IIIS Discussion Paper

No.91/October 2005

EU Agricultural Policy: What Developing Countries Need to Know

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Abstract. This paper provides a consolidated, up-to-date overview of the changes to the CAP and the factors making for further reform from the particular perspective of decision-makers in developing countries. It discusses the principles and mechanisms by which EU farmers are supported under the CAP, and the way in which these mechanisms have been changing since the first major reform of the CAP was adopted in 1992. The main pressures for further reform of the CAP are identified, emphasising the political economy of further reform to provide some sense to developing country policy-makers of how these pressures for reform might play out in the future. Taking a horizontal approach, the impact of reform on developing countries of the three main policy instruments – domestic support, border protection and export subsidies – are then discussed, followed by a focus on a few commodities of particular interest to developing countries. The conclusion develops a checklist of factors which developing country policy-makers can use to help track the evolution of the debate on CAP reform and its impact on developing countries.

Keywords. Common Agricultural Policy, Agricultural trade, WTO, developing countries.

JEL classification. F13, Q17, Q18

Acknowlegements. This paper is an output of the Policy Coherence project based in the Institute for International Integration Studies and supported by a research grant from the Advisory Board for Development Cooperation Ireland. Further details can be found on the project website, available at www.tcd.ie/iiis/policycoherence. We acknowledge helpful assistance from Estelle Gozlan.

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Introduction

The European Union's Common Agricultural Policy (CAP) was introduced in the early 1960s.[3] It remains largely managed by the provisions of the 1957 Treaty of Rome.[4] With its combination of high and stable guaranteed prices, the CAP has been successful at boosting production, and also in easing the transformation of a largely rural society to an economy of manufacturing and services, limiting the human and economic cost of transition. However, the CAP has subsequently been the victim of its own success. The CAP arrangements resulted in large surpluses and budget crises in the 1980s. Because of the peculiar decision making process in the European Union, the required reforms were delayed until the early 1990s. Since then, the CAP has now changed dramatically after three successive reforms, the last one taking place in 2003 and being progressively implemented.

From a developing country point of view, the impact of the reformed CAP on agricultural markets has become more complex. Even though the "new CAP" still has some unwanted effects, they are less direct and more difficult to assess. The traditional image of a "fortress Europe" that is closed to developing countries' exports, while the EU dumps considerable quantities of agricultural products on these countries, hurting local producers, no longer fully corresponds to the new CAP arrangements. This is even though EU farmers are still heavily subsidised, and some high tariffs persist.

This paper provides a brief description of the main CAP mechanisms and their effects on developing countries, with a particular attention to recent and future reforms. The motivation is to provide an accessible overview of the way the CAP works and how it has evolved over time, so that developing country policy-makers are in a better position to understand how the further reforms which are taking place, and which will take place in the future, may impact on them.

Section 1 of the paper summarises the key dimensions of the EU agricultural economy in terms of production and trade, highlighting the significant differences which persist between the Member States which make up the European Union. Section 2 describes the principles and mechanisms by which EU farmers are supported under the CAP; it also explains the way in which these mechanisms have been changing, especially since the first major reform of the CAP was adopted in 1992.

How important is the support provided to European farmers? Section 3 looks at various measures of support which quantify its importance. Important distinctions in this section are between

[3] The legal name has changed over time; for convenience we use the term European Union throughout. The European Union was founded as the European Economic Community in 1958 by six states: Germany, France, Italy, Belgium, Netherlands and Luxembourg. The first enlargement took place in 1973 when the United Kingdon, Denmark and Ireland joined. Greece joined in 1981 followed by Spain and Portugal in 1986, then Sweden, Finland and Austria in 1995. The most recent, and largest, enlargement occurred in 2004 when ten countries joined. These are Poland, Hungary, Slovakia, the Czech Republic, Malta, Lithuania, Latvia, Estonia, Slovenia and Cyprus.

[4] The European Communities (which became the European Union after the Maastricht Treaty) results from five legislative treaties. These are the 1951 Treaty of Paris establishing the Coal and Steel Community, the 1957 Treaty of Rome establishing the Economic Community, the 1958 Treaty establishing the European Atomic Energy Community, the 1987 Single European Act and the 1993 Treaty of Maastricht. The 1997 Treaty of Amsterdam and the 2000 Treaty of Nice amended the Treaty of Rome. The 1957 Treaty of Rome contains most of the founding texts setting up the CAP. The EU is in the process of replacing these treaties by a single constitution. However, the rejection of the proposed text for the EU constitution in 2005 by French and Dutch referendums raises doubts regarding the completion of the process.

budget-financed and consumer-financed support, and between trade-distorting and decoupled forms of support. Section 4 looks at the extent of external protection provided by the CAP. EU tariffs on agricultural imports are unquestionably high, but their impact is mitigated for many developing country exporters by preferential access arrangements of one kind or another. Section 5 looks at the contentious issue of export subsidies; it argues that their scale, and thus the significance of their trade-distorting impact, is now much less than in the past.

Section 6 identifies the main pressures for further reform of the CAP. It also discusses the political economy of further reform to provide some sense to developing country policy-makers of how these pressures for reform might play out in the future. Our conclusion is that the balance of forces makes further reform highly likely, even if it is somewhat delayed. This leads to the obvious question of how further reform will affect developing countries.

This issue is discussed in Section 7. Taking a horizontal approach, the impact of reform of the three main policy instruments – domestic support, border protection and export subsidies – is first discussed. This is then followed by a focus on a few commodities of particular interest to developing countries. Finally, Section 8 develops a checklist of factors which developing country policy-makers can use to help track the evolution of the debate on CAP reform and its impact on developing countries.

1. European agriculture

The protection of European agriculture did not start with the Common Agricultural Policy. Three waves of protection can be distinguished. Competition in grains, dairy products and meat from the newly settled areas of North America and Oceania, together with the revolution in transportation and refrigeration during the last quarter of the nineteenth century, led a number of European countries to introduce protection of domestic agriculture and especially the grain sector. A second wave of protection took place in the depressed interwar period, when agricultural intervention and self-sufficiency policies were adopted or intensified by both importers and exporters.A third wave arose as a result of post war reconstruction and the concomitant balance of payments difficulties experienced by Western European governments, together with the memories of wartime and immediate post-war food shortages. Thus when a number of European countries came together to form the European Economic Community in 1958, how to weld the various national agricultural policies into a Common Agricultural Policy (CAP) was one of the main hurdles to overcome.

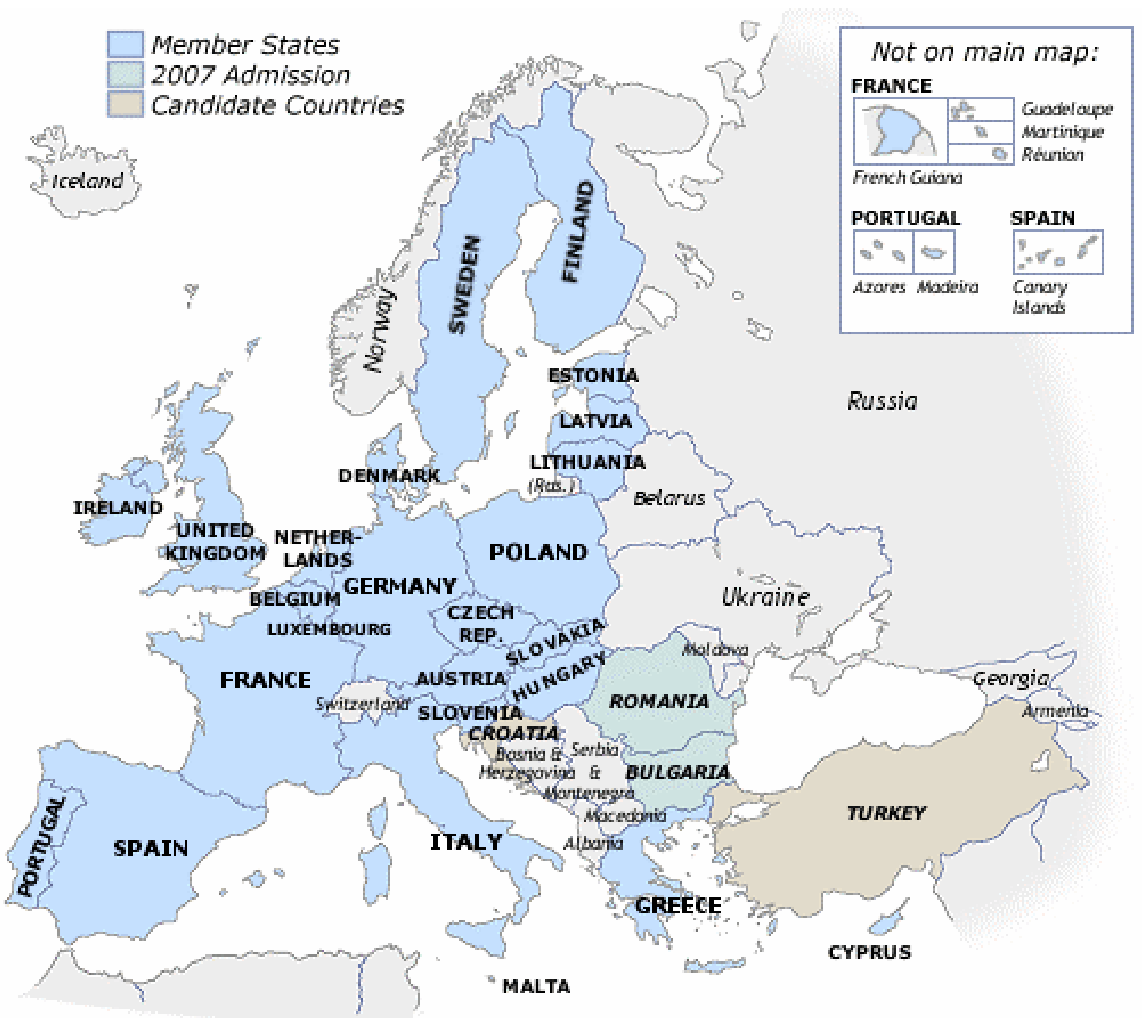
The CAP was introduced in the early 1960s at a time where farming accounted for a large share of Europe's GDP and population. In the late 1950s, primary agriculture accounted for one-third of employment and 20% of GDP in the six founding members of the European Union. By the early 2000s, these proportions had fallen to 5% and 2% respectively, though the importance of the EU’s strong agri-food industry must also be taken into account.

The early CAP introduced a system of guaranteed prices through public intervention, and some funding for structural actions, such as improving farm size and infrastructure. By bringing stable prices and a predictable planning horizon, the CAP helped the modernisation of agriculture and the diffusion of technological change. At the same time, a considerable restructuring of the sector took place, with a rapid outflow of labour to jobs in the growing manufacturing and services sectors in the 1960s and 1970s, which resulted in larger average farm size.

1.1. Structure and performance

The structure of farming is still very differentiated across regions after 45 years of a common agricultural policy. Production and performance varies across the 25 member states. In some countries, such as the United Kingdom, agriculture takes places on large farms, and only a very small share of the population is employed in the farm sector (roughly 1%). In other countries, in particular in some of the new member states but also Greece and Portugal, farmers still account for 10 to 16% of the population. There are more than two million agricultural holdings in Poland, for example. In Poland, Hungary or Slovenia, the average farm size is less than 7 hectares. The productivity of agriculture also varies greatly across countries. Yields for cereals are very high in some regions in the United Kingdom, France or Italy, while agriculture in mountainous regions is much less productive, on a per hectare basis. Productivity is also low in countries characterised by small holdings and a farm workforce which is poorly educated. That is, the CAP has done little to offset natural differences across countries. By providing support as a function of the quantities produced, it may have even reinforced them.

