

French-German Economic Forum
9th meeting
June 25-26 2001

The Future of European Agricultural Policies

Winfried von Urff

1. Issues of the present debate

The Common Agricultural Policy (CAP) of the European Union (the European Economic Community at the time when it came into being) is a never-ending subject. On the one hand it was a driving force in the process of integration - although this role is often over-estimated – on the other hand it was a permanent source of conflict that sometimes brought the Community at the edge of collapse. In an area as densely regulated as agriculture, conflicts of national interests are quite natural. Underlying subjects were the level of protection and the way in which protection takes place, both affecting the agricultural sector of Member States in a different way, production quotas, common subsidies, national subsidies etc.. A major source of conflict that unduly dominated the debate during the 1970s and the 1980 was the system of Monetary Compensatory Amounts, strongly defended by Germany and attacked by others. A permanent issue for Germany is the distribution of financial resources brought about by the CAP in which Germany has the position of a net payer.

At the core of the present debate about the CAP is the question, whether the actual problems of BSE (Bovine Spongiforme Encephalopathie) and FMD (Foot and Mouth Disease) should be used for a fundamental reform, which is the official position of Germany, or more targeted measures should be implemented to directly treat these problems with some revisions but no fundamental change of the CAP, which seems to be the position of France. The direction in which Germany wants to see a fundamental change in the agricultural policy can be summarized as “greening” in combination with more emphasis on consumer protection and on social aspects (more support for organic farming, no large scale production, more employment in agriculture, more emphasis on animal welfare, high food safety standards) under the implicit assumption that there is a strong

positive correlation between the underlying objectives¹. One possible way to bring about the desired changes is seen in re-assigning more responsibility to the national or to the regional level, simplified as “re-nationalisation” of agricultural policy, another alternative being a change of the CAP towards the new priorities (or a combination of both). From the German point of view “re-nationalisation” would have the advantage of reducing Germany’s net-payer position. France is against “re-nationalisation” and against drastic changes, arguing that the CAP after the Agenda 2000 decisions offers sufficient possibilities to take ecological and social aspects into account by “cross compliance” and “modulation” both used in France but not in Germany. One should, however, also not forget that France is among the winners of the financial redistribution resulting from the CAP in its present form and therefore will lose advantages if fundamental changes take place.

The following paper tries to analyse the chances and limitations of a re-allocation of responsibilities in agricultural policy between the EU and Member States and to change the content of agricultural policy in connection with such a re-allocation. This is done in the light of the historical evolution of the CAP, with particular emphasis on the 1992 reform and the Agenda 2000, taking into account the international framework set by the results of the Uruguay-Round and the ongoing WTO negotiations as well as the requirements of the eastward enlargement of the EU.

2. Is re-nationalisation an option? - Lessons thought by history

As a point of departure it may be helpful to go back in history to the time when the European Economic Community was established. If preliminary considerations included the idea to exempt agriculture from the Common Market such idea was dropped very soon, primarily for two reasons. One reason was the impossibility to differentiate between agricultural and industrial commodities. Food is mostly traded in processed form, i.e. as an industrial commodity. It would have been completely unrealistic to have a common market that included food but excluded the primary agricultural products used as raw material for food commodities, thus allowing Member States to stabilise agricultural commodity prices at different levels by national interventions. Another reason was the vital interest some of the founding members had in a common market for agricultural products. Besides the Netherlands, a major exporter of animal products, France showed such an interest. The

¹ Bundesministerium für Verbraucherschutz, Ernährung und Landwirtschaft: Agrarbericht der Bundesregierung 2001.p.9/10.

agricultural sector played an important role within the French economy, making France to expect a lot from unrestricted trade within the Community, whereas the French industry felt threatened to be exposed to competition by the strong German industrial sector. In Germany it was the other way round. Industrialists were looking forward to the common market with great expectations, whereas farmers had the feeling of being sacrificed for the sake of overall economic growth. Even at present one sometimes gets the impression that this constellation still prevails in the minds of some of the actors.

Given the situation just outlined it was quite logical that Art. 38 of the Treaty of Rome (Art.32 after the revision of Amsterdam) clearly states that the Common Market includes agriculture and trade in agricultural commodities. It continues by stipulating, that the creation of the Common Market should go hand in hand with the introduction of a Common Agricultural Policy. For other sectors of the economy common policies are not mentioned. The special treatment of agriculture is due to the fact that in the national policies of all founding members the agricultural sector was largely exempted from the market economy by sophisticated systems of regulations and interventions, which gave national agricultural policies a special role. The Treaty of Rome implied a continuation of such situation. Art.39 (now Art.33) defines the objectives of the CAP, that include increased productivity in agriculture as a means to allow people working in agriculture an adequate standard of living, market stabilisation, assured availability of food and supply to the consumers at adequate prices. With regard to market regulations three options were offered by Art.40 (now Art.34): (1) coordination of national market organisations, (2) common rules for competition, and (3) common market organisations. Experience showed that for practical reasons only option 3 was feasible, given the intensity and the complexity of market interventions that already existed within the Member States.

