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# EU Revisits Ag Reform With Bold New Proposals

The Commission of the European Union (EU) is proposing bold changes to its Common Agricultural Policy (CAP). The core proposal is a single annual whole-farm payment, not requiring production by farmers, in contrast to the current payments that are linked to production of specific commodities. Based on historical direct payments, this single payment would reduce the link between farm subsidies and production. Farmers would have greater flexibility in choosing what to produce.

Also, the proposals would cut support for large farms for the first time. Greater emphasis would be placed on rural development, food safety, animal welfare, and environmental regulations. Nonetheless, for many commodities, traditional CAP price support and stabilization mechanisms would be maintained.

These proposals are contained in the Commission's Mid-Term Review (MTR) of "Agenda 2000," a 6-year (2000-06) budget and agricultural policy reform package to facilitate enlargement of the EU to include Central and Eastern European (CEE) countries during the coming decade. The EU legislative process requires a formal proposal from the Commission and approval by the Council of Agricultural Ministers. The MTR proposals are not yet formal legislative proposals, and many important details are not specified, making assessment of impacts difficult. The Commission intends to produce a detailed legislative proposal by the end of the year.

As part of the ongoing EU agricultural policy debate, these proposals are prompted by structural market imbalances, World Trade Organization (WTO) negotiations, the prospect of enlargement, and growing demands of consumers and environmentalists. The Commission alleges that these proposals would create a more market-oriented farming environment, facilitate enlargement, and provide a major WTO advantage because most EU direct payments would become less trade distorting.

## Pressures for CAP Reforms Past & Present

The proposed reforms would be the latest of many CAP reforms. Since its inception, the CAP has relied principally on high prices protected by high tariffs to support farmers. Sugar quotas were established in 1968.

During the 1980s, consumption and export subsidies to dispose of surpluses led to soaring budget costs. These internal pressures led to reduction of effective support prices and introduction of dairy production quotas. Despite many reforms, most EU agricultural prices and trade are still managed by policy. Threats of future surpluses for many commodities, as well as recent accumulation of stocks of rye, rice, and beef, are an important underlying motivation for the MTR proposals.

Subsidized exports have depressed world prices, prompting other countries to press for reduction of trade-distorting EU policies in the Uruguay Round (UR) of multilateral trade negotiations, beginning in 1986. The UR agreement, implemented during 1995-2000, included significant reductions in domestic agricultural support and export subsidies.

The "MacSharry" reforms (named for the agricultural commissioner at the time), implemented from 1993 to 1995, addressed CAP budget problems and provided for expected UR commitments. Support prices were reduced and farmers were fully compensated with direct income payments, a significant CAP change. Larger farms were required to idle some cropland. Payments to beef producers were also associated with production limitations.

The prospect of EU enlargement places additional pressure on the CAP because of the potential cost for support of millions of CEE farmers. Agenda 2000 addressed enlargement budget issues, and extended MacSharry reforms, further reducing grain support prices and effective support for beef. EU grain support prices have been reduced by 45 percent since 1992, and payments for oilseeds were reduced to the same level as payments for grain.

Anticipation of further restrictions on trade-distorting policies in the current Doha Round of multilateral trade negotiations has become an important source of pressure on EU policymakers, in part because of the impact of EU enlargement on WTO commitments.

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### EU Agricultural Policy

| Current | Proposed |
|---|---|
| • Mandatory land set-aside determined annually by EU Council. Annual rotation of set-aside land is required. All land eventually is set aside in turn. | • Mandatory set-aside of 10 percent of land for 10 years. Annual rotation not required. |
| • Multiple, commodity-specific direct payments for arable crops, rice, beef, and sheep. | • A single whole-farm payment based on historical payments for arable crops, rice, beef, and sheep, adjusted for full implementation of Agenda 2000. |
| • Large farms receive direct payments at the same rate as small farms. | • Whole-farm payment above a minimum amount (that increases with each farm employee) to be reduced by 3 percent annually, reaching 20 percent over 7 years. |
| • Payments unlimited. | • Total payments, including whole-farm payment and other direct payments, limited to 300,000 euros per farm. At *AO* press time, exchange rate was about 1 euro to US$1. |
| • Voluntary enforcement of regulations by member states. | • Payments conditional upon mandatory compliance with environmental, food safety, and other measures. |
| • No further cuts in single grain intervention price (for bread wheat, barley, and corn) or rice. Rye intervention maintained. Cuts under Agenda 2000 already implemented. | • Single grain intervention price cut by 5 percent. Rice intervention price cut by 60 percent. Rye intervention abolished. |
| • Rural development funding maintained at 4.5 billion euros. | • Spending on rural development nearly doubled over 7 years, financed by payment reductions for large farms. |

influential. Increasingly, agriculture is seen as part of the rural economy, shifting the orientation of policy towards rural development. Animal disease and food contamination incidents have directed attention to food safety and quality issues. There is a growing perception that CAP support has led to intensive agricultural production, resulting in significant environmental degradation. Finally, animal welfare advocates are calling for changes in production systems. The EU refers to measures addressing these emerging issues as the CAP's "Second Pillar," the first being market and income support.