Figure 1. Map of the EU25 and candidate countries



Within each country, agriculture is also much differentiated, with large scale commercial producers often coexisting with a large number of small farms. Small farms are often operated by older farmers. A recent Eurostat study reveals that, in Italy, 62 percent of farmers are over 55 years old. The percentage is 56 and 53 per cent for Greece and Spain respectively (even though in Finland, Germany and Austria only 27 per cent of farmers are over 55).[5] This suggests that a large number of small farms are likely to be absorbed by larger entities in the near future.

Table 1. Characteristics of agriculture in the 25 EU members

	Utilised agricultural area (1000 ha)	Share of agriculture in GDP	Share of agriculture in employment*	Number of farms (1000 holdings)	Average farm size	Yields (common wheat, 100 kg/ha)
Belgium	1392	1.0	1.7	55	25.4	85
Czech Republic	3 674	1.1	4.5	54	66.9	41
Denmark	2 641	1.6	3.3	49	54.7	71
Germany	17 008	0.7	2.4	412	41.2	65
Estonia	796	2.2	6.3	37	21.6	22
Greece	3 897	5.4	16.3	na	na	26
Spain	25 270	3.6	5.6	na	na	31
France	29 430	2.0	4.3	614	45.3	64
Ireland	4 370	1.9	6.4	135	32.3	83
Italy	15 097	2.2	4.7	na	na	44
Cyprus	136	3.7	5.2	45	3.5	Na
Latvia	1 582	2.1	14.6	141	10.2	28
Lithuania	2 531	2.6	18.7	279	9.1	36
Luxembourg	128	0.5	2.4	3	52.3	61
Hungary	5 865	2.7	5.4	773	5.6	37
Malta	11	1.6	2.5	11	1.0	Na
Netherlands	1 924	2.0	2.7	86	23.5	88
Austria	3 374	1.2	5.5	na	na	44
Poland	16 136	2.3	18.2	2 178	7.0	34
Portugal	3 745	2.5	12.8	na	na	12
Slovenia	509	1.6	8.4	77	6.3	Na
Slovakia	2 236	1.2	6.0	72	29.8	30
Finland	2 246	1.0	5.3	75	29.9	35
Sweden	3 129	0.6	2.5	68	46.1	56
United Kingdom	16 352	0.7	1.2	281	57.4	77
EU-25	163 479	1.6	5.2	na	na	54

* including forestry and fishing. Source: Eurostat and European Commission.

Concentration of farmland will occur in the most productive regions. However, there are also areas where farmland is returning to wilderness in Europe, because of the lack of profitability of agriculture. In other areas, there is a significant development of part time farming, which helps to maintain relatively small farm structures. Part-time work is particularly widespread in Southern Europe. In Greece, Portugal, Italy and Spain, half of all farmers and more than half of all agricultural labourers work part-time. The reason is mainly that full-time work is impossible on the existing structures. In other countries, such as Ireland and Germany, where part time farming

[5] Eurostat is the Statistical Office of the European Union, based in Luxembourg. It compiles statistics for the EU 25, using data provided by national statistical agencies.

is also widespread (almost one farmer in three engaged in a non-agricultural gainful activity), employment possibilities in rural areas are a driving force.

1.2. Trade

One of the motivations of the CAP was to develop domestic production, at a time when the memory of food scarcity in the immediate post-war years was still recent. As the scientific revolution in farming took hold, EU production has surged, facilitated by the high and stable prices guaranteed by the CAP. The net deficit situation in the 1950s was transformed into a net surplus food situation in most sectors by the 1970s.

Technically, however, the EU 25 remains a net importer of food products. According to the latest statistics available, the EU25 imported some 58.1 billions euros of agricultural food and tobacco products, and exported 49.5 billion euros of the same products.[6] Imports include very large quantities of fruits, fish, oilseeds and feedstuffs. Tropical products account for a large share of the imports. EU exports include a lot of processed products such as wine and alcoholic beverages, but also some dairy products and beef, some of them subsidised (Table 2).

Table 2. External trade of the EU-25 (million euros)

		Import	*Export*
1	Live Animals	540	967
2	Meat And Edible Meat Offal	2 849	3 892
3	Fish And Crustaceans	9 940	1 829
4	Dairy; Eggs; Honey; Edible Products Of Animal Origin	1 038	5 203
5	Products Of Animal Origin	865	413
6	Live Trees And Other Plants; Bulbs	1 206	1 365
7	Edible Vegetables And Certain Roots And Tubers	2 723	1 449
8	Edible Fruit And Nuts; Peel Of Citrus Fruits Or Melons	10 011	1 478
9	Coffee	3 638	828
10	Cereals	2 380	1 612
11	Products Of The Milling Industry; Malt; Starches; Gluten	65	1 884
12	Oil Seeds And Oleaginous Fruits; Miscellaneous Grains	5 423	944
13	Lac; Gums	458	525
14	Vegetable Plaiting Materials; Vegetable Products	98	12
15	Animal Or Vegetable Fats And Oils	3 454	2 482
16	Preparations Of Meat	2 966	914
17	Sugars And Sugar Confectionery	1 646	1 817
18	Cocoa And Cocoa Preparations	2 934	1 908
19	Preparations Of Cereals	718	3 451
20	Preparations Of Vegetables	3 270	2 388
21	Miscellaneous Edible Preparations	1 372	4 010
22	Beverages	3 933	13 263
23	Residues Prepared Animal Fodder	6 480	1 520
24	Tobacco And Manufactured Tobacco Substitutes	1 939	2 447
52	Cotton	3 413	3 993

Source Eurostat, million euros, figures for 2004, HS classification.

[6] Imports CIF, exports FOB, data for the last twelve months starting may 2004, SITC classification, source Eurostat.

2. How Europe protects its farmers – the principles

2.1. The "old" CAP

For a long time, the CAP has been the only genuinely common policy in the European Union, i.e. the only one managed at the EU level.[7] It still represents half of the community budget (the main reason being that other policies are managed at the national level).

Initiated in the early 1960s, the CAP is a domestically oriented farm policy based on three major principles: i/ a unified market in which there is a free flow of agricultural commodities within the EU; ii/ product preference in the internal market over foreign imports through common customs tariffs; and iii/ financial solidarity through common financing of agricultural programmes through the EU budget.

The listed objectives of the CAP are to increase agricultural productivity; ensure a fair standard of living for farmers; stabilise markets; guarantee regular food supplies; and ensure reasonable prices to consumers. However, not all these objectives have been reached (and some are actually quite contradictory). The "fair" standard of living for farmers has been achieved in a limited number of countries, such as the United Kingdom. In others (Germany, Portugal), farm incomes are much lower than those of the average population. Low farm incomes have been the driving force behind the considerable restructuring of the sector in countries such as France, Italy or Spain, where the farm population has decreased at a very high rate for the last 30 years, and where average farm size has increased dramatically.

The CAP has relied since 1962 on a variety of instruments to reach the objectives of the Rome Treaty. The first component of the CAP, and by far the largest in terms of financial outlay, is the market intervention mechanism, funded by the "Guarantee" instrument of the European Agricultural Guarantee and Guidance Fund or FEOGA, the EU Agricultural Budget.[8] It funds a combination of market interventions, public storage, border protection and export subsidies so as to guarantee a minimum price to producers, known as Common Market Organisations (hereafter CMOs). The CMOs cover all sectors with the exception of potatoes and spirits.[9] In order to maintain a minimum price for producers, a system of variable levies ensured that imports would not enter the Community at lower prices, and a system of disposal of surplus domestic production with the aid of export subsidies ("refunds" in the EU language) was put in place. This system made it possible to stabilise farmers' incomes, and had the advantages of providing a stable price and a predictable planning horizon to producers.

The second component of the CAP was a socio-structural and rural development policy (funded by the "Guidance" instrument of FEOGA). This policy initially focused on the improvement of farm and processing structures. It has always represented a relatively small share of the budget of the CAP.

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[7] The other truly common policy is the common external policy governing trade relations with third countries. However, unlike the CAP, the common external policy does not make demands on the budget.

[8] The creation of the European Agricultural Guidance and Guarantee Fund (EAGGF, more often called by the French acronym FEOGA that we will use hereafter) in 1962 provided the financial instrument for the management of the CAP.

[9] While some CMOs have involved very large market intervention and budget costs (grains, beef, dairy, and oilseeds in the 1980s) and have largely substituted public intervention for market mechanisms, some others like horticulture or pork have had a limited impact on markets, and have used rather parsimoniously public instruments designed to smooth the functioning of markets.

In addition to EU expenditure on agricultural policy, spending by the Member States remains important, particularly in areas of structural policy and general services to farmers (research, extension, education and market information). However, under the provisions of the Rome Treaty, member states cannot subsidise farmers for activities that could result in a distortion of competition. That is, the CAP is highly centralised at the EU level. This is not the case for side policies, such as environmental policies, in which member countries have larger latitude when designing their own policies.

Minimum (or intervention) prices under the Guarantee instrument of FEOGA were set at relatively high levels and subsequently increased as a result of political compromises in the 1970s and 1980s. With the combined effect of high and stable prices and rapid technological change bringing real production costs down, agricultural production grew faster than consumption. The EU agricultural sector began to generate surplus production in the 1970s, and the problem became worse in the 1980s. Disposal of surpluses on the domestic market (milk powder included in animal feedstuffs) or on third markets (export subsidies) required substantial budget expenditure. The CAP also had unwanted consequences for producers in third countries, who had to face competition from EU subsidised exports, raising problems at the international level. The "subsidies" war with the United States during the 1980s drove down the world price of cereals and dairy products to a very low level, requiring additional export subsidies to cover the increased gap with the intervention price.

After years of ineffective measures, a significant reform first took place in 1992. It curbed the mechanism of market intervention, which provided incentives for farmers to produce regardless of market conditions. Guaranteed prices have since been lowered under successive reforms.

Box 1. EU Decision Making

In the present European Union, the Council of Agricultural Ministers (the Agricultural Council) has the main responsibility for CAP-related decisions, but the Commission plays an important role by preparing proposals and ensuring application of the Council's decisions.

The Council is the meeting of the 25 government representatives. When it consists of the heads of state and government, it is called the European Council which meets four times a year. This Council sets the main orientations of the EU. For sectoral policies, Member States are represented by the relevant government minister, e.g. the ministers of agriculture for CAP related aspects. The Council of Ministers is the real executive power, and is the ultimate decision-making institution, especially in agriculture where the role of the Parliament is limited. The presidency of the Council rotates on a six-month basis, but since 1998 there is a relative sharing of responsibility within a "troïka" (the President, the immediate predecessor and the designated successor). In foreign matters, the country holding the presidency speaks on behalf of the EU. In addition, the role of the President is particularly important because the minister of the country in charge draws up the agenda of the council meetings. This makes it possible to progress or delay reforms depending on the interest of the member state in a particular topic.

The Commission constitutes the EU executive arm. It is responsible for the management of EU policies including the CAP. It represents the EU in negotiations with third countries. The Commission watches the implementation of the treaties and is the initiator of policies. The Commission includes 20 commissioners, appointed by Member States. The president of the Commission allocates a particular area of responsibility to each commissioner, but all proposals and measures must be adopted by the Commission as a body. A new Commission is appointed every five years, and the current Commision's term of office runs until October 2009. The current Commissioner for Agriculture and Rural Development is a former Danish Minister for Agriculture, Mariann Fischer Boel. Each Commissioner works with a Directorate General (e.g. Commissioner Fischer-Boel with the Directorate General for Agriculture and Rural Development). In agriculture and trade (as well as in competition policy) the Commission has special powers. In the area of trade, the Commission has the power to negotiate treaties on behalf of the member states. This gives the Trade Commissioner (currently Peter Mandelson) the capacity to speak on behalf of the whole EU, even though the outcome of the negotiation is scrutinised by member states (the Council and Parliament must ultimately approve trade agreements).

