Agriculture

This brief will address the history of the Common Agricultural Policy (CAP) in both the EC and in the context of the international trade regime. The discussion will also highlight more broadly the special status of agriculture in international trade relations between the US and the EC, as well as between the West and the developing world. Recent developments in agricultural policy have a direct bearing on the potential for a successful conclusion of the current Doha Round of trade negotiations.

The Early CAP (1950s – 1980s)

The CAP emerged as the policy response by European governments to the food shortages that threatened public health in the aftermath of the destruction caused during the Second World War. Therefore, the CAP was launched in the 1950s to achieve several interrelated goals. The first goal was to ensure the survival of a European agricultural sector. Several large European states – most notably France – could ill afford to allow their agricultural sectors to collapse, neither politically nor economically.

Even more important were the immediate needs of feeding Europe's population. The CAP funds were therefore invested in increasing the productivity of the sector in order to meet the demands of European consumers. To this end, the CAP guaranteed prices for farmers as well as providing them with generous subsidies; the goal of this system was to encourage people to move off the land by creating an incentive to capitalize and aggregate small holdings. This ensured that the agricultural sector would survive and that farmers would retain a strong incentive to produce ever more agricultural foodstuffs. Linked to these production subsidies were funds designed to restructure and modernize European farming practices. These funds were earmarked for ensuring that Europe's farmers adapted to changing technologies as well as new management techniques.

The CAP also had external effects. Even though the nascent European Community established a free market for agricultural goods internally, it also substantially raised tariffs externally. This policy had considerable trade-diverting effects that virtually closed the European market off to other agriculture producing nations, much to the frustration of Europe's trading partners, including the United States. There was very little that could be done in the context of the international trade rules at the time: though the GATT agreement signed in 1947 was a landmark document in the liberalization of world trade, the text was riddled with "holes" that allowed signatories to exempt agricultural trade from liberalization.

It is worth noting at this point that this special treatment for agriculture was not an exclusively European venture; the United States also supported exemptions for

The European Union Center of Excellence of the University of North Carolina at Chapel Hill is funded by the European Union to advance knowledge and understanding of the EU and its member countries.

agriculture during the original GATT negotiations. However, unlike European price supports, US subsidies guaranteed incomes for agricultural producers, and the American system was designed to protect small farmers rather than encourage consolidation. Nevertheless, with the subsequent rounds of trade negotiations in the 1950s and 1960s, as the US sought to use international trade rules to manage the potential trade disruptions of the creation of the European Common Market, the European Community emerged as the main obstacle to liberalizing agricultural trade. The CAP had proven too popular, and the political coalition supporting its existence too powerful.

By the 1980s, the CAP had long since outlived its original justification as a means to sustain a war-wracked population. The production subsidies became a victim of their own success: European farmers, even though dwindling as a percent of Europe's population, had modernized and were able to provide more than enough for consumption in Europe's internal markets. To remedy the situation of overproduction that led to "butter mountains" and "wine lakes", European farmers sold these surpluses overseas at prices well below market value. These policies distorted world trade, stifled agricultural sectors in developing countries, had high budgetary costs, and became increasingly unpopular with European taxpayers and Europe's trading partners.

The Uruguay Round and the WTO (1980s – 1990s)

The crisis in the CAP coincided with the onset of the Uruguay Round of international trade negotiations in 1986 that ultimately led to the creation of the WTO in 1995. Agriculture was high on the agenda for American negotiators, who were specifically interested in dismantling the Community's agricultural policies by negotiating agreements that would eliminate the export subsidy regime, internal price supports, and import restrictions. The EC was immediately thrown on the defensive, which had a mixed result. While the EC lost the initiative in agricultural negotiations, it provoked a strong counter-reaction by certain member states – hardening their positions against any reform of the CAP. The EC negotiators favored a so-called "global approach" addressing all manner of supports beyond just export subsidies; this method would lead to the "management" of international markets in agricultural goods, which could then eventually lead to a reduction of subsidies and protective measures.