The Common Market Organisations that form the core of the CAP were designed and implemented between 1962 and 1969. They were built on three principles: (1) free movement of goods within the Community, (2) preference for production within the Community against imports, and (3) common financial responsibility.

In most of the market organisations prices (target prices) are fixed annually by the Council of Ministers and to a large extent guaranteed to the producers by an intervention mechanism. Quantities that are not absorbed by the market can be sold to intervention offices at intervention prices that are

also fixed annually by the Council of Ministers. During the last decade the mechanism, that formerly offered complete protection to the producers, was modified by making intervention purchases dependent on the condition that the market price dropped below specified levels and by lowering the prices paid for interventions below the official intervention prices. In the market organisation for sugar the price guarantee was limited to specific quotas from the beginning, in the market organisation for milk a similar system was introduced in 1984. The intra community price level was protected against the world market by variable levies (the importer had to pay the difference between the world market and the internal price). As a result of the Uruguay-Round of the GATT the variable levies were converted into tariffs in 1995. In order to allow exports on the world market at prices below the internal prices export restitutions are paid, whose amount roughly corresponds to the import tariffs. Some of the market organisation, including those for poultry meat, pig meat and several varieties of fruits and vegetables, do not include interventions or limit them to extraordinary situations. For perishable commodities, which cannot be stored, quantities purchased through intervention can either be processed (e.g. wine to alcohol, often not for human consumption), distributed to charitable organisations or destroyed which creates high costs and problems of acceptance. Other market organisations like those for olives, tobacco, durum wheat and (since the reform of 1992) oilseeds include direct payments as a means to increase farmers' income putting the financial burden on the taxpayer instead of the consumer. The same principle was applied in the common market organisations for hops, flax, cotton, silk worms, and seeds, all products of minor general importance but for various reasons important enough to justify an interest of the Community to prevent a discontinuation of their production².

It seems self-evident that in a single market in which on the one hand the principle of free movement of commodities is guaranteed, whereas producers are heavily protected against outside competition and their income is largely influenced by price support and by direct payments the options offered by Art. 40 (now Art. 34) other than common market organisations are infeasible. This part of the CAP does therefore not allow re-nationalisation. That past decisions of the Council of Ministers do not exclude to revert to the other options mentioned in Art.40 is true from a juridical point of view³ but

² V. Urff, W.: Agrarmarkt und Struktur des ländlichen Raumes, in: Weidenfeld, W. (Ed.): Europa-Handbuch, Bonn 1999, P.445-461.

³ Seidel, M.: Rückführung der Landwirtschaftspolitiken die Verantwortung der Mitgliedstaaten? Rechts- und Verfassungsfragen des Gemeinschaftsrechts, Zentrum für Europäische Integrationsforschung, Policy Paper B00-17, Bonn 2000.

from a practical point of view it seems impossible. Politicians who advocate for re-nationalisation of agricultural market and price policy do not acknowledge the lessons toughed by history.

3. The principle of common financial responsibility – How to deal with its implications?

A question closely related to re-nationalisation is that of co-financing the expenditures originating from the market and price policy that sometimes seemed to dominate the debate in Germany and created a lot of tensions within the Community.

Parallel to the implementation of the common market organisations the European Agricultural and Guarantee and Guidance Fund (EAGGF) was established in order to finance the costs originating from the market organisations. This is completely done by the Guarantee Section of the EAGGF. The Guidance Section was established in order to co finance structural measures within the Member States. In the beginning the EAGGF absorbed more than 70 p.c. of the EEC budget because there were no other common policies leading to expenditures. In 2000 total expenditures of the EAGGF were 45.5 billion Euro (40.4 billion for the Guarantee Section and 5.1 billion for the Guidance Section), still 51 p.c. of the EU budget⁴. Besides the importance of the total amount the distributional effect of the market and price policy is the object of strong criticism. In 1999 an amount of 10.0 billion Euro of the Guarantee Section originated in Germany whereas expenditures in Germany were only 5.7 billion Euro resulting such in a German net contribution of 4.3 billion Euro. Other net payers were the UK, the Netherlands, Austria, Sweden, Finland, Belgium, and Italy. Net beneficiaries were Denmark, Greece, Spain, Ireland, Portugal and France⁵. The main criticism is that the distribution effects do not follow the principle that comparatively rich countries support poor countries, but are accidental, sometimes benefiting rich countries with a strong agricultural sector.

It is not surprising that most criticism comes from Germany. Following German requests in the past several models were calculated and discussed within the political bodies but without results. The

⁴ Bundesministerium für Verbraucherschutz, Ernährung und Landwirtschaft: Agrarbericht der Bundesregierung 2001, p.91.

general answer to the German plea for co financing the market expenditure was that the financial burden resulting from jointly decided policies has to be financed jointly. Moreover one has to take into account that the incidence of expenditures of the market and price policy is not as straightforward as they seem to be. If surpluses are withheld from the market by interventions and thus prices stabilised, the beneficiaries are all farmers who produce the respective commodity within the single market and not only those of the county in which the intervention actually takes place. If surpluses are limited by exports with the help of export restitutions the beneficiaries are European farmers and not the country in which the exporter resides.

