Ireland: The likely effects of full decoupling

Trevor Donnellan[1]

FAPRI-Ireland Partnership, Rural Economy Research Centre, Teagasc
Sandymount, Dublin 4, Ireland

Summary

On June 26th 2003 Agriculture Ministers from across the European Union (EU) reached a compromise on reform of the Common Agricultural Policy (CAP). The Luxembourg Agreement (CEU, 2003) provides the setting in which farming in the EU will take place over the next decade and beyond. The dominant feature of the agreement is the decoupling of agricultural income support payments from production.

Contained within the details of the final agreement are a number of options, principally relating to the decoupling of policies within the beef sector, but with significant options also available in other key sectors. Preferred national options will be decided upon and implemented at Member State level.

Currently, only Ireland has officially declared its intentions with regard to these options. On October 19th 2003, the Irish Minister for Agriculture, Mr. Joe Walsh, announced that Ireland would select the so called full decoupling option - a complete break in the link between agricultural production and support payments the most extreme policy change allowed under the Luxembourg Agreement. In the process of arriving at this decision, the Minister commissioned a report from FAPRI-Ireland[2] which analysed some of the options available. The results summarised here, and in the related presentation, are based on this report.

Composition of Irish Agriculture

Irish agriculture is dominated by dairy and beef production, which each account for about one third of Irish agricultural production in value terms. Of the remaining one third, sheep, pigs and poultry make up a further 15 percent and the remainder is split between cereals, fruit, vegetables and other outputs. Many farms, particularly in the livestock sector, operate mixed systems, producing a variety of outputs. On average, farms are generally of medium size when compared with the average across the EU15. Production, in the beef, dairy and sheep sectors is highly export focussed.

Luxembourg Agreement

The MTR Luxembourg Agreement is motivated by a diverse range of issues including, inter alia, constraints on the EU agricultural budget, food quality, animal welfare and related consumer concerns and perhaps, most importantly, the prospect of trade reform under the World Trade Organisation Doha Round.

To make the analysis and the interpretation of the results of our analysis manageable, it was decided that only a selection of the over 500 possible scenarios that could emerge from the Luxembourg Agreement would be investigated. The options chosen have the advantage that the results derived should present an upper and lower bound within which the outcomes of other possible policy permutations would lie. Among the policy options selected for examination were:

- Full decoupling of all beef payments, ewe premiums and arable aid payments across all Member States in the EU15 (MAX Decoupling).

- Partial decoupling of the slaughter premium, suckler cow premium, ewe premiums and arable aid payments across all Member States in the EU15 (MIN Decoupling).

Results of the analysis are highly detailed, and consequently only the briefest of summaries can be provided here. Therefore, we focus only on the projected effect of full decoupling in this summary. For a much more detailed analysis see Binfield *et al*. 2003.

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[1] Email: tdonnellan@HQ.TEAGASC.IE

[2] The FAPRI-Ireland Partnership is a joint venture between the Food and Agriculture Policy Research Institute at the University of Missouri, Teagasc - The Irish Agriculture and Food Development Authority and the Irish Universities

WTO issues
Even though our report focuses on CAP reform it could not ignore the WTO Doha Round negotiations. While the talks process has stalled, it is likely to resume at some point. For this study we operated on the assumption that the EU's proposals on WTO reform are accepted. From an EU perspective some would argue that this is a *best case* WTO outcome for the EU.

Effect of MTR reform on the Dairy Sector
Under the dairy reform, producers will be free to exit milk production and retain the right to receive the new compensatory payments - subject to specific criteria. At the same time dairy support prices will be reduced. The effect is to reduce the EU and Irish average milk price by about 5 percent relative to the 2012 Baseline (Agenda 2000) position. This would put Irish milk prices at about 22 cent per litre in 2012, some 4 cent below the EU average. This will be offset to a degree by the 3.5 cent per litre compensation.

As farm milk prices fall under the reforms (due to reduced dairy intervention prices), for some EU producers this may mean that it is no longer economically rational to produce milk. Consequently, we are likely to see the exit from dairying (and a consequent scaling up of production) over the next few years taking place at a higher rate than would have been the case under Agenda 2000.

Effect of MTR reform on the Beef Sector:
Full decoupling, which would totally break the link between beef production and all direct payments, if adopted across the EU, is projected to lead to an 11 percent decline in EU suckler cow numbers. This result illustrates the importance of the suckler cow premium to EU suckler cow farming. EU finished cattle prices are projected to reach over 8 percent above the level that would have been achieved under Agenda 2000.

The effect of the reform is magnified for Ireland. The decline in the Irish suckler cow herd under full decoupling is projected to be almost 18 percent. This large decline reflects the greater dependence of Irish suckler cow farmers on the suckler cow premium. Less efficient producers are likely to exit the system as a consequence.

