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EU's Agenda 2000 & Beyond

The European Union's (EU) Agenda 2000, finalized in March, builds on key agricultural reforms of 1992 by further reducing support prices for some commodities while partially compensating producers for the price declines through direct payments. In general, Agenda 2000 changes in the grain, oilseed, dairy, and beef sectors are modest and depend on world price levels. But for wheat, the reforms will likely move the government purchase price below a rising world price, enabling the EU to expand wheat exports without subsidies. Besides moving the EU further from price supports in favor of direct payments, Agenda 2000 will modify supply control measures.

While Agenda 2000 effects on production and trade are modest, implications for the next round of World Trade Organization (WTO) negotiations are more profound; the EU will have more negotiating room on support prices, tariffs, and export subsidies (depending upon the commodity) while still protecting its domestic markets from imported agricultural products.

In 1992, the European Community (EC) adopted a set of reforms to its Common Agriculture Policy (CAP) in pursuit of an agreement in the General Agreement on Tariffs and Trade (GATT) multilateral trade negotiations. The reforms, the most comprehensive in the nearly 30-year history of the CAP, have become the philosophical basis for future changes in the CAP, featuring lower support prices, partially decoupled direct payments, and cropland set-aside.

Agenda 2000 represents the European Union's initial position for the next round of WTO negotiations on agriculture, to begin in November 1999. Agenda 2000 is also a financial package and a prelude for the next EU enlargement, which will include a number of Eastern European countries. The EU also imposed a ceiling on CAP spending from 2000 to 2006, a ceiling that will surely be surpassed if EU enlargement occurs during that time. In fact, the ceiling probably would have been surpassed even without enlargement. Compensation payments will continue and will likely be extended to East European farmers (EU enlargement), putting even greater pressure on the CAP budget.

If Agenda 2000 does not produce the desired results while meeting budgetary and WTO commitments, the reforms could be revised as early as 2003, after midterm reviews. Pressures for deeper reform will likely be greater in 3 years because of the need to complete the WTO multilateral negotiations on agriculture, the strain of mounting expenses on the CAP budget, and EU enlargement encompassing countries with agricultural sectors competitive with existing EU members.

This analysis by USDA's Economic Research Service (ERS) compares an Agenda 2000 scenario with USDA February 1999 baseline projections. The baseline projections were made with the assumption that the EU would use unreformed CAP mechanisms to comply with its WTO limits on subsidized exports. The baseline set-aside for cropland is 5 percent in 1998/99, 10 percent in 1999/00, 15 percent from 2000/01 to 2002/03, and a maximum of 17.5 percent from 2003/04 to 2009/10. In the baseline scenario, the EU does not accumulate stocks beyond the historical average. The ERS analysis of Agenda 2000 suggests that most EU agricultural commodities will continue to be uncompetitive in world markets, and will require continued EU subsidization for exports.

Domestic Support & Export Subsidies May Fall

In the Uruguay Round Agreement on Agriculture (URAA), countries agreed to curtail programs and policies that provide direct economic incentives to producers to increase resource use or production, such as administered price supports, input subsidies, and producer payments not accompanied by limitations on production. Support reductions were implemented by agreed reductions to a country's Aggregate Measure of Support (AMS), a numerical measure that quantifies the economic benefits from policies considered to have the greatest potential to affect production and trade (*AO* December 1998). The EU's compensatory payments**,** designed to replace farm income lost through support-price reductions, as well as former U.S. deficiency payments, were exempt from curtailment because they were considered to be payments under production-*limiting* programs and are scheduled to be renegotiated in the upcoming WTO Round.

Production-*enhancing* policies, subject to AMS reduction, are considered to have the largest production and trade effects. According to the URAA, the AMS for production-enhancing policies was to have been reduced by 20 percent from the

1986-88 base period. The 1992 CAP reforms exceeded the 20-percent reduction required in the EU's AMS. Agenda 2000 also lowers the AMS because of the reduction in support prices. Consequently, the EU appears able to agree to a substantial reduction in its domestic support without affecting its internal markets.