4. Changes brought about by past reforms

By the CAP reform of 1992, the so-called MacSharry reform, the level of price support for major commodities was reduced (for cereals by 33 p.c., for beef by 15 p.c. over a period of three years) and per hectare or headage payments introduced or increased in order to compensate farmers for the income effects of price cuts. The compensation payments were calculated in such a way that on average full compensation was achieved, except for beef where upper limits for the number of animals per farm and for the stocking density were introduced with the effect that farmers received premiums only for a part of the cattle they kept for fattening⁶. From a budgetary point of view the reform led to the result that the costs for market interventions decreased from 95 p.c. of the total expenditure of the Guarantee Section of the EAGGF to about 50 p.c. and the amount of direct payment from 3 p.c. to 45 p.c. the rest being expenditures for agro-environmental programs.

The shift from market interventions to direct payments will continue following the decisions of the Agenda 2000. The negotiations and the tensions coming up within the process are certainly still fresh in everybody's memory⁷. On the German side the net-payer position was one of the issues, on the French side it was the wish to shield agriculture against too drastic changes. The EU was under the pressure to honour the commitments of the Agreement on Agriculture of the Uruguay-Round and to

⁵ Bundesministerium für Verbraucherschutz, Ernährung und Landwirtschaft: Agrarbericht der Bundesregierung 2001, Annexe, p. 81.

⁶ Bulletin der EU 5 (1992) p.55.

⁷ v. Urff, W.: Agrar- und Fischereipolitik, in: Weidenfeld, W. / Wessels, W.(Eds): Jahrbuch der Europäischen Integration 1998/1999, p.125-134.

prepare the ground for the WTO-negotiations starting in November 1999. The Heads of State wanted to limit EU expenditures, particularly those for the CAP and of the structural funds. Decisions had to take into account the requirements originating from the eastward enlargement of the EU. Fundamental decisions were taken at the Berlin Summit of 24/25 March 1999 and later on converted into a series of regulations by the Council of Ministers on 17 May 1999.

Concerning the common market organisations it was decided to reduce the level of support prices for cereals by 15 p.c. over two years and to increase the per hectare payment in a way that compensates 50 p.c. of the income effect of price cuts. The per hectare payments for oilseeds, that were about 35 p.c. higher than those for cereals, will be reduced to the same level over a period of three years. For beef the level of support prices will be reduced by 20 p.c. in three annual steps and the headage payments increased accordingly, but also in this case - except for suckler cows - full compensation will not be achieved even with the inclusion of slaughter premiums which were introduced as a new element. The ceiling of 90 animals per farm was abolished. Its re-introduction is one of the issues presently debated. For milk the quota system was extended until 2006. A further extension of the system will depend on a mid-term review in 2003. The quotas were increased by specific amounts for Greece, Spain, Ireland, and Italy and by 1.5 p.c. over a period of three years, for all other Member States. Beginning in 2003/04 the support prices for milk will be reduced by 15 p.c. over a period of four years and compensation payments based on the milk quota per farm will be introduced and increased correspondingly. They will, however, compensate only 40 p.c. of the effects of price cuts. Another 20 p.c. may be compensated by lump sum amounts put at the disposal of the Member States who will be free to distribute them, as they consider appropriate⁸.

The increasing importance of direct payments in comparison to the costs of market interventions has initiated a debate whether these payments could and should be co financed by the Member States, for which Germany strongly advocates. The main argument is that in contrast to market interventions these payments directly benefit farmers within the respective Member States. It would therefore be fair – so the argument – to put part of the burden on the national budgets. Among the German “Länder” Bavaria goes further by arguing that even the amount of the compensation payments should

⁸ Deutscher Bauernverband: Situationsbericht 2000. P.92-109.

be left to the decision of national or regional authorities allowing them thus to maintain small farms under unfavourable conditions if they give high priority to traditional farm structure and are prepared to pay for it in addition to EU payments.

One may, however, have serious doubts whether such nationally co financed or national payments are feasible from a juridical and a political point of view. Would it really be possible that the Council of Ministers decides on the level of payments, which have partly to be paid by the Member States? Most probably the answer is no⁹. Would it be possible that EU compensation payments are topped-up by national payments? Does this not imply a violation of the principle that national subsidies, which may distort competition, are forbidden? With the help of national payments more farms are kept in production than would have been otherwise which makes economic survival more difficult for farms in other Member States. In order to allow national payments their character must be different from the compensation payments introduced by the CAP reform of 1992 and increased by the Agenda 2000.

