
UNIT 9 THE COMMON AGRICULTURAL POLICY (CAP)

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9.0 INTRODUCTION

The Common Agricultural Policy (CAP) is one of the oldest, most integrated and also one of the most controversial policies of the European Union (EU). More than fifty per cent of all the EU regulations deal with the CAP. Similarly, CAP absorbs about half of the total EU's budget expenditure. This despite the fact that agriculture accounted for only 1.6 per cent of the EU-15 GDP and employed only 3.8 per cent of total working population of EU-15 in 2004. Current paraphernalia of the CAP is justified on the basis of food safety, animal welfare standards, income stability of farmers as well as protecting the natural environment, farming practices and rural communities. In this unit we will study about various aspects of CAP.

9.1 OBJECTIVES

After studying this unit on CAP, you would be in a position to:

- understand the background and evolution of the CAP;
- describe its guiding principles, key actors and main components;
- explain major benefits and huge costs of the CAP;
- a appreciate reform measures, particularly since 1992; and
- a understand contemporary debates in the context of EU enlargement and the World Trade Organization (WTO).

9.2 BASIC PRINCIPLES OF CAP

The roots of CAP lie in the crippled European agriculture in the 1950s, where societies were damaged by the Second World War and where food supplies could not be guaranteed. Therefore, the policy was formulated against the backdrop of food shortages and rations following the Second World War. Moreover, at the signing of CAP, about 25 per cent of the total labour force of original Six member states was employed in agriculture. In addition, the people working in the agriculture sector were worse off compared to other sectors. As a result, the earlier emphasis of CAP was on encouraging better food productivity to improve stable and affordable food supply and a viable agriculture sector. To provide incentives to farmers, the CAP offered subsidies and guaranteed prices. Financial assistance was also provided for the technological and operational restructuring of agriculture. Overall, the major declared objectives of the CAP which were set in the Article 39 of the Treaty of Rome were:

- to increase agriculture productivity;
- to ensure a fair standard of living;
- to stabilize agricultural markets;
- to ensure the availability of food supplies; and
- to ensure that supplies reach consumers at reasonable prices.

Although most of the EU policies are based on some kind of free market principle, the CAP is based on the notion that markets in the agriculture sector need to be managed. The CAP has been designed to modify the markets in the agriculture sector **through** price supports, production quotas, production subsidies and import barriers. Even after the recent reforms in the CAP (discussed later), the basic character of the policy has not changed much. As discussed in the basic framework and amended later, the main guiding principles of the policy are as follows:

- 1) **Market Unity:** The policy assumes that there is free movement of agricultural products within the European Union, meaning no cross-border barriers to agriculture trade.
- 2) **Community Preferences:** This means that the CAP must protect the Union's agricultural products from outside imports. It also means promotion of EU agricultural products. In other words, the principle of free trade in agricultural goods, which applies within the EU, is not extendable to outside the Union.
- 3) **Joint Financial Responsibility:** The running of this policy is the responsibility of the whole Community. It means that all member states must pay for the CAP. These costs will not be based on the "just return" criterion means financial benefits to a Member State may not be equal to its contributions.

9.2.1 The Key Actors

The common Agricultural Policy (CAP) of the EU is managed and implemented by the following bodies:

- 1) **The Agriculture Council:** The Agriculture Council is the main-decision making body within the EU on agriculture. Agriculture Ministers of all Member States are members of this Council. The meetings of the Agriculture Council are prepared by the Special Committee on Agriculture (SCA) and not by the Committee of Permanent Representatives (COREPER). The European Parliament has very little role in agriculture as most CAP issues fall within the "consultation procedure" and most agriculture expenditures are "compulsory expenditures".
- 2) **The Commission:** Within the European Commission, the Director General of Agriculture and Rural Development formulate major guidelines, draft proposals, executes policy decisions and observe the implementation of the policy by the Member States.
- 3) **National Administrations:** Most practical aspects of policy like management of payments, purchases of agriculture products, inspections, etc. are implemented by the national governments and in some cases even by the regional authorities.