Under full decoupling, the Irish cattle price is projected to fall initially (as producers de-stock) as the volume of beef on the market rises. However, once the suckler herd has contracted, it is projected that Irish beef prices will to be almost 10 percent higher than would have been achieved with Agenda 2000.

Effect of MTR reform on the Sheep Sector:
Fully decoupling the value of ewe premiums would reduce ewe numbers across the EU by approximately 5 percent. This reduction in the EU ewe flock is small when compared with the projected fall in EU suckler cow numbers that would take place. The impact of the decoupling of ewe premia in the light lamb-milk system is projected to be less than in heavy lamb system due to a lower dependence on direct payments in the light-lamb milk system. Differences between the beef and sheep sectors in the operation of policy relating to extra-EU trade are also important. Under full decoupling, the EU sheep reference price is projected to increase by over 12 percent relative to the Baseline by 2012.

In this circumstance, the Irish ewe flock is projected to be almost 6 percent smaller by 2012 relative its projected size under Agenda 2000. It is worth noting that other circumstances unrelated to agriculture policy, such as the labour intensive nature of sheep production and competing off-farm job opportunities, are already set to lead to reduced sheep numbers in Ireland.

Effect of MTR reform on the Crops Sector:
The decoupling of direct payments (arable aid and set-aside payments) from production across the EU would have a generally negative effect on cereals area harvested and on production of cereals. The magnitude of the changes in supply that would occur in response to decoupling are small by comparison with the supply effects of decoupling direct payments in the livestock sector. The effect of decoupling in the cereals sectors is likely to be relatively small because direct payments under the crop and oilseeds programmes of the CAP were already partially decoupled under Agenda 2000.

The effect of full decoupling on cereals supplies is modest. EU wheat, barley and maize area harvested are projected to decline by less than 1 percent compared with Agenda 2000. This will leave EU prices relatively unchanged.

Full decoupling would have only a limited impact on the Irish cereal sector. Areas harvested in Ireland would decline for both wheat and barley by between approximately 4 percent relative to areas projected to be harvested under Agenda 2000. Cereal prices would be subject to little or no change. The decline in cereal area occurs due to the relatively unchanged price for cereals, the permanent set-a-side element of the Luxembourg Agreement and the decoupling of the arable aid payments.

Effect of MTR reform on the Pigs Sector

The impact of the MTR on the pig sector is not likely to be significant. Changes mainly derive from the cross price effects of the reforms in the cattle and sheep sector i.e. higher beef and lamb prices encourage some switch by consumers towards substitutes such as pigmeat which then boosts price and production. On the other hand, a small increase in extra EU imports is triggered by the tariff reduction in the EU proposal and this has some downward pressure on pigmeat prices. Overall, EU and Irish production levels are likely to be unchanged.

Effect of MTR reform on the Input Usage:

In Ireland, full decoupling is likely to lead to a decline of 8 percent in agricultural input expenditure by 2012. Levels of feed and fertiliser usage in particular will decline due to the expected lower level of livestock numbers and lower intensity of production facilitated by full decoupling.

Effect of MTR reform on the Aggregate Agricultural Income

The benefits from decoupling in terms of improvements in the agriculture sector's Operating Surplus (agricultural sector income) flow in large measure from reduced expenditure on inputs. Under full decoupling, there is likely to be little change in the overall agricultural output value (the total value of agricultural produce sold) compared with that projected under Agenda 2000. However, the decline in expenditure on inputs means that in 2012 operating surplus is up 10 percent relative to what would have been achieved under Agenda 2000. In other words, from a "money in the farmer's pocket" perspective, the reform would represent an "improvement" over a continuation of the existing Agenda 2000 policy.

Concluding Remarks:

Decoupling has important and serious implications for Ireland, especially for its two largest agricultural sectors – beef and dairy. Importantly, it could be misleading to draw inferences from the aggregate results in terms of specific farm level effects. Few Irish farms are specialised in the production of a single commodity. Most will have a mix of enterprises, be it differing types of livestock, livestock products or crops. In order to optimise their incomes, farmers change the enterprise mix in response to changing prices, policy payments and other factors. Also the continuing process of structural change in Irish farming means that output on farms and the number of farms is changing over time. For these reasons, specific farm level impacts are best derived from detailed farm level analysis. See Breen and Hennessy (2003), for more details.

Further Reading

Binfield, J., T. Donnellan, K. Hanrahan, and P. Westhoff (2003). "The Luxembourg CAP Reform Agreement: Implications for EU and Irish Agriculture" FAPRI-Ireland Publication, Teagasc, Economy Research Centre, Dublin, October.
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Council of the European Union (2003). CAP Reform – Presidency Compromise (in agreement with the Commission). Brussels, 30 June 2002