Of basic interest are two possibilities introduced by the so-called “Horizontal Regulation” as part of the Agenda 2000. Member States are permitted to reduce the level of compensation payments for a farm if (1) the number of work units is lower than a certain level, (2) farm income exceeds a certain level, or (3) the total amount of compensation payments exceeds a certain amount (“modulation”). Member States also have the possibility to link compensation payments to environmental standards and to reduce their level in accordance with the degree of violation of these standards including non-payment in severe cases (“cross compliance”). The total amount saved by modulation and cross compliance is available for agro-environmental programs, which are nationally co financed. Contrary to France and UK, Germany has so far not yet used these possibilities but obviously the present Minister of Consumer Protection, Food and Agriculture wants to make use of them as part of a new policy. Co-financing was a problem not least because of the financial burden resulting from BSE and FMD but this problem seems to be solved after an intervention of the German Chancellor.

⁹ Seidel, M.: Rückführung der Landwirtschaftspolitik in die Verantwortung der Mitgliedstaaten? Recht- und Verfassungsfragen des Gemeinschaftsrechts, Zentrum für Europäische Integrationsforschung, Policy Paper B00-17, Bonn 2000.

5. Agro-environmental measures

Agro-environmental measures are a more and more important element of the CAP. They are a reaction to the fact that modern highly intensive farming may cause environmental damages such as percolation of plant nutrients (primarily nitrate) and chemicals into the groundwater, loss of natural and semi-natural habitats, loss of bio-diversity, erosion, soil compaction etc. At the first time the “Efficiency Regulation” of 1985 introduced the possibility for Member States to pay premiums to farmers for environmentally friendly farming practices. They were subjected to strict rules in order to prevent that they became national subsidies of a competition distorting nature. Later on the Community decided to co finance such premiums.

In the context of the CAP reform of 1992 so-called “accompanying measures” were introduced consisting of agro-environmental measures, an early retirement scheme, and an afforestation programme. All these measures are co-financed by the EU and Member States, normally on a 50 to 50 basis. Most important of them is Regulation 2078/92 concerning agricultural production methods that are in line with environmental requirements and protect natural habitats. It stipulates that programmes designed by member states and accepted by the Commission may include granting premiums to farmers who on a voluntary and contractual basis undertake:

- to reduce substantially, or maintain a reduction, in the use of fertilisers and /or plant protection products, or to adopt or continue with organic farming production methods;
- to change to, or maintain, more extensive forms of crop production, or to convert arable land into extensive grassland;
- to reduce the stocking rate of sheep and cattle per forage hectare;
- to use other farming practices compatible with the protection of the environment and natural resources, as well as the maintenance of the countryside and the landscape;
- to rear animals of local breeds in danger of extinction or plants endangered by genetic erosion;
- to maintain abandoned farmland or woodland for reasons of environmental protection;
- to set aside farmland for at least 20 years with a view to its use for purposes connected with the environment, in particular for the establishment of biotope reserves or natural parks for the protection of hydrological systems:

- to manage land for public access and leisure activities.

Farmers participating in the scheme are paid in compensation for the associated loss of income plus an incentive, which should not exceed 25 % of the premium. For each kind of activity upper limits for the premiums are defined by the Regulation. The premiums are paid on an annual basis. The scheme requires that farmers commit themselves for a period of five years except for the set-aside scheme, where the period is twenty years. The Regulation offered different forms for implementing agro-environmental programmes, which were used by the Member States in different ways.

Taking into account the different ways in which the Member States made use of the opportunities offered by Regulation 2078/92 it is no surprise to see large differences in the allocation of EU-contributions between Member States. The lion's share went to Germany, followed by France, Austria and Italy. Greece, Belgium and Denmark are countries whose share did not exceed 1%. By and large the programme was quite successful. It was largely accepted by farmers and for the period 1994-1999 the average annual amount spent out of the EU budget was nearly 0.9 billion ECU¹⁰. The Agenda 2000 offers the possibility to continue agro-environmental schemes along the same lines within a different institutional arrangement. Member States who want to give more emphasis to environmental aspects have the opportunity to do so.

6. Structural Policies

Compared to the market and price policy structural policies receive less recognition in the public debate which is a wrong perception taking into account the real importance this part of the CAP has. From the outset policy makers were aware that the creation of the Community, changing technology in the agricultural sector and rising real income in other sectors, would demand substantial structural change in farming. In the early years, i.e. from 1962 to 1972 the Common Agricultural Policy limited itself to co-ordinating and supplementing national structural policies. In the light of the Mansholt Plan of 1968 a more active approach to structural policies was adopted. The Community began to co-finance certain measures of the Member States, provided they fulfilled certain conditions laid down in

¹⁰ Schramek, J. / Biehl, D. / Buller, H. / Wilson, G. (Eds.): Implementation and Effectiveness of Agro-environmental Schemes Established under Regulation 2078/92, Final Consolidated Report, Frankfurt, June 1999.

common directives or regulations. Most of these measures aimed at structural improvements in farming including small scale processing and marketing of farm products. Horizontal measures applicable in all Member States, such as modernisation of farms, re-training of farmers and supports to help older farmers to retire were introduced by the so-called structural directives (Directives EEC 159 to 1961 of 1972). They were complemented in 1975 by the Directive EEC 268/75 on mountain and hill farming and farming in less favoured areas.