The core of the transatlantic disagreement was over the existence of the CAP, with the Americans clearly trying to force its elimination and the Europeans offering proposals to assure its continued existence. The US and EC traded negotiating proposals for several years. The Americans wanted to break the link between production and subsidy, which had created incentives to overproduce, leading to runaway levels of subsidies to farmers. The European position evolved over time, but retained elements consistent with the CAP that were unacceptable to the US as well as a coalition of other agricultural exporting nations (known as the Cairns Group). European resistance was driven by the unwillingness of certain member states – principally France – with powerful agricultural interests to abandon the advantages of the CAP, making this one of the clearest examples of how national interests can still disrupt the EU's negotiation position in trade policy. It

The European Union Center of Excellence of the University of North Carolina at Chapel Hill is funded by the European Union to advance knowledge and understanding of the EU and its member countries.

worked: the US position softened considerably when it became evident that the EC was either unable or unwilling to substantially alter its negotiating position. With no real scope for agreement, the negotiations collapsed in 1990.

The next significant developments occurred inside the EC itself. Member states were not of one mind when it came to the EC's position on agriculture. Several member states who were reliant on agricultural production of grains and cereals, such as France and Ireland, were adamantly opposed to any position that would threaten the CAP. Other agricultural member states less reliant on these foodstuffs nevertheless wanted to support their agricultural constituency. However, there were also several member states such as Britain, the Netherlands, and Denmark who nevertheless pushed for a more liberalizing position. The European Commission, led by Agricultural Commissioner Ray MacSharry, used this fragmentation to propose radical changes to the CAP. The core of the Commission's proposal was a reduction in the supported prices for cereals through direct payments along with controls on supply by reducing the amount of land tilled by farmers. This arrangement would reduce European cereal exports, thereby addressing the export subsidy concerns of the US and the Cairns Group. Lower prices would enhance the competitiveness of European cereals in European markets, reducing the threat to the EC of opening its market to foreign competition. Finally, decoupling subsidies from production was a step towards addressing concerns about the EC's domestic support policies.

This reform movement used the ongoing dissatisfaction with CAP's flaws as well as pressure from other industries not to let the Uruguay Round fail to press reluctant member states to agree to CAP reform. The two most difficult member states to satisfy in this regard were France and Germany. Given the power of France's agricultural lobby and the consequent political consensus in favor of the *vocation exportatrice* ("export orientation") for agricultural goods, a modulation in the French position was obtained only when the President and Prime Minister overruled their own Agricultural Minister. Germany's support for high agricultural prices was a basic tenet of its commitment to a high income for its farmers. While it was able to wrest concessions from other member states, it finally relented and gave its consent to the reform proposal.

CAP reform provided the necessary impetus to the final Uruguay Round Agreement on Agriculture (URAA). The URAA represented a major improvement in the treatment of agricultural issues by finally closing the "holes" present under the original GATT. The agreement provided a rule-based structure in which further liberalization could be negotiated. Limits were placed on domestic agricultural supports, nontariff barriers were subject to tariffication, and countries agreed on minimum market access. However, the establishment of these rules did not equate with substantial liberalization. As the CAP reform indicated, the EC was not willing to make sizeable moves beyond its traditional system; their URAA commitments did not impose any significant changes beyond current policies. Furthermore, the URAA grouped domestic support policies into three "boxes" which were subject to different rules: green (minimally distorting), blue (linked to production controls) and amber (output-increasing). By strategically placing certain policies in certain boxes, both the US and the EC were able to escape many of the more stringent requirements of the URAA rules. The URAA also contained a ten-year "peace clause" preventing any challenges to subsidy regimes by signatories to the agreement; this has protected the CAP from challenges in the WTO dispute settlement system until the present.