Even with price reductions of the CAP 1992 reform, the EU was constrained by the quantity of subsidized exports allowed under the URAA. Grain and beef exports were particularly troublesome because EU prices continued to exceed world prices throughout most of the 1990's. Agenda 2000 price cuts will enable the EU to export wheat without subsidy in 2000, and marginally more pork, poultry, and eggs will be exported without subsidy because of lower feeding costs.

Agenda 2000 Reforms EU Farm Policy

The final agreement calls for:

- a 15-percent reduction in grains support price (18 euros/mt), phased in over 2 years, to be offset by an increase in direct payments (9 euro/ton);
- a 33-percent reduction in direct payments to oilseed producers, implemented over 3 years, equaling the grains direct payment in 2002;
- a 10-percent minimum required cropland set-aside for 2000-06;
- a 20-percent reduction in the support price for beef to 2,224 euros/ton, to be phased in over 3 years and offset by direct payments;
- a delay in dairy reform until 2005/06;
- a 1.2-percent increase in the dairy quota in the first 2 years for a group of specified deficit countries, and, starting in 2005, a 1.2-percent increase in the group quota over 3 years for the remaining countries; and
- a limit to total agricultural spending for 2000-06 of 40.5 billion euros per year, in real terms.

Grain & Milk Output To Rise

Under the EU's Agenda 2000 proposals, grain production would increase above USDA's baseline projections. The 10-percent set-aside requirement, agreed upon within the EU, is lower than the baseline for most years, making more land available for production. However, grain yields are expected to be slightly lower than baseline projections as farmers use less fertilizer in response to a 15-percent cut in support price.

Based on USDA grain price projections in the 1999 baseline, the EU grain intervention price would be below world and U.S. wheat prices but above world and U.S. prices for corn, barley, and oats. With the world wheat price above the intervention level, EU wheat producers could export at the world price without subsidies. The price of other EU grains would remain at the intervention level, above world prices. Growing wheat in the EU would be more profitable than other grains, shifting some acreage out of coarse grains and oilseeds and into wheat.

Grain feeding would increase in response to the support-price cut, at the expense of meal feeding. As the internal wheat price moves above the internal price of other grains, wheat feeding would decline while feeding of barley and corn would increase. The 15-percent cut in support price could make EU *wheat* competitive in world markets in 2000, compared with 2005 in the baseline, eliminating the need for export subsidies. The proposed grains intervention price is well above USDA projected world prices for coarse grains. EU wheat exports would increase above USDA estimates, while coarse grain exports would remain at the EU's WTO subsidized export limits.

The reduction in EU direct payments to *oilseed* producers would initially cause a slight shift out of oilseed production into wheat production. However, oilseed production would be slightly higher than USDA baseline projections, due to the lower 10-percent set-aside.

While EU *dairy* reform has been postponed until 2005, milk production will increase 1.2 percent in 2000 in response to the 1.2-percent increase in the dairy quota. The quota will rise another 1.2 percent from 2005 to 2007. The support price for skim milk powder (SMP) will be allowed to fall 15 percent over the same 3-year period.

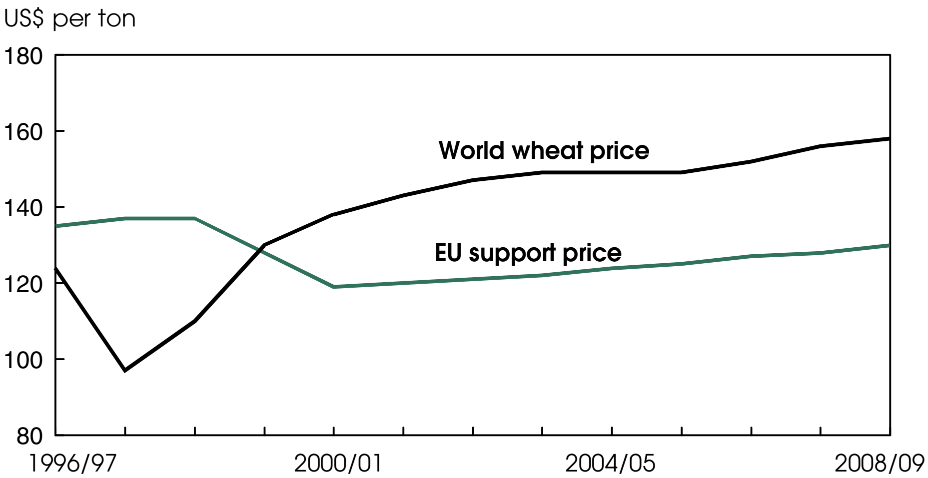
Current EU dairy prices appear too high to allow the EU to export dairy products without a subsidy. Currently, all EU butter exports, nearly all SMP exports, and 82 percent of cheese exports are subsidized. Because the 15-percent reduction in support price is far smaller than average export subsidies for both butter and SMP, the dairy support price will remain above world prices and export subsidies will continue to be required.