The European Parliament has had an increasing role in policy making since the Maastricht Treaty. It nominates the Commission, contributes to the making of EU regulations and directives (with the Council), votes the budget, and investigates petitions from EU citizens. It can therefore amend legislative proposals from the Commission, including the budget. However, in the area of the CAP, the power of the parliament is particularly limited. The Council of Ministers needs to consult the Parliament but can proceed without approval of its decisions by the Parliament. The only agricultural area where the Parliament has important power is the one related to the impact on human health, where the Treaty of Amsterdam gives the Parliament the power of co-decision on matters related to public health. The Parliament can force the whole Commission to resign, but has limited pressure on a particular Commissioner.

The Court of Justice regulates conflicts between EU institutions, and between EU institutions and a member country. It can be approached by individuals and firms about the application of a EU text by a member states, and by national courts for interpretation of European texts. The European Court of Auditors reviews accounts and reports to the Council and the Parliament. It has reviewed several CAP arrangements, and has often been very critical (review of the sugar policy in 1991, review of the environmental aspects of the CAP in 2000, for example).

2.2. CAP Reforms

Major reform packages have significantly modified the CAP over the last decade. The first reform, adopted in 1992 and implemented in 1993/94, began the process of shifting farm support from prices to direct payments. The 1992 reform reduced support prices and created direct payments based on historical yields, and introduced supply control measures. This reform affected the grain, oilseed, protein crop (field peas and beans), tobacco, beef, and sheepmeat markets. The core element was a nominal cut of 30% in cereal prices, together with (smaller) cuts in intervention prices for beef and butter. The impact on farmer's income of these reductions in support prices was compensated by a generous per hectare payment in the case of cereals, and by premium payments for beef cows and cattle. The 1992 reform introduced a set-aside scheme which allowed the Commission to curtail the area devoted to arable crops.[10] The reform was accompanied by an early retirement scheme, an agri-environment scheme and a scheme for afforestation, designed to reduce production capacity, to improve the structure of farming, and to address some growing environmental concerns about the effect of agricultural practices.

Further changes took place in 1995 to accommodate the CAP to the newly-agreed disciplines of the WTO Uruguay Round Agreement on Agriculture. Variable levies converted to fixed tariffs (though with exceptions for fruits and vegetables, and special provisions for cereals, under which the tariffs must automatically go down if the intervention price is lowered). Minimum access

[10] "Set-aside" is a measure under which farmers must keep a certain percentage of arable land out of production in order to get payments. This policy was heavily used during the period 1993-2004, since a mandatory set aside of 10 to 15% of land devoted to arable crops (depending on the year) was required to get the arable crops payments. The objective was to reduce production, and therefore the surplus that had to be exported with subsidies. Since 2005, set aside is on a voluntary basis. A farmer can get paid for leaving land in fallow, in particular for conservation (environmental) objectives.

requirements were introduced, which were met by tariff rate quotas.[11] Disciplines also introduced on the overall amount of trade-distorting domestic support which could be provided, and on the quantity of subsidized exports and the value of export subsidy expenditure.

The Agenda 2000 programme, introduced in 1999, was the second major reform implemented in preparation for EU enlargement to include the ten countries of central and eastern Europe. In a similar way to the first CAP reform, the Agenda 2000 arrangements used direct payments to compensate farmers for the loss from new support price cuts (15% for cereals and 20% in beef production). This time, however, compensation was only partial. Agenda 2000 reforms focused on the grain, oilseed, dairy, and beef markets. Agenda 2000 also introduced a major change in the overall philosophy of the CAP, by promoting the idea of a "second pillar". That is, instead of supporting agricultural production (the "first pillar"), public policy would support more the provision of environmental and social services, or the promotion of quality products. While this "second pillar" remained limited in terms of budgetary outlays, it constituted a major change in the overall orientation of the CAP, paving the way for future reforms. Following Agenda 2000, the various environmental and rural development measures were brought together into a single Rural Development Regulation.

The midterm review of Agenda 2000 in June 2003 resulted in a third major set of reforms. The 2003 reforms allow for decoupled payments—payments that do not affect production decisions—that vary by commodity. Called single farm payments (SFP), these decoupled payments are based on the 2000-02 historical payments received by farmers and replace the compensation payments introduced by the 1992 reform. In order to receive the SFP, compliance with EU regulations regarding environment, animal welfare, and food quality and safety is required. Cuts in intervention prices were made for rice, butter, and skim milk powder, to begin in 2005. Intervention support for storage was limited for rice and butter and eliminated for rye in 2004. In addition, the CAP budget ceiling has been fixed from 2006-13, and—if market support and direct payments combine to come within 300 million euros of the budget ceiling—SFPs will be reduced to stay within budget limits.

Box 2. The June 2003 Reform: Decoupled support

On 26 June 2003, EU farm ministers adopted a fundamental reform of the CAP. After an initial period of adjustment, the vast majority of subsidies will be paid independently from the volume of production. To avoid abandonment of production, Member States may choose to maintain a limited link between subsidy and production under well-defined conditions. These new "Single Farm Payments" are linked to respect of environmental, food safety and animal welfare standards. More money will be made available to farmers for environmental, quality or animal welfare programmes by reducing direct payments for bigger farms. The Council further decided to revise the milk, rice, cereals, durum wheat, dried fodder and nut sectors. In order to respect the tight budgetary ceiling for the EU-25 until 2013, ministers agreed to introduce a financial discipline mechanism. The different elements of the reform entered into force in 2004 and 2005. The single farm payment entered into force in 2005. If a Member State needs a transitional period due to its specific agricultural conditions, it may apply the single farm payment from 2007 at the latest.

The key elements of the reform are :

[11] A tariff rate quota allows either all exporters or designated exporters to export a specified quantity of production into the EU at a lower tariff, the in-quota tariff, than the ordinary Most Favoured Nation (MFN) tariff which would normally apply, the out-of-quota tariff. Becdfause the volume of exports at the preferential in-quota tariff rate is limited, specific administrative arrangements to allocate export rights among exporting countries are required as part of tariff rate quota.

● A single farm payment for EU farmers, independent from production; limited coupled elements may be maintained to avoid abandonment of production. This payment is linked to respect of environmental, food safety, animal and plant health and animal welfare standards, as well as the requirement to keep all farmland in good agricultural and environmental condition (these conditions are referred to as "cross-compliance").

● A strengthened rural development policy, new measures to promote the environment, quality and animal welfare and to help farmers to meet EU production standards starting in 2005.

● A reduction in direct payments ("modulation") for bigger farms to finance the new rural development policy.

● A mechanism for financial discipline to ensure that the farm budget fixed until 2013 is not overshot.

● Revisions to the market policy of the CAP. The intervention price for butter will be reduced by 25% over four years, which is an additional price cut of 10% compared to Agenda 2000. For skimmed milk powder a 15% reduction over three years, as agreed in Agenda 2000, is retained. The monthly increments in the cereals sector are reduced by half, and the current intervention price will be maintained. Reforms are implemented in the rice, durum wheat, nuts, starch potatoes and dried fodder sectors.

Finally, a reform of hops and Mediterranean products—cotton, tobacco, and olive oil—was completed in April 2004. These reforms follow the logic of the 2003 reforms, with decoupled payments based on historical payments and compliance with EU regulations. A reform of the sugar regime has been proposed by the Commission (this sector had not been touched by earlier CAP reforms) which it hopes will be approved by November 2005.

2.3. A more decoupled support

Altogether, the CAP has changed dramatically over the last 12 years. Intervention prices have been cut by more than 45% in the cereal sector, for example. A large share of the support to farmers, which was paid by consumers through high institutional prices, is now paid by taxpayers as direct payments to farmers with no direct link with the quantities the produce. A significant change in the CAP is the transfer of money between CAP objectives. The announced reorientation of the CAP towards the "second pillar" is now more concrete. After full implementation of the July 2003 reform, 5% of the value of the SFP for large farmers will be "modulated" and transferred to rural development measures.

The decoupling of the payments from production modifies considerably the orientation of the CAP. Instead of receiving money for the quantities produced, farmers now receive a single payment, a fixed amount based on what they received in the agreed reference period in the past, so that production decisions should no longer be driven by the attempt to maximise subsidies: the only way farmers can increase their income is now from the marketplace. Farmers receive the same payment regardless of their production (they can also continue to set aside land; however, eligibility for the SFP will continue to require demonstration of "good agricultural practice" and farmland cannot be abandoned). A single farm payment should also reduce incentives for farmers to intensify production, although the actual effects of the reform on yields and animal stocking per hectare remain to be seen. The SFP should also reduce the administrative burden on farmers, make it easier to extend CAP payments to farmers in the accession countries, and reduce the leakage between the amount paid by taxpayers and consumers and the amount received by producers.

Finally, the SFP was designed with the criteria of "green box" supports in the World Trade Organisation (WTO) in mind.[12] The EU hopes that the reform will make it easier to defend the CAP payments in the WTO in the future.

However, the degree of decoupling varies across countries. In that sense, the June 2003 reform has introduced a certain degree of re-nationalization of the CAP. Member states were allowed to retain a proportion of the previous production-linked payments based on a series of menu choices, and to continue to pay some fraction of these former payments.[13] While some countries opted for full decoupling, some others, such as France, fearing the abandonment of production in large areas, choose to keep as many payments linked to the number of head of cattle and sheep as it was legally permitted.

3. The degree of farm support in the EU

3.1. Budget based measures

There are multiple ways to measure agricultural support. One way is to count the budget that is provided to farmers, or to agricultural policy in general. Using such an indicator, total EU expenditures for the agricultural sector for the budget year 2003 reached 37.8 billion euros (for EU15). Some 4.7 billion euros extra went to rural development (source FEOGA). The CAP budget includes some 20 billions of direct payments to farmers. Other expenses include storage, export subsidies, etc. In addition, additional expenditures are made by the Member States either as co-financing of CAP measures or as national aids within the framework of EU competition policy on state aids.

From this budget, not all money went to farmers. Indeed, some of the money spent, say, on export subsidies leaks to foreign consumers. Some of the structural measures benefit also the processing sector. Some of the direct payments are capitalised in the price of fixed assets and benefit landowners. For these reasons budget outlays could overestimate the transfers to farmers. On the other hand, budget expenditures do not provide a complete picture of all the support to farmers, since they measure only support paid by taxpayers, not the support paid by consumers through supported prices. In order to solve this problem, two measures have been developed, one by the WTO and the other one by the Organisation for Economic Co-operation and Development.

3.2. The Aggregate Measure of Support

One of the drawbacks of the budget outlays figure is that this measure does not take into account an indirect way to support farmers, through higher prices paid by consumers: the market price support component. This is why the official measure of trade-distorting support that was agreed upon by countries that have signed the Uruguay Round Agreement on Agriculture (i.e. the 148 members of the World Trade Organisation) includes a measure of market price support.

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[12] "Green box" support, in WTO terminology, includes farm support that has no or minimal effect on production, such as environmental subsidies or decoupled payments.

[13] Member states could, for example, pay 25% of the arable aid payment or 40% of the durum wheat payment; pay 50% of the exe premium; pay 100% of the suckler beef cow premium and 40% of the slaughter premium or 100% of the slaughter premium or 75% of the special male premium.

Under the WTO, the Aggregate Measure of Support (AMS) attempts to measure all forms of support that distort markets. That is, the AMS takes into account direct payments that provide some incentive to increase production, i.e. payments that have some link to the quantities produced or the use of inputs (payment per hectare, etc.) as well as market price support. Market price support is measured as the difference between "administered" prices such as minimum prices paid to producers and the world price, the latter being kept constant at a reference level, so that the AMS is not affected by exogenous fluctuations.