A fundamental change was brought about in 1988 by the decision laid down in Regulation (EEC) 2052/88 to bring together the three major structural policy instruments, the European Regional Development Fund (ERDF), the European Social Fund (ESF), and the Guidance Section of the EAGGF. The resources made available to the structural funds were doubled in real terms from seven billion ECU in 1989 to 14 billion ECU in 1993. For interventions of the structural funds the following objectives were defined:

- Objective 1: Promoting the development and structural adjustment of regions whose development is lagging behind;
- Objective 2: Converting the regions seriously affected by industrial decline;
- Objective 3: Combating long-term unemployment and facilitating the occupational integration of young people and of persons threatened by exclusion from the labour market;
- Objective 4: Facilitating the adjustment of working people to industrial changes and changes of production systems;
- Objective 5a: Speeding up the adjustment of agricultural structures to the reform of the CAP,
- Objective 5b: Facilitating the development and structural adjustment of rural areas.

Three of the six objectives refer to agriculture itself or regions, where agriculture has an above average economic and social weight. Objective 1 supports the development of - mainly - rural areas, which substantially lag behind the Community's average gross domestic product per capita. Regions eligible for objective 1-support were Greece, Ireland and Portugal in total und Northern Ireland large parts of Spain and southern Italy. In 1994 the new Länder of Germany (the former German Democratic Republic) also became eligible for objective 1-support. Objective 5b supported the development of rural areas, characterised by an above average proportion of people employed in agriculture, a below average gross value added per labour unit in agriculture, and a relatively low gross domestic product per capita. Objective 5a included the so-called "horizontal structural

measures“, i.e. all activities destined to facilitate and accelerate structural adjustments in agriculture without regional limitation. Out of the total financial resources of 58.3 billion ECU provided for the Community's structural funds for the years 1989-93, more than 64 p.c. were assigned to objective 1, about 6 p.c. to objective 5a and 5 p.c. to objective 5b¹¹.

At the Edinburgh summit in December 1992 the European Council decided that between 1993 and 1999 a total amount of 176.4 billion ECU should be assigned to the structural funds. This provided an annual average of 25.2 billion ECU compared with an annual average of 13 billion ECU between 1988 and 1992 (both at 1992 prices). The objective structure remained unchanged and the percentage amounts allocated to the various objectives by and large corresponded to those of the previous period. Following the accession of Austria, Sweden and Finland in 1995 a new objective 6 was introduced providing support similar to that of objective 1 in certain areas in the northern parts of the Scandinavian countries with extremely low population density.

In the Agenda 2000 particular emphasis was given to economic and social cohesion. This was underlined by the proposal to allocate a portion of the Community's budget to structural policies corresponding to 0.46 % of the Member States' gross national product throughout the whole period. This would have meant an amount of 275 billion Euro for the years 2000 to 2006 or 75 billion Euro more than the amount of 200 billion Euro that was available for the period 1993 to 1999 (both at 1997 prices). Out of that total an amount of 45 billion Euro should have been earmarked for the accession countries of Central and Eastern Europe, leaving for the EU-15 an amount of 230 billion Euro¹². The Berlin Summit did not entirely follow the Commission's proposal but reduced the total amount to 258 billion Euro, thus making 213 billion Euro available for the EU-15.

Following the Commission's proposal the number of objectives was reduced from 7 to 3. Among this three objective 1 remained more or less unchanged. The regions lagging behind in development and thus facing most serious difficulties were given the same priority as in the past. About two thirds of the total amount were allocated to this objective. In future, however, the threshold of a per capita

¹¹ European Commission, Directorate-General for Agriculture: Rural Development, CAP 2000, Working Document, Brussels 1997.

¹² EU-Kommission: „Agenda 2000. Eine stärkere und erweiterte Union“, Bulletin der EU, Beilage 5, 1997.

income of 75 % of the Community average should be applied more strictly. By this the population living in areas eligible for objective 1 will be reduced from 25 to 20 p.c..

The newly defined objective 2 „economic and social restructuring“ brought together measures for other regions suffering from structural problems. These are areas undergoing economic change (in industry or services), declining rural areas, crisis-hit areas dependent on the fishing industry or urban areas in difficulty. All these areas are facing structural problems resulting from economic restructuring such as high rates of unemployment or depopulation. The new programmes to support the objective 2 areas, to which 11 p.c. of the total financial means were allocated, will favour economic diversification, particularly in regions heavily dependent on a single economic sector. As compared with the previous objective 2 covering an area in which 16 p.c. of Europe's population were living and objective 5b-regions with 9 p.c. of the population the new objective 2-regions will only comprise 18 p.c. of the population (5 p.c. within the rural areas). A new objective 3 will be introduced for regions not covered by objectives 1 and 2 to develop human resources.