### MTR Proposals: Some Details

The MTR proposals would alter the regimes for grains, oilseeds, protein crops, rice, legumes, dried fodder, nuts, beef, and sheep. Other regimes, including fruits and vegetables, potatoes, dairy, and sugar, would remain unchanged. Instead of a specific dairy proposal, several dairy options are presented, ranging from maintenance of the current regime to a dramatic elimination of production quotas combined with large price reductions.

**The Whole-Farm Payment.** The Commission's most innovative proposal is the whole-farm payment. Current payments require production of specific products. Historical payments for arable crops, rice, beef, and sheep, adjusted for implementation of Agenda 2000, would be combined into a single annual farm payment. The whole-farm payment would be largely decoupled because production would not be required.

The payment would be attached to the land, conveying with transfer of the land. If part of a farm were sold or leased, an equivalent part of the whole-farm payment would be transferred. Farm support would be simplified, another Commission goal.

Before 1993, the EU supported most agricultural product prices directly through intervention purchasing at established prices. The MacSharry reforms converted that support to product support through direct income payments. A whole-farm payment not requiring production would be a final evolutionary shift to support for producers rather than products. Nonetheless, high CAP support prices for milk, beef, and sugar would continue to provide powerful production incentives.

**Set-Aside Requirements**. Since 1992, larger farms have been required to set aside some land. The Council fixed the set-aside percentage annually. Set-aside is rotational—i.e., all land must be set aside in turn, quality land as well as the poorest land. The MTR proposals would require larger farms to set aside at least 10 percent of their land for 10 years on a nonrotational basis, allowing farmers to idle their poorest land on a continued basis.

**Grain Support Price Reductions**. The single grain intervention price for bread wheat, barley, and corn would be reduced by 5 percent, and current monthly increases in grain storage subsidies would be eliminated. Otherwise, the grain intervention system would remain unchanged. The whole-farm payment would be adjusted to provide compensation for half of the price reduction.

Intervention support for rye would be eliminated, leaving rye to find a price in the market given its feed value relative to feed wheat and barley. Large rye price and production reductions would be likely. Germany and Poland (an EU applicant) are large producers of rye.

The MTR proposals would dramatically decrease support for rice. By 2004, "safety net" intervention would occur at 120 euros per metric ton (mt), a 60-percent reduction from current support. Below 150 euros per mt, private storage subsidies would be provided. Producers would be compensated by an adjustment in the whole-farm payment, equivalent to the overall compensation provided other grain producers for cumulative price reductions since 1992. The EU rice intervention price would be reduced to near world price levels, necessary to accommodate trade levels likely under the EU's Everything But Arms (EBA) policy. The EBA policy provides duty- and quota-free access to EU markets for the least developed countries by 2010 (*AO* September 2002).

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**Grain Import Regimes**. The MTR calls for conversion of the EU system of varying import duties for grains and rice to a simplified system. Outside the MTR proposals, the Commission has proposed to implement tariff-rate quotas to limit large EU imports of grain that recently have resulted from the tariff regime agreed to in the UR. The EU currently is engaged in preliminary consultations with WTO members to determine appropriate compensation. U.S. grain exports to the EU, 2 million mt valued at $340 million in 2001/02, could be affected. Recent EU imports have come mainly from Russia and Ukraine, however, which are not WTO members.

**Reduced Payments for Large Farms**. The MTR proposals provide for "dynamic modulation," the reduction of payments and limits on total support for large farms, a significant departure for the CAP. The reductions would occur on payments above minimum amounts that increase with each farm employee. Farm payments for about one-fourth of EU farms, accounting for 80 percent of production, would be reduced by 3 percent annually up to 20 percent after 7 years. Following reductions, total annual payments would be limited to 300,000 euros.

**Allocations for Second Pillar Programs.** Budgetary savings from payment cuts to larger farms would be allocated to rural development, environmental programs, food safety and quality, and animal welfare programs. Funding would be nearly double the 4.5 billion euros for these programs under Agenda 2000. All farm payments would require cross-compliance with Second Pillar regulations.