Countries are somewhat tardy in making returns to the WTO, and the latest AMS figure available for the EU is for the marketing year 2001/2002, i.e. for EU15. The combination of trade-distorting support (direct support and market price support) as measured by the AMS amounted to 39.3 billion euros.

If the introduction of market price support gives a more reliable picture than the focus on budgetary outlays only, there are also limitations to the AMS. The measure does not include support that has ambiguous effects on production, such as the payments subject to quantitative limitations (e.g. arable crop payments subject to the requirement of setting aside land). These payments are excluded from the AMS as part of the "blue box". It is true that the effect of these payments on third countries is unclear, since the production incentive of the payment is limited by some supply control conditions. However, these "blue box" payments represent a significant amount of assistance in the EU, at least before the implementation of the June 2003 reform: for the marketing year 2002/2003, they amounted to 23.7 billion euros.

3.3. The Producer Support Estimate

The Organisation for Economic Co-operation and Development (OECD) monitors agricultural policies in its 30 member countries every year. The OECD has put together a measure of the transfers to producers: the Producer Support Estimate or PSE. This is a broader concept than the AMS, because it not only includes market price support, but also payments that have no link with production, such as environmental and social payments, as long as they benefit producers. Unlike the AMS, the market price support is measured as the gap between producer price and the actual world price in each particular year, using nominal exchange rates. That is, the PSE can vary even though domestic policies remain unchanged, simply because world prices or exchange rates have fluctuated. On the other hand, this gives a picture of support more in line with actual market situations.

The OECD measure is comprehensive and (unlike the AMS) up to date. However, the measure is not flawless. Because some commodities are not covered by the precise calculations of support, the average PSE of those commodities whose support is precisely calculated is applied to these other products. In the case of the EU, the products not covered tend to benefit from less support, so the PSE measure could be biased upwards. Second, in some cases, the world reference price used to calculate market price support is questionable: this is the case in the dairy sector (in the absence of a world market for raw milk, the producer price in New Zealand is used as a reference). Again, this could introduce a bias, because this reference is not particularly meaningful. These limitations aside, overall, the PSE gives a picture of transfers to EU farmers that is reasonably accurate.

The PSE provides a detailed description of the various components of support in the EU (Table 3). If one adds up market price support and direct payments, EU farmers receive some 100 billion euros of transfers, even though only a proportion of this is actually support to production. With a value exceeding 39 billion euros, the market price support mechanisms still result in large transfers to producers. However, direct payments are now the major form of support in the EU. Although this is not yet reflected in Table 3 which refers to a situation prior to the full implementation of the June 2003 reforms, these payments are now largely decoupled from production.

One use for the PSE indicator is to compare trends in support across countries and over time. For this purpose, the PSE can be expressed in percentage form as a proportion of total farm revenue (including support). For OECD countries as a whole, the percentage PSE has fallen from 37% to 30% between 1986-88 and 2004 (Table 4). Support provided to EU farmers has always been a little higher than in other OECD countries, but has followed the same downward trend, falling from 41% in 1986-88 to 33% in 2004. The EU provides more support to its farmers than does the US (PSE of 18% in 2004) or Australia (4% in 2004) but less than Japan (56%) and some of the European countries outside the EU (Iceland, Norway and Switzerland).

Table 3. Producer Support Estimates, 2004

All products	EU15 (million euros)
Total value of production	250 933
Producer support estimates	100 264
Market price support (measured on a subset of products)	39 045
Market price support (extrapolation to all commodities)	53 932
Payments based on output	3 540
Payments based on area planted/animal numbers	29 332
Payments based on historical entitlements	608
Payments based on input use	8 102
Payments based on input constraints	5 230

Source: OECD

Table 4. Relative PSE percentage levels for selected OECD countries

Country	**1986-88**	**2004**
Australia	8	4
EU-25	41	33
Japan	61	56
United States	22	18
OECD average	37	30

Source: OECD

4. Border protection

EU border protection has long been held responsible for preventing developing countries from exporting agricultural products to the EU. Border protection, domestic support and export subsidies are not independent policies; border protection is required to underpin the market price support discussed in the previous section. Agricultural tariffs must be high enough to prevent imports from flooding the market, or being sold for intervention. The elimination of such tariffs would require giving up, or at least lowering considerably, intervention prices.

As a result of the willingness to enforce community preference, agricultural tariffs are particularly high in the EU. Bound tariffs in this sector average 18%, but there are high peaks in some particular sectors such as beef, dairy and sugar, far above 50% when expressed in ad valorem equivalent (many of the EU tariffs are specific tariffs expressed per tonne or head, litre, etc.).

However, the idea that the CAP is a prohibitive barrier to the agricultural exports of all developing countries needs to be qualified. First, the CAP provides protection and support to some products, those that benefit from a protective common market organization, but many products of interest to developing countries (those that do not compete with EU production) can be imported duty free: tropical fruits, coffee, cocoa, soybean, etc.

Second, many countries can export agricultural products to the EU at a much lower tariff than the bound tariff, either under special agreements or under tariff rate quotas. All developing countries can export to the EU with reduced tariffs under the Generalised System of Preferences (GSP). The coverage of agricultural products of the GSP is limited, and for some products, the preferential margin is small. Larger preferences are nevertheless provided to developing countries that fight drug trafficking, or that implement measures to protect the environment. African, Caribbean and Pacific countries can also export under another non-reciprocal agreement, the Cotonou regime, with a larger product coverage and a zero or minimal tariff for many products (Table 5). Least Developed Countries can export all agricultural products duty free and quota free under a particular component of the GSP, the "Everything But Arms" initiative (with the exception of sugar, rice and bananas for a transition period). Some developing countries have also signed bilateral agreements with the EU that also provide preferential access (Mediterranean countries, South Africa, Chile). As a result of these preferential regimes, the principle of "Community preference" of the CAP does not apply to all countries.

Third, even for those products facing high bound tariffs and which are excluded from the GSP (for example of sugar and beef, where tariffs exceed 50%), imports with a lower tariff take place under tariff rate quotas. However, such quotas are only open for a restricted number of countries.

As a result, EU agricultural protection does not have the same effects on every developing country. The protectionist nature of the EU hits hard particularly South American and Asian exporters. African countries face a lower tariff because they can export to the EU under more generous preferential agreements than, say, Brazil or Thailand. Table 4 shows that the imports from sub Saharan Africa and the Caribbean face few tariffs, given the share of exports that are subject to low or zero tariffs (coffee, cocoa, etc.) and the preferential regimes such as the Cotonou agreement or the GSP.

Most Asian and South American developing countries also face particularly high tariffs for processed food products, which encourages the export of raw materials rather than processed ones. This issue of tariff escalation is much less severe for sub Saharan African exports to EU markets, again because of the existing preferences under the Cotonou or Everything But Arms schemes.

These features of the EU tariff structure explain why not all developing countries will gain in the same way from a multilateral opening of the EU agricultural market, which is already quite open for some of them.

Table 5. EU imports of agro-food products under various regimes, year 2002

Regime	Country eligible	Value of imports, Millions €	Share in total imports
Preferential imports from developing countries		13 316	20.01%
Non reciprocal preferences		0	
Cotonou	Africa, Caribbean, Pacific	5 500	8.26%
GSP (excluding Eastern Europe)	Almost all developing countries	4 257	6.40%
GSP "plus" (drugs)	Countries fighting drug trafficking	1 714	2.58%
Everything But Arms	Least developed (except Myanmar)	294	0.44%
Others	Overseas territories.	399	0.60%
Reciprocal preferences			
Bilateral agreements with developing countries	Maghreb, Mashrek, etc.	1 153	1.73%
Imports under a zero MFN duty from developing countries	All developing countries	15 567	23.39%
Imports under a non zero MFN duty from developing countries		11 724	17.61%
Total imports from developing countries		40 737	61.20%
Total EU imports		66 559	100.0%

Source: Data from Gallezot, based on Taxud and TARIC-Eurostat. Figures for 2002, Chapters 1 to 24 of the Harmonized System. GSP indicates the Generalised system of preferences. MFN stands for Most Favoured Nation.

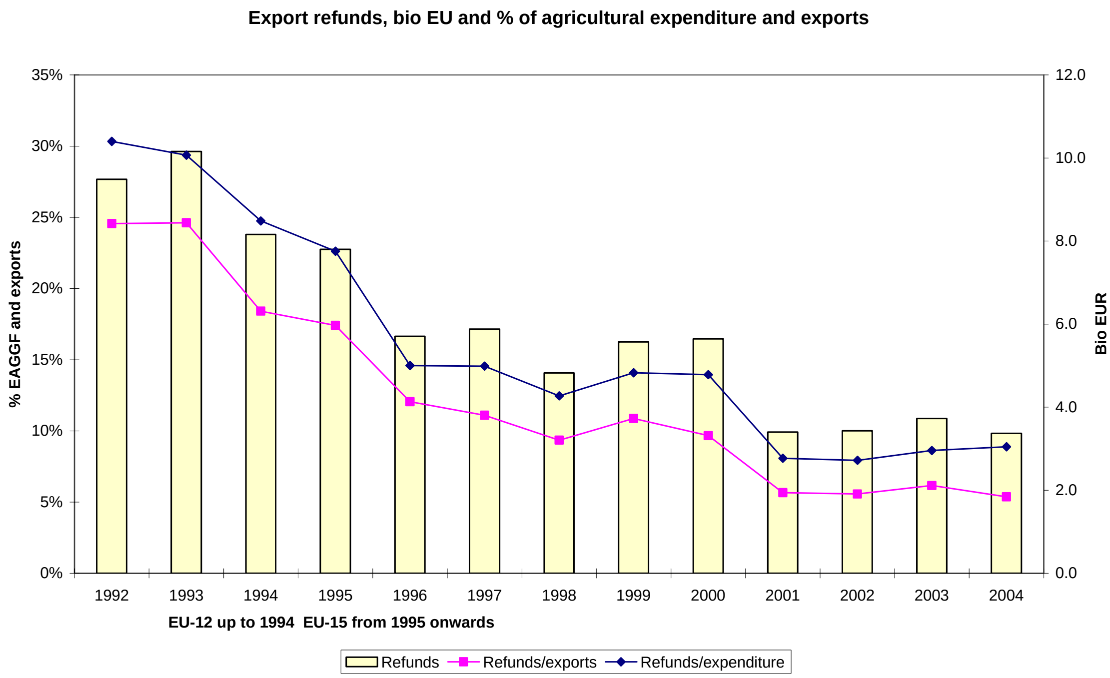
5. Export subsidies

Export subsidies, or "refunds" in EU language, remain an important component of the CAP. Renouncing the possibility of subsidising exports would make it difficult to maintain an intervention price structurally higher than world prices. However, because of the reforms in 1992 and 1999, intervention prices have been brought down in most sectors. This has narrowed the gap with the world price and has cut the expansion of production, making export subsidies less necessary. Export subsidies now amount to 2.6 billion euros (source WTO)[14], while they exceeded 10 billion euros in the early 1990s. This figure includes 400 million of export subsidies for products "outside Annex 1", which are a compensation for exporters of processed products for purchasing EU raw material (sugar and dairy products) at the higher EU price than their competitors on the world market.[15]

[14] The figure for 2004 is 3.4 billion euros for the budget year of the EAGGF 2004. The difference comes from a different budget year between the two sources, and the fact that the EU does not notify the reexport of the preferential import of sugar as subsidised exports to the WTO.