9.3 FUNDING AND SUPPORT MECHANISMS OF CAP

The CAP has been funded from the EU budget by the European Agricultural Guidance and Guarantee Fund (EAGGF). As the name suggests this fund is divided into two sections – the Guarantee Section and the Guidance Section. The Guarantee Section mainly finances the expenditure on the agricultural market organizations, the rural development measures that accompany market support and rural measures in some regions, certain veterinary expenditure and information measures relating to the CAP. The Guidance Section has been concerned with a socio-structural and rural development policy. It mainly focused on the improvement of farm and processing structures. This section has always represented a relatively small share of the budget of the CAP. This Fund is administered by the Commission and the Member States. The Fund Committee consists of representatives of the Member States and of the Commission. The Member States designate the authorities and bodies empowered to incur expenditure.

In 2005, the Agriculture Council agreed to bring different existing rules under a single Regulation. The new regulation creates two funds that will apply the same rules wherever possible: the European Agricultural Guarantee Fund (EAGF) and the European Agricultural Fund for Rural Development (EAFRD). It is hoped that this simplification will be useful for rural development as all rural development programmes will now be brought under one single fund (EAFRD), and governed by a single regulation, under a single programming, management and control system. The regulation will apply from 1 January 2007.

Even before the formation of the European Community, many European countries were practicing a variety of methods to support their farmers. These included supplements to market-determined prices, levies on imports, quantitative restrictions, direct income payments, export subsidies and input subsidies, etc. Under the CAP, price levels have been set for a range of agricultural commodities. A level of price, which should be attained under normal market conditions for a particular commodity, is referred as the *target price*. If prices of a commodity fall below a certain value, *intervention agencies* buy the farm products at the *intervention prices*. Major commodities covered by these prices are dairy products, cereals, rice, sugar, beef, veal, pork, sheep meat, some fishery products, vegetables and fruits. The mechanism is used in a variety of ways. The target price for beef, veal, wine, fish etc is called the *guide price*. The basis for calculating the price for pork, fruits and vegetable etc is called the *basic price*. At a price where certain commodities like fish, fruits and vegetables are withdrawn from the market are called *withdrawal prices*. Certain *threshold prices* are also set for imports of agricultural commodities. Below this price, these imports cannot enter the EU market.

Apart from these price supports, *direct subsidies* are given in the case of oilseeds, olive oil, tobacco and some other products. Further, *import barriers* prevent agriculture prices in the EU from falling to world levels. Apart from tariffs, a large number of non-tariff measures have also been used to protect EU farmers. Some agricultural products from developing countries do enter the EU market on preferential terms, but most of these tropical products do not threaten European farmers. To bridge the gap between the EU prices and world prices, many *export subsidies* are also provided to EU farmers.

9.4 BENEFITS AND COSTS

Some scholars believe that CAP is one of the most successful policies of the EU. It has fulfilled most of its initial objectives. The Union is self-sufficient in foodgrains. It is also the second largest exporter of agricultural products. Productivity in agriculture has increased tremendously and the sector has experienced greater modernization. It has prevented price fluctuations in agricultural products and protected rural lifestyle. Despite all these arguments, the CAP is also severely criticized on the following grounds:

- 1) **"Fortress Europe"**: The first major criticism of the CAP comes both from the supporters of globalization and from the anti-globalization activists. It is argued that the protected and subsidized agriculture in Europe has made the European continent a "Fortress Europe". Subsidized agriculture in Europe along with other Western countries and the United States creates unfair competition for the farmers in poor developing countries. On the one hand, Western countries protect their agricultural markets from imports

from developing countries, on the other hand, they damage markets in the developing world while trying to sell the oversupply of their agricultural products to these markets. In this way, they create unfair competition and increase poverty in the developing world. According to the United Nations Development Programme *Human Development Report 2003*, EU subsidized exports have contributed to the decline of dairy industries in Brazil and Jamaica and the sugar industry in South Africa (p. 155). It is calculated in the same report that in the year 2000, an annual subsidy per cow in the EU was US\$913. This compared to US\$ 490 per capita income average income in sub-Saharan Africa and US\$ 8 per person aid to sub Saharan Africa from the European Union (p. 155).