**The "Carbon Credit."** CAP provisions allowing production of nonfood crops, including energy crops, on set-aside land, would be eliminated. Support for energy crops would be provided by a payment of 45 euros per hectare.

**Durum Wheat Regime.** The payment for durum wheat in traditional production areas of 344.5 euros per hectare would be reduced by 27 percent. The 138.6-euros-per-hectare aid in other designated areas would be abolished over 3 years. A premium of 15 euros per mt would be provided for some prescribed standard of high quality.

## Implications of the MTR Proposals

**Farm Production, Budget Costs, and Farm Incomes.** The Commission forecasts that the MTR proposals would have little impact on the EU budget, but they could significantly affect product selection, overall production, and incomes of individual farmers.

Farmers would have greater flexibility in production choices among arable crops, rice, beef, and sheep, but production choices still would be influenced by high EU prices for beef and sheep. Production incentives for dairy, sugar, fruit, and vegetables would be unaffected.

Decoupling direct payments from commodities would reduce incentives to produce arable crops, beef, and sheep. Returns to dairy operations also would be reduced, since much beef production is associated with milk production. Reduced output of beef and sheep is likely, particularly if pasture can be converted to arable land. The MTR proposals would leave that issue to national governments. Reduction in beef production would be limited because of its association with milk production, which would not be reduced because current incentives are very high; production is limited by quotas.

The MTR proposals would reduce production of rice and rye, but the implications of the MTR proposals for other grain and oilseed production are unclear. Producers would likely reduce output in response to support price cuts and abolition of rye intervention. Reduced incentives for arable crops would encourage the idling of land, which would tend to reduce production. However, as farmers would be free to idle their marginal land (land on which production costs exceed market returns), average crop yields would likely rise. Conversion of pasture land to arable crops in response to reduced support for beef and sheep would also tend to increase arable crop production.

Cross-compliance with environmental, animal welfare, and other requirements could potentially raise costs significantly for EU farmers, making them less competitive in world markets. The MTR proposals include temporary direct payments to assist farmers in meeting demanding standards and additional payments for achievement of standards beyond mandatory requirements.

Farm income impacts are also ambiguous. Reduced payments would tend to lower incomes of larger farms, but greater flexibility in product selection could improve efficiency and raise net returns. Taking marginal land out of production would also raise net farm income. Increased spending on rural development would aid some farmers.

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An analysis of the MTR proposals by a German research group (reported in *AgraEurope* in August 2002) concludes that German farmers would increase set-aside by 66 percent to 13 percent of arable land, reducing grain production by 7 percent, probably mostly of rye. Net German farm income would be unchanged because reduced costs from lower production offset reduced returns. Income per farm worker would be increased because employment was reduced. Results cannot be generalized to other countries.

**WTO Commitments and Negotiations.** Support for agriculture remains high among developed countries, but EU agricultural policy has been a major target of international criticism because the CAP has employed trade-distorting policies on a substantial scale. EU export subsidies accounted for 93 percent of total global agricultural export subsidies in 1999. According to the Organization for Economic Cooperation and Development (OECD), overall support for EU agriculture is high—$94 billion in 2001, or 35 percent of the value of production. U.S. support was $49 billion, or 21 percent of production. The MTR proposals could affect EU fulfillment of its Uruguay Round commitments, and may affect the EU's ability to comply with new disciplines in the Doha Round

The impact the MTR proposals would have on export subsidies is unclear. Large export subsidies for dairy products and sugar would be unaffected. EU grain support prices have been near the long-term trend in world prices in recent years, allowing the EU to export without subsidies. However, low world prices or a strong euro relative to the dollar would again require the EU to export grains with subsidies.

The 5-percent reduction in grain intervention prices would slightly improve the likelihood that export subsidies would not be required. Slightly lower production and exports would decrease the cost of subsidies if they are necessary. The rice support price reduction is large and probably would eliminate the need for export subsidies in most years, but rice is a minor product. Reduced intervention prices for grains and rice would reduce EU tariffs, but overall EU import barriers would not be significantly affected unless the EU is successful in revising its grain import regime outside of the MTR proposals.

The MTR proposals would principally affect WTO commitments for domestic support. The Commission asserts that an important portion of EU domestic support would be converted to policies much less likely to be reduced in future agreements.

The UR established three classifications of domestic support—amber, blue, and green boxes. Amber policies are the most trade-distorting because they are linked to production, such as price supports or direct payments requiring production. The UR reduced support under these policies. For 1999, the EU notified 47.9 billion euros in amber policies to the WTO. The MTR proposals would little affect these policies.