Despite the reform of the CAP and the successful conclusion of the URAA, liberalization of agricultural trade has been disappointingly slow. While average tariffs in OECD countries remained relatively low by global standards, both the US and EC retained extremely high tariffs on sensitive agricultural areas, including dairy products, cereals and livestock. In the late 1990s, export subsidies also continued unabated, with the EU spending over $6 billion per year on export subsidies on grains, butters and beef, accounting for nearly 90% of total global subsidization. The US uses export credit programs and food aid, which are not covered by the URAA and therefore not subject to WTO rules; these programs are quite large and the EU has insisted on their inclusion in the new round of trade talks. Domestic supports, protected by advantageous box categorization, have allowed both the US and EU to escape some of the more stringent rules on these policies.

The CAP Today: Adjusting to New National and International Priorities

The Uruguay Round was the impetus for a substantial reform of the CAP. A new incentive for continued reforms was provided by the European Union's eastern enlargement. It was predicted that with the EU's expansion to 25 member states its agricultural workforce was scheduled to expand by nearly 70%. Were the CAP to continue without reform, the budgetary strain of maintaining levels of payments created by the enlargement would be financially and politically unsustainable. Moreover, given the advent of the WTO's Doha Round, the EU sought to strengthen its hand in negotiations with new reforms. As a result, EU member states embarked on a new round of CAP reforms in 2003; the so-called CAP mid-term review.

The overriding aim of the CAP's ambitious mid-term review was to create a more competitive market for agricultural products and boost investment in the environment, animal welfare and other standards. The main aims of the reforms were:

- To decouple direct payment to farmers from production;
- To make direct payments conditional on compliance with environmental, food safety, animal welfare and occupational safety measures;
- To increase the support for rural development by modulating direct payments for all except small farmers;
- To introduce a new farm audit system and new rural development measures to improve production quality, food safety and animal welfare

While the European Commission was forced to compromise on some of its ambitious goals, the mid-term review substantially changed the shape of the CAP. Above all, the reforms introduced a new payments system, under which farm aid was no longer linked to production (decoupling), except for some individual regimes (CMOs). The Single Payment Scheme (SPS), phased in over 2005-2006 (with the exception of the new member states), provides a single annual income-support payment to farmers, radically simplifying the CAP's previously byzantine payments scheme. Under SPS, farmers face reductions in payment should they breach a number of standards regarding the environment, animal welfare, etc (cross compliance standards). Certain "sensitive" sectors, such as sugar, wine, bananas and other fruits were left out of the 2003 reforms. However, following complaints from EU trade partners, the Commission has begun reforms of these special regimes despite strong opposition from the farming lobby. A new regime for sugar came into force in July 2006, while reforms of wine, bananas, fruits and vegetables are under discussion.

Significantly, the recent reforms also overhauled the CAP's budget. Spending was divided between two pillars: one responsible for direct income support, another for rural development. The new second pillar is meant to encourage diversification and restructuring of the rural economy and receives approximately a quarter of CAP founding. In the future funding is expected to be gradually shifted from the first to the second pillar. In addition, the CAP budget was fixed for the 2007-2013 financial perspective with a general overhaul of expenditure expected for the new financial framework. In 2007, EU spending on the CAP amounts to €55.1 billion, accounting for approximately 43.6% of the EU budget. A bitter conflict between France and the UK over the size of the agricultural budget and the British rebate in 2005 resulted in the establishment of an EU budget review which will deliver its findings in 2009. It is widely expected that the review will result in an overall cut of the CAP budget. A final piece of reforms has committed the EU to phase out all agricultural export subsidies by 2013, eliminating what had been one of the most contentious elements of the CAP in the past.

In November 2007, the European Commission first assessed the results of CAP reforms in its Communication "Preparing for the Health Check of the CAP Reform". The 2003 CAP reforms contained a number of review clauses, which form the basis of the Health Check. The Heath Check is therefore not another attempt at major reforms, but rather seeks policy adjustments to the existing reforms for the period covering 2009-2013. However, by recommending new policy adjustments, the Health Check also sets the stage for future reforms of the CAP in the post-2013 era. Several key proposals stand out:

- A reduction in subsidies for the biggest farms (above €100,000 annual income)
- An increase in the minimum size of holdings qualifying for aid
- Abolishing the public buying of surplus cereal production, with the exception of wheat for bread
- An increase of direct aid for Rural Development policy from 5% to 15% of the CAP budget by 2013
- Abolishing set-aside that leaves 10% of the land uncultivated
- An increase in milk quotas before their final abolition in 2015

The European Union Center of Excellence of the University of North Carolina at Chapel Hill is funded by the European Union to advance knowledge and understanding of the EU and its member countries.