- 2) **High Food Prices:** Another major criticism is that price intervention through CAP causes high food prices throughout the EU. The high prices in Europe has encouraged farmers to produce much more than the demand. This has resulted in the EU's infamous wine lakes and butter and beef mountains. In these circumstances, the EU had to spend large amounts of money to buy this surplus output. This was either disposed off or was dumped into the world market through export subsidies. Even after many reforms the EU is still paying its sugar producers three times the world prices. Beef and poultry farmers get double the world market price. Similarly farmers in the EU get 30 per cent more price for pig meat and milk. The Organisation for Economic Cooperation and Development (OECD) estimates that extra cost to food in 2003 was Euros 55 billion. These artificially high prices are in fact hidden tax on the food, which according to the OECD, costs an average European family an estimated 500 Euros a year.
- 3) **Costly CAP leads to Misallocation of Resources:** The cost of CAP implementation is very high. In 2005, the EU spent about Euros 49 billion on the CAP. This was roughly 46 per cent of the total EU budget. In the contemporary world, the conditions, which led to the creation of, CAP no longer exist. It also leads to gross misallocation of EU resources, which otherwise could have been spent on some important sectors.
- 4) **Causes Conflict amongst Member States:** Since the agricultural sector is bigger in some countries like France and Spain, they receive more money under the CAP. Other countries have greater net contributions, such as Germany and the Netherlands. France is by far the biggest recipient of CAP funds. In 2004, it received 22 per cent of the total. Spain, Germany and Italy each received between 12 per cent and 15 per cent. UK, Greece and Ireland received 9 per cent, 6 per cent and 4 per cent respectively. Other 18 members got only about 18 per cent of the total CAP spending. As the policy benefits more to some countries, it has created many tensions within the EU.
- 5) **Inequitable System:** It is not only that the CAP favours some of the richest countries within the EU, it also disproportionately benefits large and rich farmers. According to some estimates, about 80 per cent of CAP payments go to the largest 20 per cent of farms. In France, the largest one per cent of farms receive more subsidies than the smallest 40 per cent of farms combined.
- 6) **Obstacle to Global Trade Deals:** Since working of the European agricultural policy is seen by most countries as a protectionist measure, the CAP price fixing is holding up global trade deals. In recent years, one of the major issue affecting global trade negotiations is the agriculture subsidy prevalent in the EU.

9.5 REFORMING THE CAP

Since the 1960's, it has been proved again and again that it is very difficult to reform the CAP. As a result, the basic instruments of the CAP remained largely untouched during the first three decades of its existence. The Mansholt Plan in the late 1960s was an idea to remove small farmers from the land and to consolidate farming into a larger, more efficient industry. These reform proposals were blocked by powerful lobbies. In the 1970s and early 1980s, no meaningful reform was introduced. Although a quota on dairy production was introduced in 1984 and a ceiling on EU expenditure to farmers was applied in 1988, the basics of the CAP remained in place. It was only in 1992 that some serious effort was made to reform the policy.

The MacSharry Reforms

The first major reform to the policy occurred as a result of the MacSharry reforms proposed in 1992 and implemented in 1994. Under this plan, policy makers were successful in reducing the level of support prices for a number of major commodities. Under the plan, the farmers were compensated for their loss in incomes by increasing direct payments. The central theme of the reform was a 30 per cent reduction in the cereal **intervention** price, phased in over three years (1993-95), together with smaller cuts in the institutional prices for beef and butter. These cuts in support prices were compensated by a per hectare payment in the case of cereals. Increased compensations were also provided for beef, cows and cattle. These reforms also introduced a set-aside scheme in the arable sector. This set aside land could be used for other purposes like afforestation and tourism. Some other proposals included an early retirement scheme for farmers over 55, subsidies for agriculture in less favoured regions and mountain areas and measures to combat frauds.

Agenda 2000: The Agenda 2000 was a response to the need to prepare the CAP for the future enlargement of the EU. Despite huge challenges, narrow national interests dominated the agenda. Although it basically promoted 1992 reforms, it provided some new objectives to the CAP. It gave more emphasis to environmental policy objectives and the multifunctional role of the European model of farming. At the practical level, it further reduced support prices for cereals and beef. In another major development, it introduced the idea of an integrated rural development policy as a **second** pillar of the CAP. This brought together the accompanying measures of the MacSharry reform plus compensatory allowances under the less favoured areas measure, as well as rural development measures into a single Rural Development Regulation. In addition, the Agenda 2000 established tight budgetary limits on EU agricultural spending.