Policies associated with production limitations, even trade-distorting policies, were classified as blue box policies, and were not subjected to reductions. The EU notified 19.8 billion euros to the WTO in blue box policies for 1999/2000, including the current EU compensatory payments for arable crops, beef, and sheep that would be converted to a whole-farm payment under the MTR proposals.

**The impact the MTR proposals would have on export subsidies is unclear.**

Green box policies are minimally trade-distorting. They are not subject to reductions. These policies could include payments that do not require production and are not linked to prices. The EU notified 19.9 billion euros in green box policies to the WTO in 1999.

WTO challenges were rare before 1995 because of ineffective GATT dispute resolution procedures. Since 1995, agricultural challenges have been curtailed by a UR "peace clause," which protects policies subject to UR Agreement on Agriculture commitments from challenge under other WTO provisions. The peace clause expires at the end of 2003, at which time all policies will no longer be protected from challenges.

The Commission asserts that the whole-farm payments would be green and would be less susceptible either to challenges after expiration of the peace clause or to required reductions in future WTO agreements. Although there is general consensus that minimally trade-distorting policies should be considered green—i.e., exempt from reductions—classification of specific policies as green, particularly direct payments, may be challenged in the WTO.

**EU Enlargement.** Preparation for EU enlargement was a major focus of Agenda 2000. Although enlargement is not explicitly addressed in the MTR proposals, the proposals have significant implications. Direct payments for CEE producers in an enlarged EU are extremely important for the EU and candidate members. The MTR proposals signal that CEE farmers will receive whole-farm payments, but the amount and timing would have to be negotiated because CEE's have had no historical payments.

Lower support prices and the elimination of commodity-specific payments under the MTR proposals would result in lower CEE production of arable crops, beef, and sheep compared with production resulting under Agenda 2000. Rye production could be greatly reduced. The more market-oriented environment also would be expected to reduce or eliminate market imbalances.

Cross-compliance with environmental, food safety and quality, and animal welfare regulations could create significant problems for CEE countries, requiring considerable investment to meet those standards. On the other hand, enhanced funding for rural development would aid CEE farmers.

### What's Ahead

CAP reform proposals always have been more ambitious than the reforms finally enacted. Reform has occurred when the political cost of not reforming exceeded the political cost of reform. The MTR proposals have received support from the United Kingdom, the Netherlands, Germany, and Sweden, while provoking strong opposition from France and Spain. The remaining member states are cautiously critical of various proposals.

The current political and economic impetus for CAP reform is more complex than during previous reforms. While the proposals have limited budget implications, the traditional pressures of market imbalances and large stocks of rye, rice, and beef are central motivations for these proposals. The proposals also have important implications for EU enlargement and WTO negotiations.

The proposals also reveal a continuing evolution in what is considered important for EU agriculture—a much greater emphasis on food quality and safety, protection of the environment, animal welfare, and rural development to meet the growing demands of consumers and environmentalists. Reduced support for large farms also reflects a growing desire to target programs to those farms in need rather than a general commitment that overcompensates relatively wealthy farms.

The whole-farm payment represents an impressive conversion of agricultural support towards less trade-distorting policies. Combined with large past reductions in support prices for grains and effective support for beef, adoption of the MTR proposals would amount to a remarkable increase in market orientation of the CAP since 1992. The whole-farm payment could enhance the EU's bargaining position in the WTO with respect to the U.S. and other more market-oriented exporting countries.

Nonetheless, there remains much room for reform in the CAP beyond the MTR proposals. The EU dairy regime is due for review in 2005 and the sugar regime in 2006. For both these commodities, high and stabilized prices are maintained through quotas, high tariffs, direct intervention, and export subsidies.

According to the OECD, EU market price support in 2001 (i.e., domestic prices above world prices) was almost twice as large as the combined payments the MTR would convert to a whole-farm payment. For most important products other than oilseeds and meals, the CAP would continue to manage prices and trade, restricting competition from imports.

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*The European Union's Common Agricultural Policy: Pressures for Change*
www.ers.usda.gov/publications/wrs992/

*EU Enlargement: Negotiations Give Rise to New Issues*
www.ers.usda.gov/publications/AgOutlook/Jan2001/AO278H.pdf

*Agricultural Policy Reform in the WTO—The Road Ahead*
www.ers.usda.gov/publications/aer802/

Commission of the European Union: *Communication from the Commission to the Council and the European Parliament: Mid-Term Review of the Common Agricultural Policy*
http://europa.eu.int/comm/agriculture/mtr/comdoc_en.pdf