[15] Annex 1 products can be described as basic products (rice, milk, wheat, meat, cotton, etc.) Non-Annex 1 products are manufactured goods made up of ingredients which are listed in Annex 1. In such cases, the refund is claimed on the ingredient(s) covered by the Annex 1 list.

Figure 2. Export refunds



Source: EU Commission

Export subsidies face strong criticism from various non governmental organisations. They highlight the unfair and harsh competition in some industries: beef and poultry in West Africa, milk in Jamaica or in India (Oxfam 2003). These effects are real, especially as the amounts concerned can vary considerably from one year to the next according to the quantities which must be removed from the European market to support prices. However, the negative consequences for developing countries are not uniform. Developing countries which are net importers of food benefit from more favorable terms of trade when the EU taxpayer subsidises their imports.

A recent study by Gallezot and Bernard (2004) reviewed the amounts and destinations of European export subsidies. It shows that they vary considerably according to the product but also to the destination, the main subsidies being granted to dairy products followed by sugar (Table 6). Those on beef and poultry now represent only limited quantities. According to this study, subsidies are principally aimed at countries that are dependent on imports. This suggests that if they compete with local production, they also soften the import bill of the receiving countries, at least in the short term. It is difficult, however, to assess the responsibility of these subsidies for the inability of local farmers to develop local adequate agricultural production and it is undeniable that the subsidies are unfair competition for other potential suppliers.

Table 6. EU export refunds

Product	Source	Years (Mio Euros)						
		1996	1997	1998	1999	2000	2001	2002
Wheat and wheat flour	Feoga	86	210	194	376	403	106	19
Coarse grains	Feoga	227	322	235	507	501	120	77
Rice	Feoga	33	64	50	30	24	39	24
Sugar (1)	Feoga	1230	116	1370	1593	1439	1008	1168
Butter and butteroil	Feoga	237	525	337	298	325	336	382
Skim milk powder	Feoga	138	171	133	196	264	27	35
Cheese	Feoga	469	272	181	157	213	236	169
Other milk products	Feoga	761	785	775	788	805	453	498
Beef meat	Feoga	1559	1499	775	595	661	363	387
Pigmeat	Feoga	101	72	75	275	263	55	27
Poultry meat	Feoga	127	71	77	93	73	52	71
Eggs	Feoga	12	9	14	17	13	9	6
Wine	Feoga	41	60	41	27	22	23	24
Fruit and vegetables, fresh	Feoga	84	72	41	23	13	15	17
Fruit and vegetables, processed	Feoga	14	13	18	17	13	10	6
Incorporated products	Feoga	486	566	553	573	572	435	409
Total	WTO	4885	5566	4362	5337	5613	2764	2576
	Feoga	5674	4887	4906	5605	5604	3287	3319

Excluding sugar exports coming from the ACP countries and India, for which there has been no commitment to reduction in the notifications to the WTO but which are counted as an outlay in the FEOGA budget.
Source FEOGA European Agricultural Guidance and Guarantee Fund and WTO. Compilation by J.Gallezot.

6. Non tariff issues: standards and regulations

The European Commission makes a strong point claiming that the EU market is particularly open to developing countries exports. Indeed, developing countries benefit from significant tariff concessions. The Commission stresses that the EU's record of importing agricultural products from developing countries is greater than the USA, Japan, Australia, and New Zealand together. The new GSP, which will come into force on 1 January 2006, will grant wide tariff preferences to 300 additional products mostly in the agriculture and fishery sectors.

However, if tariff concessions are significant, developing countries face other types of obstacles, through regulatory issues. Different food scares, following the Bovine Spongiform Encephalopathy crisis in the mid 1990s, have put a considerable pressure on EU regulators for tighter safety standards. EU authorities responded by creating the European Food Safety Agency, and by strengthening regulations regarding microbiological standards and maximum residues limits. Recently, for example, standards were tightened on the aflatoxins content of grains and fruits, in particular. These standards are so tight that they impose considerable constraints on producers, even on European ones. In addition, the change in EU regulations has increased the liability of food suppliers in case of health problems.

Although these are not intended to prevent imports, it is a fact that the very high standards demanded by EU consumers often make it difficult for developing countries to export agricultural and food products to the EU. This is especially true for many higher-value foods, including fruits and vegetables, fish, beef, poultry and herbs and spices, for which the challenges of international competitiveness have moved well beyond price and basic quality parameters to greater emphasis on food safety and animal and plant health concerns.

Because physical inspection at the port of entry was thought to be inadequate to detect many newly identified hazards in food, the EU, like many other countries, moved towards certification of both products and production processes in the country of origin. In practice, the exporting countries bear additional costs of compliance. Would-be exporters must gain all necessary certificates and documents for export through their own efforts. For example, it may be necessary for an exporting company to have the certified system of HASSP quality monitoring (Health Approved Safety Standards Protection) in place. For some categories of goods, particular procedures, such as HACCP (Hazard Analysis at Critical Control Points) are necessary. These imply quality control and certification of the whole food chain, which is often a problem for developing countries.

Compliance costs cover a range of activities including certification, inspection and analytical bodies for countries and a requirement for sophisticated process plant and technical/managerial personnel. Cerrex (2003) provides examples of the actual costs required to match EU standards in ACP countries. Examples include control and monitoring at a 6 control point HACCP system of US$123,000; upgrading fish processing plants at US$6,000 each and certification costs ranging up to US$8,000. Overall, these are considerable costs that only a few exporters in developing countries can meet.

Box 3. Procedures for exporting to the EU

The Commission is responsible for ensuring that Community legislation on food safety, animal health, plant health and animal welfare is properly implemented and enforced. As a Commission service, the Food and Veterinary Office (FVO) controls the European Border Inspection Posts (the ports and airports where third countries exports are checked before entering the EU and being allowed to trade freely within Europe) and approves procedures for third country exports (e.g. 'first assessment' or 'reassessment' of export approvals).

The European Regulations on food safety, plant and animal health are too numerous to be described here. As a general example, the process for importing food products of animal origin into the EU involves the following steps:

1. The Competent Authority in the dispatching country contacts the European Commission to request approval
2. The EC visits the country and establishments to check that hygiene standards are equivalent to those in the EU
3. Approval is proposed, accepted or rejected. An updated list of approved countries is published in the Official Journal of the European Community and notified to Member States
4. A Commission Decision is drawn up giving the format for heath certification and a list of approved establishments
5. The Competent Authority in the country of dispatch issues and stamps the health certificate as set out in the Commission Decision
6. Products of animal origin must be imported into the EU through Border Inspection Posts (BIPs)
7. The importer must notify the BIP of the arrival of consignments (24 hours by sea, 6 hours by air)
8. The Official Veterinary Surgeon (or Official Fish Inspector - for fishery products) carries out a :
 a. Document check; b. Identity check; c. Physical check

If the checks are satisfactory, a Common Veterinary Entry Document (CVED) is issued for that consignment of goods: it can then be imported into the EU. If the consignment fails the checks then it must be either re-exported or destroyed.

Source : UK Food Safety Agency, http://www.food.gov.uk/multimedia/pdfs/import_poao.pdf

Traceability regulations have potentially adverse consequences for developing country exporters, because it places the onus of proof on the private sector and lays open company heads from both the EU production and import sectors to criminal sanctions. The threat of very large fines means that the major organisations involved in European distribution place increased pressure on their suppliers to provide all guarantees of traceability and food safety for fresh fruit and vegetables. Many developing countries exporters are not equipped to supply the amount of information required.

In addition, beyond the difficulties arising from the recognition of their own standards by the EU, developing countries also face the problem of ‘voluntary certifications’ which are becoming more and more a prerequisite for European retailers.

7. The pressures for further reform of the CAP

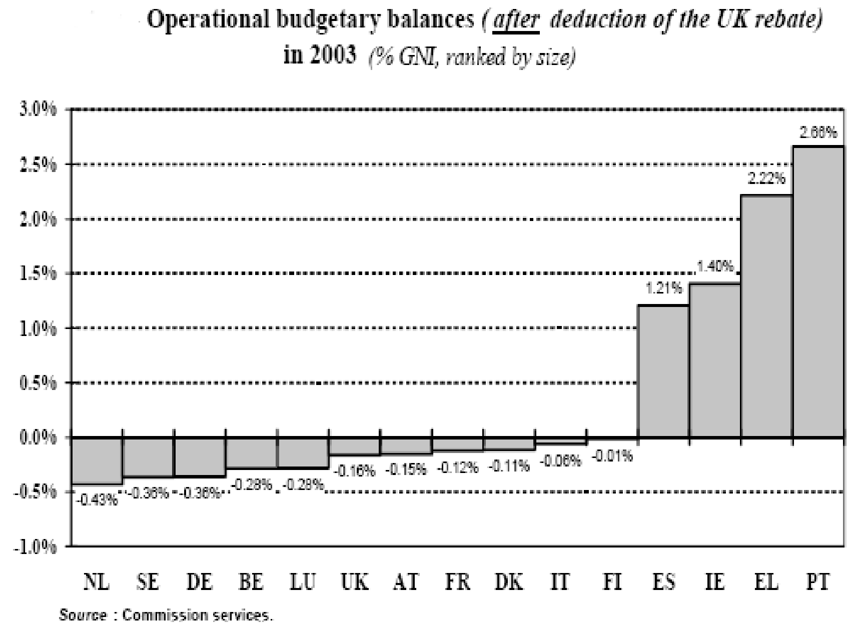
7.1. The EU budget

In December 2002, the European Council fixed the budget ceiling of the CAP’s "first pillar" – direct payments and market measures – until 2013. In brief, the budget will be frozen in nominal terms, while the payments to the EU 10 new members will be progressively phased in. This ensures a continuation of the CAP up to this horizon, even though support to individual farmers will go down in real terms, especially if the EU is enlarged to Romania and Bulgaria as expected in 2007 and CAP expenditure in these countries must be included within this budget ceiling.

However, in spite of the agreement on this ceiling there is so far (September 2005) no consensus regarding an overall financial package from 2007 to 2013, and there are pressures, particularly in the United Kingdom, for cutting the CAP budget agreed upon in 2002. While it is unlikely that large cuts will take place in the near future, an assessment of the past reform scheduled to take place in 2008/2009 could trigger further reforms. It is likely that these reforms will press for a reduction in the CAP budget, given the need to fund other European priorities such as research and education. After 2013, it is possible that the CAP could be reduced dramatically, as demanded by the United Kingdom as well as a few other member states.

There is now a club of countries willing to cap the EU budget and freeze their contributions (the EU budget is funded by different sources, including custom tariffs and a contribution based on the gross national income of each member country). In particular, the group of countries that benefit less from the CAP, because of their net food import position, or because they specialize in products that receive little support, are increasingly reluctant to maintain agricultural expenditure at the present (high) percentage of the EU budget. Figure 3 shows the relative budget positions of the old Member States of the EU15 in 2003, expressed as a per cent of their gross national income; just four countries (Spain, Ireland, Greece and Portugal) emerge as net beneficiaries, with all other countries net contributors. With the addition of ten new Member States, all of whom will be net beneficiaries from the EU budget, the position of the net contributor Member States will further disimprove. Discussion of the financial package for 2007-2013 is made more difficult by the terms of a special deal with the UK which limits the size of its overall net contribution, even though its per capita income is now higher than other Member States which make larger net contributions. An agreement is not now expected until Spring 2006 and thus the outlook for CAP direct payments will not be know until then.

Figure 3.



7.2. EU enlargement

Ten new members joined the European Union in 2004. Many analysts feared for the consequences for the CAP, given the large number of farmers in countries such as Poland (and Romania, scheduled to joined in 2007). It was predicted that, given the production potential of these countries, when farmers would face higher EU prices, production would increase considerably, jeopardizing the common market organizations. Indeed, numerically, enlargement's impact on EU agriculture added 4 million farmers to the EU's existing population of 7 million. The new Member States also added about 38 million hectares of utilised agricultural area to the 130 million hectares of the 15 States, an increase of 30%, while production in the EU expanded by about 10 - 20% for most products.