In connection with the proposed changes for the Common Market Organisation the Commission acknowledged that these would affect not only agricultural markets but also rural areas and local economies, of which many were already confronted with acute economic problems. On the other hand the Commission saw an increasing importance of environmental and recreational needs that would offer new development opportunities from which farmers and their families should be able to benefit. The Commission suggests that these developments should be encouraged and supported by the following reorganisation of the existing rural policy instruments¹³:

- Existing accompanying measures financed by the EAGGF, Guarantee Section (agro-environment scheme, afforestation, early retirement) should be supplemented by the Less Favoured Areas scheme including its application in the objective 1 regions and implemented horizontally in a decentralized way.
- For those rural areas, which are located in objective 1 regions, the current approach of integrated development programmes should be maintained.
- In rural areas eligible under the new objective 2, operations (formerly objectives 5a and 5b) will be financed by the EAGGF Guarantee Section as accompanying measures together with measures of other structural funds within the same region.

¹³ EU-Kommission: “ Agenda 2000. Eine stärkere und erweiterte Union“, Bulletin der EU, Beilage 5, 1997.

- In all rural areas outside objective 1 and the new objective 2, rural development measures to accompany and complement market policies will be co-financed by the EAGGF Guarantee Section. They will embrace all types of measures supporting structural adjustment and rural development as presently co-financed by the EAGGF Guidance Section. Included into the same legal framework as the present accompanying measures, they will be applied horizontally and implemented in a decentralised way at the appropriate level, at the initiative of Member States.

The Berlin Summit followed the Commission's proposal and based on that decision the Council of Ministers adopted on 17 May 1999 the Regulation No 1257/99 on Promoting Rural Development, which is considered as the „*second pillar*“ of the CAP and to which 30 billion Euro were allocated for the period 2000-2006 within the Guarantee Section of the EAGGF.

7. Why does the CAP has to continue to evolve?

The previous sections of this paper have shown a remarkable evolution of the CAP from a set of market organisations to complex and comprehensive policy with an increasing emphasis on environmental aspects on rural development. The question therefore arises whether the heated debate about the future of the agricultural policy is justified and whether the CAP really needs fundamental changes? Only if the answer to these questions is yes one can tackle the question into which direction changes should go.

The reasons why changes in the CAP are needed are manifold¹⁴. The following seem to be the most important ones:

There is a continuing and perhaps even growing *domestic dissatisfaction* with the CAP. Consumers are more and more concerned about *food safety* particularly after the incidence of BSE and FMD. One may argue that from a scientific point of view food has never in history been safer than at present but the perception of the public at large is completely the other way round. There is

¹⁴ European Commission, Directorate-General for Economic and Financial Affairs: Towards a Common Agricultural and Rural Policy for Europe, European Economy, Reports and Studies No. 5, 1997.

the general suspicion that intensive production is itself a threat to food integrity and food safety¹⁵. Availability of food is taken for granted and food prices that are at a historically low level are not a major issue in public awareness. That there are environmental problems caused by agriculture is beyond dispute. There is a fundamental conflict between many systems of intensive crop and animal production and many aspects of the environment. The impact of agro-environmental measures is by far less than what environmentalists want to see. Animal welfare is also a growing concern for many people mostly seen in connection with the number of animals kept on a farm and the intensity of production. Farmers are frustrated because the CAP failed in achieving its aim to enable farmers to earn an income that by and large reflects the general income development and allows them a standard of living comparable to other groups of the society. Moreover they feel discriminated by the visibility of the compensation payments and discouraged by increasing restrictions on farming practices for environmental reasons. European citizens, first of all politicians, are concerned about the high expenditures of the CAP, that – despite the upper limit of 40.5 billion per annum (at 1998 prices) imposed by the Berlin Summit - still absorb 51 p.c. of the EU budget. Economists regret the low efficiency of these expenditures and the misallocation of resources resulting from distorted incentives. Public expenditures and transfers from consumers resulting from price support exceed the income effect of policy measures for European farmers, primarily because of the low efficiency of export subsidies, by which consumers in the countries that import EU surpluses are subsidised. Efficiency of the CAP is also less than satisfactory with regard to the development of rural areas. Many rural areas are still lagging behind in economic development despite high CAP expenditures, due to the fact that these expenditures are not adequately geared to development purposes but largely distributed depending on the volume of production. It is largely felt that the unsatisfactory results are related to a wrong allocation of responsibilities: too much centralisation and too little responsibilities assigned to the national and the regional level.