The support price for *beef* is cut by 20 percent, but because of lower feed costs, increases in the dairy quota (more milk cows producing more calves for beef), and larger direct payments, beef production will decline only slightly. If the full 20-percent cut in the beef support price is passed on to consumers, beef stocks could be eliminated. If half the price cut reaches consumers, beef stocks could drop from 828,000 tons in 1998 to about 150,000 tons by 2007. The support price for beef will decline 556 euros/ton, far less than the average export subsidy of 1,388 euros/ton in 1995/96-1996/97, thus remaining above the world price and requiring subsidies for exports.

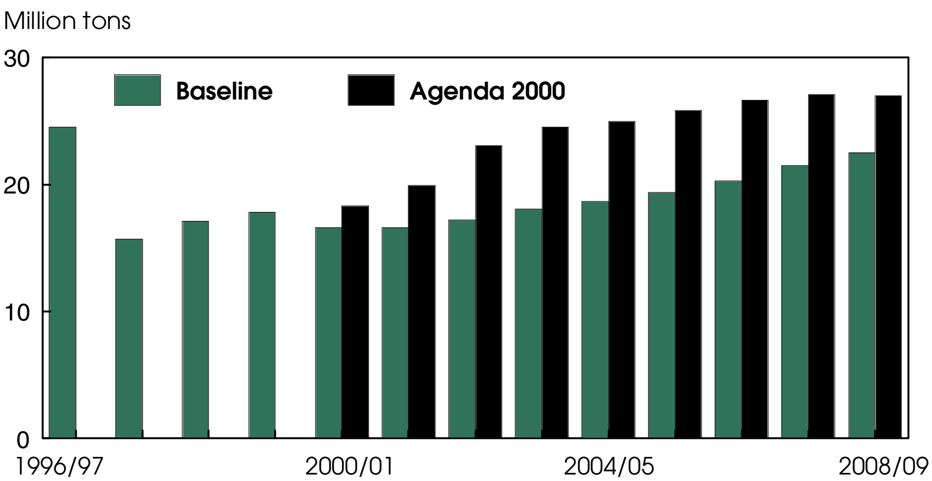
Effects of Agenda 2000 on U.S. agriculture will vary by commodity. EU livestock product exports will be small, producing only marginal effects on U.S. livestock product exports. EU wheat exports are likely to increase significantly under Agenda 2000, which will push the world price of wheat down about 4 percent. Consequently, U.S. wheat production would decline about 1 percent (less than a million tons), and consumption would increase slightly in response to the lower wheat price, diminishing exports by about 1.5 million tons.

World Agriculture & Trade

With EU Wheat Support Prices Below World Prices in ERS's Agenda 2000 Scenario...



...EU Wheat Exports Are Projected Above Baseline Levels



1999/2000-2008/09 projected.

Economic Research Service, USDA

Market Access Remains Restricted

The URAA provided for a minimum level of market access and maximum allowable levels of domestic support and export subsidies. Market access committed member states to tariffication and reduction of all border measures by an average 36 percent over a 6-year period to 2000, and no less than 15 percent for any individual tariff. Member countries also had to establish access quotas equal to historical import levels to maintain current levels of imports or, in the absence of historical imports, establish a minimum access quota that would provide an opportunity for imports. However, "dirty tariffication" occurred where countries exaggerated measures of domestic prices and/or understated world prices, thus increasing tariffs. In addition, the chosen base period against which the cuts would be measured was 1986-88, a time of high levels of protection, which added to the high tariff levels allowable.