It is too early to be conclusive on the actual impact of the enlargement on EU production and, indirectly on the common market organisations. The direct payments will be phased in progressively in the 10 new members, and it is only in 2013 that these will be fully aligned with those of the EU15. However, the prospect of building large surplus in the future has played a role in the decrease in intervention prices under the Agenda 2000 and in the decoupling of the direct payments in 2003. In the future, the enlargement could modify the orientation of the CAP. While some of the new members are likely to benefit from the CAP, nothing in their recent positions indicates that they will strongly argue for larger funding of the CAP.

7.3. The need for a greener CAP

Pressures from the public opinion are increasingly calling for a more environmentally-friendly, greener CAP. The environmental balance of the CAP is particularly controversial. The maintenance of an agricultural population and farm production in some marginal rural areas contributes to some positive externalities. For example, it has been shown that biodiversity is often greater in "open spaces" including some agriculture than in forests or abandoned land, and the maintenance of a combination of livestock and crops is a positive externality that has been shown to be valued by citizens and tourists (Mahé and Ortalo-Magné 2002). Agriculture still plays a significant role in the process of economic and social cohesion in certain rural regions. Even as a minority in the countryside, farmers are still the main managers of the land. Agricultural practices largely determine the degree of attractiveness of these regions, particularly where the landscape is concerned.

In Europe, these positive links between agriculture and the environment and rural development have been promoted as evidence of the multifunctionality of agriculture in post-industrial societies. Agriculture remains important as a producer of food and raw materials, but it also contributes in other ways to protect the environment, preserve rural landscapes and contribute to the socio-economic development of rural regions. Agriculture is seen as multifunctional because it is not limited to the sole function of producing food and fibre but also fulfils these various other functions. What is characteristic for these other functions is that they have mainly a public good character, that is, these services cannot be bought and sold in a private marketplace. To secure the continued availability of these services, farm lobbies and other interest groups argue that public intervention to support the continued survival of farming is justified, even where agriculture cannot compete solely in terms of the value of food production alone.

However, the CAP has long provided an incentive to increase production, and therefore use chemical inputs. As a result, in a country like France, more than two thirds of surface water exceed maximum limits for nitrates, and close to 80% of groundwater is tainted by pesticides. Agriculture uses more than two thirds of the final consumption of water. In addition, the CAP has often encouraged intensive farming and is said by the French National Institute for Environment (IFEN) to be responsible of one third of the endangered species among vertebrates. In 10 years, some 740 000 hectares of permanent pastures have disappeared, often replaced by other types of fodder, such as silage corn. The problem is similar in most EU countries, as shown by the European Court of Auditors, which published a very severe evaluation of the environmental impacts of the CAP (ECA 2000).

The 1992 reform introduced some agri-environmental payments in order to provide incentives for farmers to supply amenities, or at least to stop destroying natural resources. These payments were very limited, and, for example, the payment for maintaining permanent pastures was much smaller than the payments that could be obtained for less environmental friendly production. The Agenda 2000 and the June 2003 reforms have gone further in shifting some of the payments towards the provision of environmental goods. The environmental dimension of the various common market organizations was strengthened. The beef premia were made conditional on tighter maximum stocking rates and the set aside of land for conservation purposes was encouraged. The 2003 reform put more emphasis on the compliance with good environmental practices. All farmers receiving direct payments will now be subject to "cross compliance". A list of 18 statutory European standards in the field of environment, animal health and welfare has been established and farmers will be sanctioned for non-respect of these standards through cuts in the Single Farm Payment.

The rebalancing of the CAP budget towards the provision of amenities is still only very partial. Only some 15% of overall CAP expenditure can be considered as directed to environmental or rural development purposes. Because of the growing demands of citizens for cleaner surface and groundwater, and because of the recurrent problems of water supply, it is likely that there will be more pressure in the future to move towards the remuneration of genuine positive externalities. In addition, environmental payments (and the "second pillar" in general) are not subject to the same budget discipline as the "first pillar". In the area of environment, national governments also have much more flexibility for granting their own domestic aids than under the traditional CAP (the

Rome Treaty limits considerably national payments and policies that could distort competition within the single market). Given the pressure for cutting the CAP budget, it is possible that, in the future, some budget (from Community and domestic origin) will de facto shift towards the second pillar.

7.4. International pressures: preferential agreements

The international environment has been a driving force for changes in the CAP since the 1992 reform, with the aim (among others) of improving the EU position within the WTO negotiations. Preferential agreements have recently played a significant role in the reform of some common market organisations, even though agricultural products are often excluded from EU regional and bilateral trade agreements.

In 2001, the EU adopted the "Everything But Arms" initiative (EBA) as part of its General System of Preferences for Least Developed Countries. The EBA grants duty free and quota free access for all agricultural products, starting in 2001 for most products, but in 2009 for sugar (quotas are implemented to smooth the transition). Many Least Developed Countries are net importers of sugar, but some of them have a significant export potential, and already attract foreign investment in this sector. Several millions of tonnes of sugar could start entering the EU from 2009 onwards under the Everything But Arms agreement, especially if Least Developed Countries begin to export not just their surplus production but all domestic production while re-importing cheaper supplies from the world market for domestic consumption (known as triangular trade). This prospect has been important in triggering a reform of the EU sugar sector, which should involve a decrease in intervention prices (the Commission made successive proposals in July 2004 and June 2005 and it is hoped agreement will be reached by November 2005).

In the future, the prospect of a free(er) trade agreement between the EU and Mercosur (Brazil, Argentina, Uruguay and Paraguay) could be a driving force for further reforms. Such an agreement has been discussed since 1995, but negotiations have not succeeded so far, in spite of the offer of significant tariff rate quotas by the EU in 2003. Mercosur countries demand a larger (quota free) market access for agricultural products. The potential EU exports of manufactured products and services to Mercosur are such that the EU could make larger concessions in the agricultural area in exchange for concessions in the services sector should the negotiations be finally concluded. In such a case, the production potential of Mercosur in sugar, ethanol (Brazil), beef (Brazil and Argentina), cheese (Argentina), poultry and pigmeat is such that extra reforms of the CAP could be necessary.

The so-called Barcelona process aims at liberalising trade between countries around the Mediterranean.[16] A series of bilateral agreements has been concluded, completing some agreements dating back from the 1970s. However, agricultural products are largely excluded from these agreements, and when they are included, they are most of the time subject to quotas. Southern EU countries fear an ambitious liberalisation in the fruit and vegetable markets, which is one of the main demands by North African and Middle East countries. This has so far been an obstacle to the full inclusion of the agricultural sector in the process. However, there is a strong

[16] The Barcelona process is an ongoing cooperation process between the EU and the other countries of the Mediterranean area. It includes some trade provisions, as well as assistance and stabilisation programmes. Under the trade provisions, however, tariffs have been reduced only for a limited number of products. EU producers fear the competition of North African producers in some sensitive areas such as fruits and vegetables.

political willingness to develop economic cooperation with Maghreb and Mashrek countries, for geopolitical reasons. In addition, these countries are a potential market for some agricultural products (cereal, potatoes, etc), so that there are conflicting interests between EU members on the concessions that should be granted in the fruits and vegetables sector. Finally, the conclusion of a free trade agreement between Morocco and the United States in 2004 has been seen as a warning that Maghreb countries are getting impatient regarding the lack of extension of their access to the EU market. In spite of the opposition of some EU members, it is possible that the political willingness to go forward in developing economic interactions with these countries could be a driving force for a reform of the EU fruits and vegetables sector, scheduled in 2006.

The Cotonou Agreement is a comprehensive aid and trade agreement concluded between 77 ACP (African, Caribbean and Pacific) countries and the European Union, signed in June 2000 in Cotonou (Benin). The Cotonou Agreement builds on former ACP-EU cooperation (the Yaoundé and Lomé agreements), and includes economic and trade co-operation as well as aid. Under the four successive Lomé conventions (1975-2000), the EU granted a preferential trade regime to ACP countries through trade preferences, commodity protocols and other instruments of trade co-operation as well as financial and technical aid. Under Cotonou, the current non-reciprocal tariff preferences will be maintained until 31st December 2007 under the terms of a WTO waiver from its rules governing non-discriminatory treatment of third countries. Starting from 2008, a set of reciprocal Economic Partnership Agreements (EPAs) will replace them, following negotiations that began in September 2002.

The EU operates on the assumption that the EPA negotiations will be concluded on a regional basis, with those regions which have functioning regional integration processes and mechanisms. The ACP-EU negotiations are supposed to yield EPAs that would be development oriented, free trade areas and WTO compatible, meaning that the ACP countries would also have to open their borders to "substantially all" EU exports. Those countries that do not wish to open their markets to EU products after 2008 can choose to revert to the Generalised System of Preferences (GSP) regime. Because the ACP countries include both Least Developed Countries and non-LDCs, some of them can benefit from the Everything But Arms (EBA) while others cannot.

The concern is that, given the bilateral nature of the EPAs (rather than the non-reciprocal Lomé regime), some industries in the ACP countries would suffer from the competition of EU exports (chicken, tomato industries in Ghana and Senegal, milling industry in other countries). While it is unlikely that the EPAs will lead to a much larger opening of the EU market to ACP products than the previous arrangements, there will be pressure on the EU to offer some concessions to offset the opening up of ACP economies to its exports, and this will further add to the pressures to reform the CAP.

7.5. International pressures: the WTO

Multilateral negotiations have obviously been a major driving force for CAP reforms since the Uruguay Round. The main constraint imposed by the WTO discipline on the CAP has perhaps been the commitments limiting export subsidies. At the end of the 1990s, the prospect of piling up surpluses that could no longer be exported because of the ceilings on subsidised exports was the main motivation for lowering intervention prices under the Agenda 2000. More recently, the prospect that the exemption from reduction commitments for "blue box" types of support would be difficult to defend under the Doha Round was among the factors that led the Commission to push for an ambitious decoupling of direct payments from production in 2003.

The dispute settlement procedure under the WTO adds some extra pressure to CAP reform. In the case of sugar, the EU lost a WTO panel requested by Australia, Brazil and Thailand in 2005. The decision of the Appellate Body effectively requires a cut back of sugar exports by 4.6 million tonnes. This outcome takes away an important safety valve for releasing pressure from the domestic EU sugar market, and presses for an ambitious reform of the sugar sector. In addition, some uncertainty surrounds the compatibility of the Single Farm Payment with the WTO rules for eligibility for the "green box", in particular because of the jurisprudence created by the WTO dispute on cotton (Brazil-United States). Because of some restrictions introduced in order benefit from payments, some US subsidies were considered as market distorting. It remains to be seen whether the EU conditions about maintaining land in good agricultural conditions, or the restrictions regarding the planting of certain horticultural crops or protecting the area under pasture, could allow third countries to challenge the exemptions of the SFP from reduction commitments, i.e. its exclusion from the AMS (EU farmers have flexibility as to what they can produce but with the exception of explicitly excluded commodities such as fruits and vegetables).

7.6. The political economy of further reform

While there is a lot of debate within the EU regarding the external constraints imposing changes in the CAP (namely the WTO one), the major driving force for a CAP reform is likely to be domestic. The CAP budget, roughly 0.5 percent of the EU GDP, is not particularly "excessive" for the only policy that is a genuinely common one at European level. However, there is a growing feeling that the amount of money spent on agriculture would be better spent in other sectors, such as a common policy for research and innovation, or perhaps defence and foreign country assistance. In addition, criticisms are raising about the distribution of the CAP benefits, now that the shift to direct payments makes more visible that subsidies mainly benefit a minority of relatively well-off farmers (50% of the budget for direct payments go to only 7% of the beneficiaries, according to a 2002 study by the European Commission. OECD figures, which account for market price support, show an even higher degree of concentration of the benefits).