2003 Reforms: Another major set of reforms in the CAP were resulted in 2003 during the midterm review of Agenda 2000. On 26 June 2003, EU Agriculture Ministers adopted a fundamental reform of the CAP. It was agreed that in future, the vast majority of subsidies will be paid independently from the volume of production. A limited link between subsidy and production under well defined conditions and within clear limits was allowed mainly to avoid abandonment of production.. These new **Single Farm Payments** were to be linked to the respect of environmental, food safety and animal welfare standards. It was thought that severing the link between subsidies and production would make EU farmers more competitive and **market-**orientated, while providing the necessary income stability. It was also agreed that more money will be available to farmers for environmental, quality or animal welfare programmes by reducing direct payments for bigger farms. In order to respect the tight budgetary ceiling for the EU-25 until 2013, Agriculture Ministers of member states also agreed to introduce a financial discipline mechanism. The different elements of the reform entered into force in 2004 and 2005. It was agreed that the Single Farm Payments will enter into force in 2005. If a Member State needed a transitional period due to its specific agricultural conditions, it could apply the Single Farm Payment from 2007 at the latest. These **decoupled** Single Farm Payments are based on the 2000-02 historical payments received by farmers. They replaced the compensation payments introduced by 1992 reforms.

9.5.1 The Reformed CAP

According to the Directorate of Agriculture and Rural Development of the European Commission, the key elements of the Reformed CAP are:

- 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 the 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 with more EU money, 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** per cent over four years, which is an additional price cut of **10** per cent compared to Agenda **2000**. For skimmed milk powder, a 15 per cent 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 introduced in the rice, durum wheat, nuts, starch potatoes and dried fodder sectors.

Concerning the implementation of the reform, the Commission has chosen to do this by way of three Commission Regulations. Regulation 1 covers the provisions concerning cross-compliance, controls and modulation. Regulation 2 covers the key elements of single farm payment. Regulation 3 covers those areas of support, which in the future are still product specific.

In June **2005**, the Agriculture Council agreed on a regulation on rural development support through European Agriculture Fund for Rural Development (EAFRD) for the next programming period (**2007-2013**). The programme has four major objectives:

- improving competitiveness of farming and forestry;
- improving environment and countryside;
- improving quality of life and diversification of the rural economy; and
- implementation of bottom-up development strategies of local action groups.

Sugar Reforms: Sugar, which is produced from sugar beet in the EU is heavily subsidised by the CAP. The EU is by far the largest sugar beet producer, with annual production of between **16 - 18 million** tons. Sugar was not included in the **MacSharry** reforms, or in the Agenda **2000** reforms. On **20 February 2006**, the Agriculture Ministers of the EU member states formally adopted a radical reform of the EU sugar sector. The sugar reform system will come into force on **1 July 2006**. This will bring the sugar system into line with the rest of the reformed CAP. The key to the reform is a cut in the guaranteed minimum sugar price, generous compensation for farmers and a restructuring fund . Under the agreement, the guaranteed price for white sugar will be cut by **36** per cent over four years. The farmers will be compensated for, on average, **64.2** per cent of the price cut through a decoupled payment - which will be linked to the respect of environmental and land management standards and added to the Single Farm Payment. Countries which give up more than half of their production quota will be entitled to pay an additional coupled payment of **30** per cent of the income loss for a temporary period of five years. A voluntary restructuring scheme will be established to provide incentives for less competitive producers to leave the sector. The intervention buying of surplus production will be phased out after four years.

9.6 ENLARGEMENT AND CAP

On **1 May 2004**, the EU admitted ten new members, viz. the Czech Republic, Cyprus, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, the Slovak Republic, and Slovenia.

The admission of these countries in the EU was bound to have an impact on the working of CAP because in most of them the contribution of agriculture to the GDP and the percentage of total employment in the agricultural sector were greater than the EU-15 average. With enlargement, a further 4 million farmers were added to the EU's existing 7 million farmers. The New Member States have added about **38** million hectares of utilized agricultural area to the existing **130** million hectares. Although the area increased by **30** per cent, while production in the EU expanded by about **10-20** per cent for most products, the gross value added of agriculture increased only by 6 per cent. These figures show that the new Member States still have a large agricultural production potential.

Most provisions regarding CAP were already negotiated with the New Member States. It was agreed that farmers from these countries will have immediate access to CAP market measures, such as export refunds,

and intervention mechanisms. Production quotas, reference yields and base areas were set for new Member States based on recent historical reference periods. Direct aid is phased in over ten years. New Member States will first receive 25 per cent of the full EU payment rate from the EU budget, rising gradually to 100 per cent by 2013. During the phase-in period, the ten new Member States may complement EU funds for direct payments by national contributions up to 55 per cent in 2004, 60 per cent in 2005 and 65 per cent in 2006 of the full EU-15 payment rate, and, from 2007, up to 30 per cent above the applicable phasing-in level for direct payments for the relevant year. The New Members have access to a rural development fund (for early retirement, environmental issues, poorest areas, and technical assistance) with a Euros 5 billion budget.

