articulating its interests or has better access to the decision-making process. Accordingly, the researcher cum advisor, who takes political considerations into account, also makes an implicit value judgement in favour of certain alternatives. This may be questionable, as those most able to lobby are seldom the weakest groups. Thus a cautious attitude should be recommended. A viable long-term solution for agricultural economists to advocate would be to influence the institutional setting in such a way as to provide more balanced access for stakeholders outside the farming lobby. What scientific evidence should we base our policy advice on? Applying the latest ‘news’ in research may be tempting but, as was often wisely argued by Assar Lindbeck, policy advice needs to be based on the existing stock of knowledge not on the flow (i.e. the latest news), however fascinating it may appear.

References


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