The large budget allocated to the CAP has long been the result of political compromises. Some support was sometimes granted to particular products such as cotton, olive oil or fruits and vegetables, as a way of reaching political deals with particular countries in a peculiar decision making process where a few key countries can decide votes on specific issues. This political economy process also explains the persistence of the large payments for arable crop farmers, which were originally intended to compensate for price cuts in 1993 and 2000, but were extended until 2013. These payments benefit particularly some countries whose weight was determinant in the decision making process. The same thing can be said about the sugar regime, which has been more or less unreformed since 1969, also because of powerful vested interests. However, some of these obstacles to changes are now being eroded. The enlargement to 10 new members is modifying the rents that countries obtained regarding the distribution of structural funds. This modifies the overall distribution of benefits of the common policies, in which the CAP implicitly plays a large role. The shift towards more payments for the "second pillar" could lead to a renationalisation of the CAP, the countries most attached to subsidising their farmers being invited to do so at their own budget cost.

The major change is perhaps the erosion of the political strength of the farm interest groups. Bad management of their political capital of sympathy, and attacks from environmentalists, non governmental development organizations and consumer groups have changed the perception of farmers by the public in some countries where they used to find strong support. In the media, and to some extent in public opinion, the CAP is now more and more seen as a policy that encourages pollution, and that participates in impoverishing developing countries.[17] The majority of public opinion, as measured by Eurobarometer surveys, is in favour of subsidising less agricultural production and subsidising more the environment. These trends in public opinion suggest that, in the next few years, the CAP could be under increased scrutiny and its funding subject to increasing controversy.

8. What are the effects of the CAP on developing countries?

8.1. The overall impact of the CAP

Non governmental organizations have been particularly vociferous when denouncing the negative effects of the CAP on developing countries (Oxfam 2005). They argue that the EU continues to dump surplus production on world markets and that subsidized exports competing unfairly with local production drive producers out of business; that EU tariffs prevent developing countries exporting agricultural products; and that the move towards decoupled payments has been mainly cosmetic, given that huge subsidies still provide EU farmers an incentive to produce and therefore compete unfairly with developing countries which do not have such financial means to support their farm sector.

Not all economists share this point of view. Recently, for example, Panagariya (2005) has claimed that most of the analysis of the NGOs relied on a series of fallacies, and that the agricultural policies of developed countries had, overall, little negative impact on developing countries: in some cases, the removal of these policies would even have significant negative consequences for developed countries, for example by leading to a degradation of their terms of trade.

In practice, what are the overall effects of the CAP on developing countries?[18] First, these effects appear very contrasted across countries. By encouraging agricultural production in the EU, the CAP clearly hurts some developing countries that are net exporters and that would, otherwise, supply a larger share of the EU or world market. However, the situation is less clear for net food importing developing countries.

Second, the distortions on world market generated by the CAP are now much smaller that the ones that resulted from the CAP in the 1980s, because of the reforms that have taken place. Third, the reforms of the CAP have gone together with an improvement of market access, even though this access remains very uneven across commodities and across would-be exporters.

The effect of domestic support. Because of the reforms that have taken place since 1992, support to farmers in the EU now mainly takes the form of direct payments, which rely on historical entitlements and have therefore less impact on production than they had before. Decoupled payments are much less distorting than the former market price support and output subsidies. However, in the EU the decoupling is only partial, and the new Single Farm Payment remains conditional on the maintenance of the land in good agricultural condition, even though it does not require actual production. More generally, payments are only truly "decoupled" if the capital

[17] The evolution of public opinion, as measured by Eurobarometer surveys, is contrasted across countries. It does not globally show that the perception of the CAP is more and more negative. However, the enlargement has modified considerably the results for the EU as a whole, and the Eurobarometer survey contains questions that stress the positive role of the CAP in food safety and consumer protection, more than questions that open the door to criticisms of the CAP.

[18] For a fuller discussion of this topic, see Bureau, Jean and Matthews (2005).

market is perfect, and if private consumption decisions are separable from the production side of the household. Economy theory suggests that to give a sum of money, even unconditionally, to a farmer necessarily influences the amount produced. In reducing the risk of insolvency, even decoupled payments encourage higher production or riskier cultivation. There is often an implicit anticipation that cultivated areas will be used as a reference in the next reform which keeps land in cultivation.

Developing countries complain about the indirect distortions generated by "decoupled payments". There are few solid quantitative results on the effect of such aid on production. A recent study by Abler and Blandford (2005) suggests that the effects on the quantities produced are limited. Their survey of the econometric results in the literature suggests that developing countries can expect only small gains even from a large reduction in these direct payments. However, this conclusion is subject to uncertainty regarding the proper way to model these payments, which parallels the imperfect knowledge of their economic impact (Gohin 2005). It remains to be seen whether the SFP will actually lead to an observable decrease in yields, or a diminution of EU production. If it is not the case, this could mean that, indeed, the shift towards more decoupled payments will have introduced only minor changes in the distortions that the CAP brought to world markets.

The effect of border protection. The EU is still reluctant to lower tariffs for the agricultural products that benefit from a common market organisation, since they are necessary for maintaining the whole intervention system.

Because of the large number of developing countries that benefit from preferences, the impact of the border protection component of the CAP is very uneven. Basically, the developing countries that benefit only from the regular GSP obtain a very limited access to the EU market in sectors such as beef, dairy and sugar, which are not (or only very partially) covered by the preferences. The countries that benefit from the Cotonou Agreement or the "GSP plus" have a larger market access, and higher preferential margins. Least developed countries will soon face no tariffs or quotas, because of the future full opening of the banana, rice and sugar sectors.

In practice, simulations suggest that the removal of EU agricultural tariffs would have some positive consequences on Latin American and some East Asian exporters, such as Brazil and Thailand. However, simulations also suggest that the erosion of preferential access and the preferential rents would lead to negative consequences in sub-Saharan Africa, and even more in the Caribbean (Bouët et al 2005; Laird et al 2004).

The effect of export subsidies. There is little evidence of the impact of EU export subsidies on the economies of developing countries, except for some anecdotal cases highlighted by non governmental organisations. Overall, it is likely that EU subsidized exports have distorted competition with local producers in particular sectors and in particular locations (the subsidies to beef exports to West Africa have sometimes represented half the cargo value).

Nevertheless, the impact of EU export subsidies on world prices seems small, except in the case of sugar and dairy products, according to the work by Bouët et al (2004). The scheduled elimination of EU export subsidies is unlikely to alter significantly the market conditions for developing countries. It will hardly have any impact on those developing countries which sell their sugar higher than the world price in the framework of preferential quotas. With dairy produce, only some developing countries like Argentina have a definite comparative advantage. Subsidised exports of milk affect essentially West Africa, which historically does not have significant production potential. In short, the removal of such subsidies is desirable to end unfair competition, but the overall negative effect of export subsidies on developing countries has been overestimated by non governmental organizations, at least as far as their impact on poorest countries is concerned (Oxfam 2005). EU export subsidies seem mainly to drag down the world price of the exports of a few major exporters such as Brazil (sugar) and Argentina (dairy products).

8.2. A focus on a few commodities

Rice. Rice producers are now eligible for the Single Farm Payment. However, in order to preserve certain traditional production areas, producers also receive aid for rice set on the basis of yield for a maximum guaranteed area in each Member State. This area varies depending on whether or not the Member State opts to make use of the transitional period. If the area is exceeded, the aid is reduced proportionately.[19] In addition, the production of rice remains supported by an intervention price, which now amounts to 150 Euro per tonne for paddy rice (rice which has retained its husk after threshing).[20] Rice imports are subject to import duty ceilings linked to the intervention price. Reducing the intervention price has the effect of also reducing applied tariff rate which can be applied to imported rice.

The reform should therefore make the production of rice less attractive than the previous regime, which relied on a higher intervention price (298 Euro per tonne) and compensatory payments. Full liberalisation of rice access for Least Developed Countries will be phased in by September 2009 by gradually reducing the full EU tariff to zero. In the meantime, their rice can enter duty free within the limits of tariff rate quotas, increasing annually to reach 6 700 tonnes in 2008/2009. Once the quota restrictions are removed, it is very likely that rice imports from Least Developed Countries will put downward pressure on milled rice prices within the EU. Because the paddy rice price would remain supported, it was feared that this would lead to an unacceptable build up in intervention stocks. For that reason, the intervention purchases of rice will be limited to 75 000 tonnes of rice in the future. That is, overall, the combination of the reform decided in 2003, which involves a reduction in intervention price and indirectly a reduction in tariffs, and the Everything But Arms provisions should open significantly the EU market to developing countries in the future, particularly to LDC exports.

Cotton. The EU, with 708 000 tons of imports and 227 000 tons of exported ginned cotton, is the major net importer on the world scene, but its production nevertheless reaches 1.55 million tons of raw cotton. The cotton sector is concentrated in some regions of Greece (79% of the total EU production) where cotton contributes 9% of its final agricultural output while in Spain, the other main EU producer, cotton contributes 1%. Production in other Member States (only in Portugal) is less than 1 500 tonnes.

The EU cotton regime, which dates from Greek accession in 1981, was modified in 2001, in order to tighten budget discipline and limit the total area dedicated to intensive cotton production,

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[19] After the 2003 reform, all farmers may apply for direct payments, which are independent of their production and supplementary to their income. Specific support schemes have nevertheless been introduced for durum wheat, protein crops, rice, nuts, energy crops, starch potatoes, milk products, seeds, arable crops, sheepmeat and goatmeat, beef and veal, grain legumes, cotton, tobacco, hops, as well as for farmers maintaining olive groves.

[20] From 1 April to 31 July of each year, the intervention agencies can buy in quantities of rice offered for intervention up to a maximum of 75 000 tonnes (100 000 tonnes for the period from 1 April to 31 July 2004). If the quality of paddy rice offered for intervention differs from the standard quality for which the intervention price was fixed, price increases or reductions are applied. The intervention agencies can subsequently offer rice in storage for sale on the Community market or for export to third countries.

associated with environmental problems. The reform of agricultural aid for cotton (as well as, tobacco, hops and olive oil and table olives) was negotiated together and included in the same Regulation in what was known as the "Mediterranean package". All these products were subsequently included (April 2004) in the comprehensive reform of the common agricultural policy (CAP) of June 2003, with the approval of the move from direct aid (aid paid by hectare, unit of output or livestock unit) to a system of single farm payments.

The decoupling of support was only partial in the case of cotton, with only a proportion of the aid moving to a system of single farm payments. That is, 35% of aid will continue to be provided in the form of an area payment (direct aid), with the remaining 65% being provided as a single farm payment. The objective was to protect certain areas in which production would cease if decoupling was fully applied. Under the previous arrangements, growers did not benefit from direct aid for cotton but rather from indirect aid paid to ginners. The total aid available per hectare in each Member State is fixed at 35% of the national allocation that producers received indirectly. Aid is subject to a maximum eligible area (370 000 ha in Greece and 70 000 ha in Spain).

EU tariffs on cotton are low in the EU (raw cotton and yarns enter duty free). The domestic support provided to Greek and Spanish farmers are the major forces that enhance supply and therefore restrict imports. Even though the decoupling has been partial, it should provide less incentive to produce. Environmental constraints are also likely to curb intensive production in Greece, as will water supply problems in Spain. The EU market could increase for would-be exporters. However, the competition from subsidised US cotton, and the growing competition from countries such as China and Brazil, could limit the benefits for other developing countries.