Another important reason for having a critical view on the present CAP and looking for more options is the *eastward enlargement of the EU*. As in previous enlargements the accession countries will have to accept the „acquis communautaire“. If this includes the CAP in its present form, additional surpluses of some major agricultural products would be the result. To dispose these surpluses on the

¹⁵ European Commission, Directorate-General for Economic and Social Affairs: Towards a Common Agricultural and Rural Policy for Europe, European Economy, Reports and Studies No. 5, 1997.

world market would be difficult because of the restrictions on subsidised exports resulting from the Agreement on Agriculture of the Uruguay-Round. The permitted quantities that the accession countries will add to those of the present EU are small in relation to their production potential. Additional export restitutions require additional financial resources thus opening the question whether the financial ceilings that were part of the Berlin decisions would be sufficient to allow the accession of the Central and Eastern European Countries. To avoid increasing problems of surplus disposal a strict application of supply controls might become necessary. In the case of sugar and milk the debate on the quotas to be allocated to the accession countries has already started. These countries demand quotas that take into the account their production potential on the basis of historical levels of production before the collapse of the socialist system, whereas the EU tries to orientate the quotas on the much lower present production. Most controversial is the issue of direct payments. Whereas the EU argues that these payment are nothing else than compensations for price cuts as part of the 1992 CAP reform and the Agenda 2000 and therefore not applicable to the accession countries, these countries argue that they have become an essential element of the CAP and can therefore not be denied to the accession countries. They violently reject what they call second-class citizenship. In order to facilitate eastward enlargement it has to be explored whether a different mix of policy measures within a revised CAP would be more appropriate.

Among the reasons for a revision of the CAP the **WTO negotiations** should not be neglected. In the Agreement on Agriculture of the Uruguay-Round the EU accepted (1) to reduce its internal level of support by 20 p.c. as compared to 1986-88 over a period of six years, (2) to replace variable import levies by tariffs and to reduce the level of protection by 36 p.c. within the same period, (3) to reduce the amount of export subsidies by 36 p.c. and the quantities exported with the help of export restitutions by 21 p.c., (4) to open up a minimum accession to the internal market of 3 p.c. of domestic demand at the beginning, increasing to 5 p.c. at the end of the transition period, (5) to subject its area under oilseeds to a ceiling of 5.128 million hectares and to sanction production exceeding the ceiling by premium reductions¹⁶. It is only now at the end of the transition period that some of the restrictions start to become binding. The EU has, however, to be aware of the necessity to honour these commitments in the future, which may require additional actions to prevent production from increasing beyond levels in line with exports within the agreed limits.

¹⁶ V. Urff, W.: Agrarmarkt und Struktur des ländlichen Raumes, in: Weidenfeld W. (Ed.): Europa-Handbuch, Bonn 1999, p.445-461.

Part of the Agreement on Agriculture was the decision to start new negotiations early enough before the end of the so-called peace clause at the end of 2003 in order to reach an agreement for the following period. These negotiations were due to start in 1999, which they did with the Ministerial Meeting of Seattle at the beginning of December. That the meeting ended with a complete failure does not mean an end of the process. Practical work started at the working group level and it became clear very soon, that there is a strong pressure on the EU from the United States and the Cairns Group (a group countries interested in agricultural exports) to further reduce and in the long-run abolish export subsidies, to reduce the level of support and to increase market access.

The EU was partially successful in introducing the concept of multifunctional agriculture also called the European model of farming. It emphasizes the functions of agriculture in addition to food production such as preserving the cultural landscape and contributing to the economic and social viability of rural areas. In the beginning it was strongly rejected by the Cairns Group who suspected a new justification for subsidies but finally it was at least accepted to include non-trade concerns into the negotiations.

How to change the CAP in order to respond to the new challenges?

From price support to market stabilisation

Art 39 of the Treaty of Rome mentions market stabilisation as one of the objectives of the CAP, which means protection of producers (and consumers) against overly and unnecessary price fluctuations. In the course of time this has become price support, which means that producer prices were fixed above equilibrium prices and interventions and export restitutions were used to enforce the desired price level. Price support was the most important means to achieve a certain level of farm income, which became more and more costly and less efficient. With the CAP reform of 1992 direct payments were introduced as a more efficient means to influence farm incomes and price support was decreased. The Agenda 2000 was a second step in the same direction. There is certainly scope for further steps. If the WTO negotiations lead to further restrictions and in the long run a ban on export subsidies import tariffs will become the only instrument to defend the level of internal prices. For commodities that EU farmers cannot produce at the world market price the quantity produced

will not exceed domestic consumption and the internal price be determined by the equilibrium between supply and demand. Market interventions will have to be limited to stabilisation. Farmers will have to continue to increase production productivity. Food prices will decline. Food safety and environmental aspects will be taken care of by regulations to the extent necessary without jeopardizing competitiveness. For the support of farm incomes other measures will have to be used.

The future role of compensation payments

A crucial question of the evolution of the CAP is that of the future scope and role of the compensation payments the central elements of the reform of 1992 and the Agenda 2000. It goes without saying that they will have to be maintained for some time for the reason of protection of confidence. Farmers have made decisions, for example investment decisions, confident that the economic environment determined by policy parameters will continue for a foreseeable future, and it would therefore be unfair to suddenly expose them to the effects of drastic policy changes. The validity of this argument has, however, a time limit; it cannot last forever. The longer the policy change took place back in history, the more difficult it becomes to justify compensation payments that have the only justification to compensate farmers for the income losses originating from price cuts as a result of policy change. There is therefore a tendency to use cross compliance and modulation to make compensation payments more acceptable.