Agenda 2000, by lowering intervention prices, effectively lowers the tariff on grains and beef. The EU could thus agree to tariff reduction at least equal to the reduction effected by Agenda 2000. However, EU tariffs are so high that the EU could reduce tariffs by a substantial amount and still not face competition from imports, with the exception of currently imported high-quality grains such as durum wheat, malting barley, and high-quality common wheat. No country is likely to penetrate the EU beef market because the applied tariff is much higher than that required to protect EU producers.

Consumer Issues Affect EU Ag Policy

Food quality and safety regulations will likely have little short-term impact on the outcome of Agenda 2000 reforms for grains. EU corn producers are not likely to be greatly affected by changes in competitive conditions resulting from restrictions on genetically modified varieties, as little corn is currently exported by the EU, and corn exports are not expected to expand significantly even after support price cuts. Furthermore, EU corn producers will continue to be protected by market barriers protecting grains.

With respect to nutrition, a number of consumer advocates have pointed out that the CAP undermines the advice of the latest medical research, which emphasizes the need for increased vegetable and fruit consumption. Production restrictions and encouraged market withdrawals make vegetables and fruits, which are not addressed by Agenda 2000, relatively more expensive.

The growing influence of consumers in agricultural policy is evidenced by the EU's acknowledgment that one of the motivations for CAP reform is to address consumer concerns. The CAP has been criticized for its cost and its large share of the EU budget, for contributing to pollution and the spread of animal diseases by promoting intensive agriculture and overproduction, and for failing to promote economic development. However, support price cuts for grains and beef may discourage overuse of chemicals and undesirable practices associated with intensive livestock production. Provisions for promoting less intensive production of livestock and other agri-environmental measures will help meet environmental objectives. Targeting of funds to areas in greatest need will help direct funds based on development objectives and farm income equality goals.

Some of these consumer, animal welfare, and environmental pressures are steering the EU toward common ground with its trading partners and away from subsidizing overproduction. For example, consumers and animal rights' advocates are pressing the EU for more stringent food safety regulations of pathogens, pesticides, livestock production methods, and crops developed through biotechnology. Farmers are increasingly being required to moderate the effects of their practices on animal welfare and the environment.

Some of these regulations have led to policy changes that will likely create greater trade conflict. Trade disputes over hormones in beef, genetically modified organisms (grains and oilseeds), fur trapping, battery cages (confinement cages for layer hens), size of living space for livestock, and a host of other issues have already surfaced between the EU and its trading partners.

Trade conflicts have been precipitated by mandated labeling in the EU, demanded by activist consumer groups there. Labeling, whether mandatory or voluntary, is one way food processors can transmit information to consumers and target those who prefer foods produced in what they view as an environmentally benign and humane way.

Anticipating the Next WTO Round

The EU is better positioned to aggressively negotiate in the WTO round than in the Uruguay Round. Because of the 1992 reforms and Agenda 2000, the CAP can withstand a substantial cut in domestic support and lower tariffs without compromising internal markets. But further cuts in allowable levels of subsidized exports will require changes in the CAP beyond Agenda 2000. And competitors have made it clear that subsidized exports will be the principal target of the next WTO round.

Concurrent with the WTO round of negotiations will be budget issues generated by EU enlargement. While EU enlargement does not appear to affect the WTO negotiations in terms of market access, domestic support, or export subsidies, enlargement will create severe budget problems under the strictures of Agenda 2000. With a budget fixed at 40.5 billion euros through 2006, the CAP will have to be reformed again if enlargement is to occur. Deepeniing reforms could produce fully decoupled CAP compensation payments and could lower support prices to world levels, thus removing the need for export subsidies. Such a move would pressure the EU's international trade partners to do likewise.

The EU has stated that it plans to introduce consumer, environmental, and animal welfare issues into WTO negotiations. The EU feels that if its farmers are to incur costs because of labeling and processing regulations, imported goods must be subject to the same cost-incurring regulations. If not, EU representatives have stated that these exports will not be allowed to enter the EU. The U.S. position is that these issues are already covered under the URAA. AO

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For more on Agenda 2000

See the forthcoming report on:

The European Union's Common Agricultural Policy and the pressures for change

* Agenda 2000 reforms
* Potential impacts of EU enlargement
* Food safety and environmental issues

Watch for it on the Economic Research Service website
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