9.7 WTO AND CAP

Even though the recent reforms in CAP do not directly address trade in agricultural products, it is argued by many scholars that World Trade Organization (WTO) concerns played a significant role in the design of these reforms. It is becoming clear that the international environment and the WTO negotiations have been a major driving force for CAP reforms since the Uruguay Round. The WTO is becoming an engine of CAP reform because of its constant pressure to reduce tariff protection, eliminate export subsidies and provide domestic support in a minimally trade distorting way. It is also becoming an effective tool for overcoming resistance to reform by countries and lobbies within the EU. More importantly, it has provided a platform for developing countries to fight against perceived commercial domination by developed countries. In global trade negotiations, even the United States is trying to be one step ahead because of its flexible decision making structures. Through CAP reforms, the EU is trying to improve its position at trade negotiations. Although the European Union is trying to protect its agriculture through newly created arguments like the rural development, environment, food safety and animal welfare, etc., it is becoming difficult to defend the policy in a radically different global environment. The dispute settlement procedure under the WTO is also adding some extra pressure to CAP reform. For example in the case of sugar, the EU lost a WTO panel requested by Australia, Brazil and Thailand in 2005.

9.8 FUTURE TRENDS

In the contemporary environment, both external constraints and domestic opposition are preparing grounds for further reform of the Common Agricultural Policy. Major argument in favour of the policy is that this is the only policy that is genuinely common at the European level. The CAP budget, which consumes roughly half of the EU budget, constitutes only about 0.5 per cent of the EU GDP. Therefore, for a common European policy, this may not be particularly "excessive". Still there is a growing feeling within the EU that the amount of money spent on agriculture would be better spent in other sectors, such as a common policy for research and innovation. Similarly criticisms are also becoming loud because it principally **benefits** the biggest farms in the richest EU countries. More importantly, the policy is losing its purpose as Jack Thurston, a former adviser to the British Agriculture Minister, wrote recently: "Today's CAP is the outcome of historical compromises, not economic logic. Every time the EU has partially reformed the CAP, it has come up with a new reason for continuing the policy. Initially, the CAP was aimed at ending food shortages; then at supporting farmers; and more recently at protecting the environment." In spite of "all the reforms implemented since the 1990's" he adds, "the CAP remains largely what it was when it was first created: an EU-administered policy to reward large scale and resource-intensive agriculture production." Since this is now outdated, all the three components of CAP policy, namely price supports, direct payments to farmers and the rural development and conservation policy, is under scrutiny. In fact, the battle of CAP is turning into a proxy for a deeper debate on the future of Europe. The scheduled review of the CAP for 2008 may witness some serious confrontations in an increasingly diverse Europe.

9.9 SUMMARY

The Common Agricultural Policy was set up against a backdrop of food shortages following the war with the objectives of increased productivity, support for farmers and stable markets. It was based on the principles of a single market, community preferences and shared costs. It is operated through the Agriculture Council, Commission and local administrators. Farmers are subsidized through price supports, direct subsidies and

withdrawal prices. Although it has fulfilled its initial objectives, it is severely criticized for protectionism, high costs, high food prices, inefficiency and inequality. It benefits the biggest farms in the richest EU countries. To reform the policy various reforms measures like 1992 MacSharry reforms, Agenda 2000, 2003 reforms and sugar reforms are introduced. Integrated rural development policy is introduced as a second pillar of the CAP. The 2003 reforms introduced a new system of single farm payments (income support) and cuts the link between support and production (decoupling). Farmers will receive direct payments only if that they maintain their land in good agricultural condition and comply with the standards on public health, animal and plant health, the environment and animal welfare (cross-compliance). To finance the policy, a new institutional mechanism through European Agriculture Guarantee Fund and European Agricultural Fund for Rural Development will be implemented soon. Many of these reforms are introduced because of WTO pressures as well as internal criticism and enlargement.

9.10 EXERCISES

- Discuss the background and basic objectives of the CAP.
- Despite a huge success why the CAP is criticized?
- How farmers are supported through CAP?
- Write an essay on CAP reforms since 1992.
- Is WTO-led global trade environment responsible for CAP reforms?
- What are the prospects of further reforms in the CAP?

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