From a logical point of view it seems, however, better to consider compensation payments and payments to farmers for other services such as preserving bio-diversity or maintaining the cultural landscape as two different instruments. Instead of linking compensation payments for price cuts to environmental conditions, which was not the case when they were introduced, a clear distinction should be made between compensation payments strictu sensu and payments for other services. The first ones should be phased out over a specified period of time in a clearly defined manner, the second ones should be phased in by broadening the scope of already existing programmes and allocating more money for this purpose. With regard to the eastward enlargement it may be acceptable for the accession countries to see farmers in the present EU receiving compensation payments for a limited time and in decreasing order of magnitude knowing that they fully participate in all programmes aiming environmental protection and rural development.

Strengthening of the „Second Pillar“

As described earlier in this paper rural development was an integral part of the CAP from the very beginning and environmental policy became one of its components when negative impacts of highly intensive farming could no longer be neglected. In the course of time both components became more and more important. Functions of agriculture in addition to food production are sometimes even more important than food production itself¹⁷. The Agenda 2000 brought these two elements together in the Regulation on Promoting the Development of Rural Areas. It includes the activities introduced as „accompanying measures“ by the 1992 reform, i.e. agro-environmental schemes, early retirement, and afforestation, measures for less favoured areas, adjustment of production and processing structures in agriculture and forestry (former 5a-measures), development of rural areas (former 5b-measures) and a long list of new measures including soil melioration, consolidation of farms, marketing of quality products, village renewal, improvement of living conditions in rural areas, protection and preservation of rural heritage, diversification of agricultural and non-agricultural activities, improvement of rural infrastructure, promotion of tourism and handicraft. The new regulation offers a broad spectrum of activities out of which national and regional authorities can select and combine those that they consider most appropriate to achieve their objectives of rural development and environmental protection. All these measures are co financed by the Guarantee Section of the EAGGF at a rate of 50 p.c.

The concept, to offer a broad list of optional measures to national or regional authorities thus giving them the possibility to choose and to design tailor-made programmes for specific regions according to their priorities and their willingness to co-finance such programmes exactly corresponds to the principle of subsidiarity. If unnecessary bureaucracy in the decision making process can be avoided it is difficult to see a need for re-nationalisation, if one accepts the principle that a common framework is necessary to avoid distortion of competition and to execute financial solidarity less wealthy countries and regions within the Community. The latter is of particular importance for the Central and Eastern European Countries. These countries certainly have a need for rural development and environment protection but their own budgets will not allow financing the necessary measures. Since probably many of their rural areas will be classified as objective-1-regions the respective measures

¹⁷ Akademie für Raumforschung und Landesplanung: Regional Aspects of Common Agricultural Policy: New Roles for Rural Areas, Hannover 1996

will be co financed by the EU at a rate of 75 p.c. Channelling funds into development measures will be more appropriate than paying farmers compensation payments on the basis of historical production.

Concerning the evolution of the CAP the most appropriate way would be to strengthen the “second pillar“. Such strategy can make a major contribution to the development of rural areas, for which there is a real need in many European countries. The multifunctionality of agriculture can be better taken into account by measures of the „second pillar“ than by purely protective measures. Taking into account that some measures, which were formerly, financed by the Guidance Section of the EAGGF the yearly amount available of 4.3 billion Euro (30 billion Euro for the period 2000-2006) is practically the same as it was in the period 1994-1999 for the measures that are now integrated into the Regulation on Rural Development. The narrow financial restrictions do not correspond to the importance of the task. Financial resources that will be released by a reduction of price support - which will probably be unavoidable under the influence of the WTO - should be used to increase the financial basis. The same should be done with financial resources resulting from reductions of compensation payments¹⁸.

Measures of animal welfare can easily be included in the concept if the society so wishes and is prepared to pay for it. Organic farming is already part of the concept. Promotion should, however, take place with great care. Basically it should be driven by demand. If supply increases faster the demand because of promotion, prices may collapse at the detriment of farmers who already changed to organic farming. Correct labelling should give the consumer the choice between foods produced by different practices. Food safety has to be guaranteed by adequate standards. Compliance with the standards has to be checked by controls. The perception that food quality is the direct result of farming practices or of farm size does not stand scientific tests. Attempts to maintain a farm structure primarily based on small farms or to split-up larger units into small farms, and to put an upper limit on production intensity coupled with price support may be counterproductive. Most probably they will not be successful because isolation from the world market will not be tolerated by the WTO. If nevertheless efforts are made in that direction, for example by offering compensations to WTO

¹⁸ European Commission, Directorate-General for Economic and Social Affairs: Towards a Common Agricultural and Rural Policy for Europe, European Economy, Reports and Studies No. 5, 1997.

members, whose export interests will be violated, one has to aware that it would mean to strengthen the „first pillar“ at the detriment of the „second pillar“, the contrary of what a long-term solution requires.