Tobacco. Like cotton, tobacco was reformed under rules known as the Mediterranean package in 2004. Those products were included in the major June 2003 reform framework when the switch from direct support to the single farm payment was approved. The common organisation of the market in raw tobacco has been fundamentally changed in order to switch over completely to the single-farm-payment system by means of decoupling starting in 2006. Decoupling will apply in full from 2010, but Member States may opt for a four-year transitional period starting in 2006. During that period, at least 40% of direct aid for tobacco under the old system will be allocated to single farm payments. The (at most) 60% remaining may continue during the transitional period (2006-10) as production aid for raw-tobacco growers, including in Objective 1 regions (whose development is lagging behind) or for those growing varieties of a specific quality. There is a ceiling to the coupled aid for each Member State in 2006-09, with maximum aid being some 227 million euros in Greece and 200 million euros in Italy, 71 million euros in Spain and 48 million euros in France.

Bananas. The common organisation of the market in bananas has been altered to prepare for its switch, from 1 January 2006, to a tariff-only system, and for the EU enlargement in 2004. Domestic assistance includes support to encourage the setting up of producer organisations recognised by the Member States which promote the production and marketing of the products concerned (granted for a period of five years). Associations of producers and individual producers who are unable to participate in a producer group on account of their geographical remoteness may receive compensation. The guaranteed Community quantity for which compensation may be claimed is 854 000 tonnes allocated among the producer regions (Canary Islands, Guadeloupe, Martinique, Madeira, Crete, Algarve and Lakonia). A guaranteed quantity of 13 500 tonnes has been granted to Cyprus in the accession negotiations. The Commission determines the amount of the compensation each year.

Since 1 January 2002, the following three tariff quotas have been applicable: Quota A: 2 200 000 tons at the rate of EUR 75/tonne. (ACP bananas - African, Caribbean and Pacific countries - are zero-rated); Quota B: 453 000 tons at the rate of EUR 75/tonne (ACP bananas are zero-rated); Quota C: 750 000 tons at the rate of zero euro/ton (reserved for ACP bananas). A and B quotas are opened for bananas of any origin, while the C quota is reserved for the ACP States. Imports of non-quota bananas are subject to customs duty of EUR 680/tonne, save for the ACP countries which qualify for a tariff preference of EUR 300/tonne. The Commission, under an agreement concluded within the WTO, allocated A and B tariff quotas among the main supplier countries with the agreement of the latter. Furthermore, the new Regulation provides for the import of an additional volume of 300 000 tons of bananas from 1 May up to 31 December 2004, taking into account EU enlargement. Tariff quotas may be granted on the basis of a traditional/newcomers method and/or other methods. The method currently adopted following agreement with the United States (main distributor country) and Ecuador (one of the main producer countries) is that of historical reference quantities which takes account of the need to ensure balance in supply to the Community market.

A common tariff per tonne will apply to imports of fresh bananas from 1 January 2006. After this date the market organisation for bananas will switch to a tariff-only system. The level of the tariff continues to be disputed by Latin American exporters and, following WTO arbitration, the Commission put forward a revised banana tariff proposal in September 2005. This reform is likely to lead to result of a significant reorientation of trade, towards imports originating from lower costs producers, in particular Central America.

Sugar. The ongoing reform of the sugar sector is certainly the one that could have the largest consequences for developing countries.[21] The EU is a major sugar exporter although it also absorbs a significant amount of sugar imports under preferential agreements with developing countries. However, sugar production in the EU is highly supported, so sugar exports can only take place with the aid of export subsidies. The volume of subsidised sugar exports is now constrained by the EU's commitment limits under the WTO Agriculture Agreement.

Several factors have contributed to the need for the EU to reform its sugar regime. The Everything But Arms agreement opens the EU to increases in sugar imports from least developed countries. Because the EU is more than self-sufficient in sugar, any increase in imports will require a one-for-one reduction in domestic EU production if the EU is to remain within its export subsidy limits. This pressure will be exacerbated by a successful outcome of the Doha Round if it requires the eventual elimination of all subsidised exports. Furthermore, the EU under the WTO Agriculture Agreement had not declared as subsidised exports either so-called 'C' sugar (surplus sugar production exported without the aid of formal export subsidies) or an amount of subsidised exports equal to the volume of imports from ACP countries and India under the sugar protocol of the Cotonou Agreement. However, a WTO panel in a dispute brought by Australia, Thailand and Brazil concluded that C sugar exports should be included under export subsidy limits as should the subsidised exports equivalent to the volume imported under the ACP protocol. To comply with this ruling requires a further reduction in domestic EU production. Finally, the Doha Round negotiations are also addressing the issue of high tariffs which reduce market access. Any agreement to reduce tariffs and/or to restrict the use of the special safeguard measure would compromise the ability of the EU to retain the high internal sugar price.

In response to these pressures, the EU Commission put forward a reform proposal in July 2004, which was revised in the light of Member State reactions and the outcome of the WTO dispute in

[21] A fuller discussion can be found in Chaplin and Matthews (2005a, 2005b).

June 2005. The main elements are summarised and compared in Box 4. It is planned that the reform will be agreed in November 2005.

Because of the reform, the price at which preferential imports of sugar are purchased from ACP countries and India, as well as from the least developed countries under the EBA agreement, will be lowered. This will result in an erosion of the rents these countries receive, which for some countries account for a large share of their economies (for example, the rent from preferential sugar exports to the EU accounts for up to 9% of the GDP in Guyana). Some of these countries may be competitive exporters to the world market, and may benefit from alternative market opportunities if the Doha Round results in a greater market access for sugar exporters (something which may not happen if sugar is treated as a sensitive product by the main importers). For other countries, the EU has proposed a small compensation fund to assist in improving competitiveness or diversification.[22]

Box 4. The forthcoming sugar reform

Talks about sugar reform have lasted for years, until a detailed proposal in 2004 by the EU Commission. After discussions and in order to account for new international developments, such as the WTO panel on the exports of EU sugar, new Commission proposals for reform of the EU sugar sector were released in June 2005. The proposals tabled deal with:

- the introduction of direct aid payments to EU sugar farmers and the incorporation of such payments into the single farm payment scheme;
- reduction in the administratively determined prices set in the sugar sector;
- reform of the production-quota management system;
- restructuring aid for enterprises wishing to leave the sugar sector;
- the regulation of imports and exports;
- the uses of sugar in the chemical, pharmaceutical and bio-fuels sectors.

Of most importance to developing countries is the phased reduction of the raw sugar price over a 4-year period beginning in 2006. This would bring the price down to €319.5 per tonne from the 2009/10 season onwards. This would result in a significant erosion of the value of preferences. Although some adjustment measures are included in the reform, there are worries regarding the speed of the reform and the lack of time for adjustment in the ACP countries that benefit from the Cotonou agreement sugar protocol. However, competing sugar exporters, mainly Brazil but possibly also including some low-cost ACP suppliers, will be in a position to expand production to make up the gap left by the reduction in EU production..

Fruits and vegetables. The fruit and vegetable reform, scheduled to take place after 2005, could ease access to the EU market for developing countries. Presently, the CAP protects the EU fruits and vegetable sector with a complex system of tariffs, which de facto impose a minimum entry price. Tariffs are high during the months when the EU production is marketed. Mediterranean countries, whose production is mainly exported during these particular months could be a winner. Exports of fresh vegetables from sub-Saharan Africa could also be made easier by a reform of the EU system.

[22] Further discussion of the EU sugar reform and its implications for developing countries can be found in Chaplin and Matthews (2005a, 2005b).

9. Conclusion

The purpose of this paper was to describe the operation of the EU's Common Agricultural Policy and the background to the reforms underway – the factors making for change and the extent of change – from a developing country perspective. The paper presents a positive evaluation of the reforms which have taken place over the past decade: market price support has been reduced; most direct payments will be decoupled from 2005 onwards; preferential treatment for some developing countries and some commodities has improved market access; dependence on export subsidies has fallen. Nonetheless, tariff peaks remain for many agricultural products and the CAP still presents a barrier to developing country exports, not least for meat, sugar, dairy products and fruits and vegetables.

Longer term reform of the CAP is likely to continue the trend towards a reduction of farm support, and a reorientation of the CAP budget towards the second pillar. What is at issue is more the pace rather than the direction of reform. This should lead to even lower levels of trade-distorting agricultural support. But because major changes have already taken place in the CAP, the resulting impact on world prices will be small. The progressive decoupling of the farm support should lower production, but agricultural output is likely to rise more than consumption in the 10 new Member States.

A successful conclusion to the Doha Round of WTO negotiations could lead to significant cuts in the highest EU agricultural tariffs, depending on the treatment of sensitive products. Competitive middle-income exporters will gain from improved market access. However, some developing countries (ACP, Least Developed Countries) which are presently heavily dependent on agri-food exports to the EU exported under preferences are likely to suffer, because of extra competition from Australia, Brazil and Thailand. Lower market prices in the EU (whether driven by internal reform or WTO/preferential trade agreements) will also lower the benefits of preferential market access in the future.

However, as tariff barriers fall, market access is becoming increasingly dependent on quality assurance and the ability to meet the standards and requirements of major supermarket chains. These non tariff issues should be kept in mind, since they are likely to become the major constraints for a number of developing countries, which have difficulties meeting quality, certification and traceability standards. For example, a large number of developing countries will not be able to draw any benefit from the growing EU imports of beef which are expected to take place with the implementation of the Single Farm Payment because they are not free from particular animal diseases.

From the point of view of developing countries wanting to understand the dynamics of CAP reform, the following factors are likely to influence the pace of change.

- The overall deal on the EU financial perspective for 2007-2013 which has implications for the level of direct payments received by EU farmers into the future. Two issues are important here: whether the overall size of the budget is limited to 1% of EU GNI over the period and, if so, whether the savings required relative to the current Commission proposals which are based on a ceiling of 1.14% are made in the CAP Pillar 1 budget (farm support) or in other budget lines (CAP Pillar 2 funding (rural development), other internal policies such as research or external programmes such as development assistance).
- The pace at which export subsidies are eliminated in any Doha Round agreement. While EU expenditure on export subsidies for agricultural exports has declined significantly in recent years, they still play an important role for particular commodities, notably dairy

and sugar. Production of both of these commodities is controlled by quota within the EU, so in principle supply could be curtailed to eliminate exportable surpluses and thus avoid the need for export subsidies should they be eliminated.[23] However, the elimination of export subsidies would hit producers of non-Annex 1 products (higher value added food products) hard, as they would be required to purchase their raw materials at high EU internal prices and compete with companies with access to raw materials at lower world market prices. The elimination of export subsidies would encourage food companies to become powerful advocates of lower agricultural prices within the EU.

- The extent to which additional market access commitments are agreed in any Doha Round agreement. The reduction in intervention prices which has already occurred means that there is currently some water in EU tariffs, i.e. they are higher than they need to be to keep out low-cost imports. Nonetheless, under a tiered tariff reduction formula, some EU tariff peaks would be cut significantly, creating pressure for a further reduction in internal support prices for some commodities. The number and treatment of sensitive products in the negotiations will be critical here, as will the nature of any agreement on the Special Safeguard (currently important in helping to raise the level of market protection for sugar).Outside the WTO framework, any attempt to resuscitate talks on a free trade area with Mercosur would also inevitably require market access concessions on the part of the EU.

[23] Not all dairy product exports require export subsidies to be viable. The main EU surplus product is butterfat, and high value cheeses and occasionally some milk protein products can be exported without subsidy.

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http://europa.eu.int/comm/agriculture/index_en.htm

A good source of commentary on EU agricultural policy developments from a developing country perspective is the CTA: Technical Centre for Agricultural and Rural Cooperation ACP-EU website
http://agritrade.cta.int/index.htm

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