The publication of the Commission recommendations will be followed by a short consultation period, preceding the formal adoption of the "Health Check" during the French Presidency in the second half of 2008. It seems likely that amongst these proposals, those concerning a reduction of subsidies for large farms will prove most contentious. Likely to hit especially large farms in the UK and Germany, both countries have raised concerns over the direction of the proposals, arguing that there are "no clear links between the wealth and the size of farms". Nevertheless prospects for CAP reforms have received a boost from the new French President Nicolas Sarkozy, who declared that reforms were needed and that "today's CAP cannot meet the challenges of the post-2013 period".

On the other hand, no new impetus to CAP reforms can be expected from WTO negotiations under the Doha Development Round. The EU in many ways has preempted demands for trade concessions by embarking on the 2003 reforms of the CAP and its commitment to scrap agricultural export subsidies by 2013. Moreover, trade negotiations are unlikely to resume in earnest until well after the US Presidential elections. Most parties also agree that the collapse of negotiations in summer 2007 was more on account of US intransigency than EU protectionism. Indeed, on agriculture, the EU has already made far-ranging commitments. Previous offers included a cut of its highest tariffs on farm imports by 60% and a reduction of overall trade distorting subsidies (OTDS) to the order of 75%. These numbers do not diverge a great deal from demands by developing countries for a cut in tariffs of up to 73% and a reduction in OTDS of 75-85%. A compromise is therefore likely to be found once negotiations will resume.

The Future of the CAP: Towards a Post-2013 Structure

The Health Check of 2008 and the European Budget Review of 2009 will set the framework for a debate on the future of CAP reforms in the post-2013 period. Given domestic and international pressure for CAP reform and the specter of Croatian, Macedonian and Turkish accession, it is widely expected that future reforms will lead to a considerable reduction in agricultural expenditure, especially in the first pillar of the CAP. Many expect that the main burden of adjustment will fall on livestock farmers, as prices for cereals are forecasted to remain high, making this sector less dependable on farm subsidies. Moreover, market liberalization will especially bring new competition from livestock farmers in Latin America and elsewhere.

While it is expected that direct income support for farmers will fall, there seems to be an emerging consensus on the necessity to shift attention towards a greater emphasis on rural development and management. Rural policy, currently addressed under the second pillar of the CAP, includes a cluster of concerns that have recently increased in importance. Concerns over the environment, biodiversity and climate change meant that there is now growing support for the CAP to focus on land use in a more integrated way addressing agriculture, forestry and the rural economy. That would enable the CAP to

The European Union Center of Excellence of the University of North Carolina at Chapel Hill is funded by the European Union to advance knowledge and understanding of the EU and its member countries.

focus on new areas, such as carbon sequestration, the use of agricultural waste products in the production of biogas and the growth of feedstocks for second generation biofuels.

It seems that there now is a broad consensus emerging within Europe on the general direction of reforms for a post-2013 structure of the CAP. However, different questions concerning funding remain to be addressed and there will be considerable resistance towards change from the parts of the agricultural lobby and some countries. All this, has given rise to speculations that Europe might witness a renationalization of agricultural support. Indeed, with the abolition of market price support mechanisms and the increased emphasis on rural development, some analysts have argued that funding would be better provided by member states. Nevertheless, confronted with cross-national concerns and bound by common EU legislation, it is likely that a common agricultural and rural policy funded at least in part from the EU budget will remain a reality for some time to come.

The European Union Center of Excellence of the University of North Carolina at Chapel Hill is funded by the European Union to advance knowledge and understanding of the EU and its member countries.