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The evolution of the European Union's agricultural policy

1 Preface

The focus of the European Union's Common Agricultural Policy (CAP) (EU) has changed considerably in the last two decades. However, the reform steps taken over this period are often misunderstood or under-appreciated by the general public. The image of artificial 'mountains' and 'lakes' of grain and milk generated by CAP subsidies in the 1970s and 1980s is still widespread. However this image is outdated. The objective of this article is to summarise the recent evolution of the CAP, with special attention to the results of the most recent CAP reform of 2013.

2 The EU subsidising system

Until the first radical CAP reform in 1992, policy-makers in the European Union (EU) mainly employed price support to subsidise agriculture[1]. They established fixed, guaranteed prices (so-called intervention prices) for most important agricultural products. These prices exceeded the prices on the world market, often by as much as a factor of two or more. Figure 1 illustrates this for the case of wheat in the 1970s and 1980s. These high domestic producer prices were supposed to ensure a decent standard of living for farmers, and to reduce the need for structural change. Policy makers were concerned that many of the small farms in the EU would not be able to survive international competition and would be forced to cease production if they did not receive supported prices.

This policy of supported intervention prices led to increased production and surpluses which could only be exported (in other words, dumped) outside the EU with the help of export subsidies. As shown in Figure 2, market support measures and export subsidies caused the budget cost of the CAP to grow rapidly. Between 1980 and 1991 alone, CAP expenditure almost tripled. Many other major agricultural exporters such as Australia, Canada and the US were angered by the fact that the EU was competing unfairly by dumping agricultural products on the world market. Developing countries complained that subsidised exports from the EU were undermining their efforts to develop

[1] For a detailed account of the history and development of the Common Agricultural Policy, see TANGERMANN and VON CRAMON-TAUBADEL (2013).

their own domestic agricultural sectors. Hence, in the late 1980s the EU came under increasing pressure in the Uruguay Round of the General Agreement on Tariffs and Trade (GATT, known today as the World Trade Organization, WTO) to lower its levels of price support and eliminate or at least reduce its export subsidies. In the first years of the 1990s it became increasingly apparent that it would not be possible to bring the Uruguay Round to a successful conclusion without a substantial reform of the CAP.

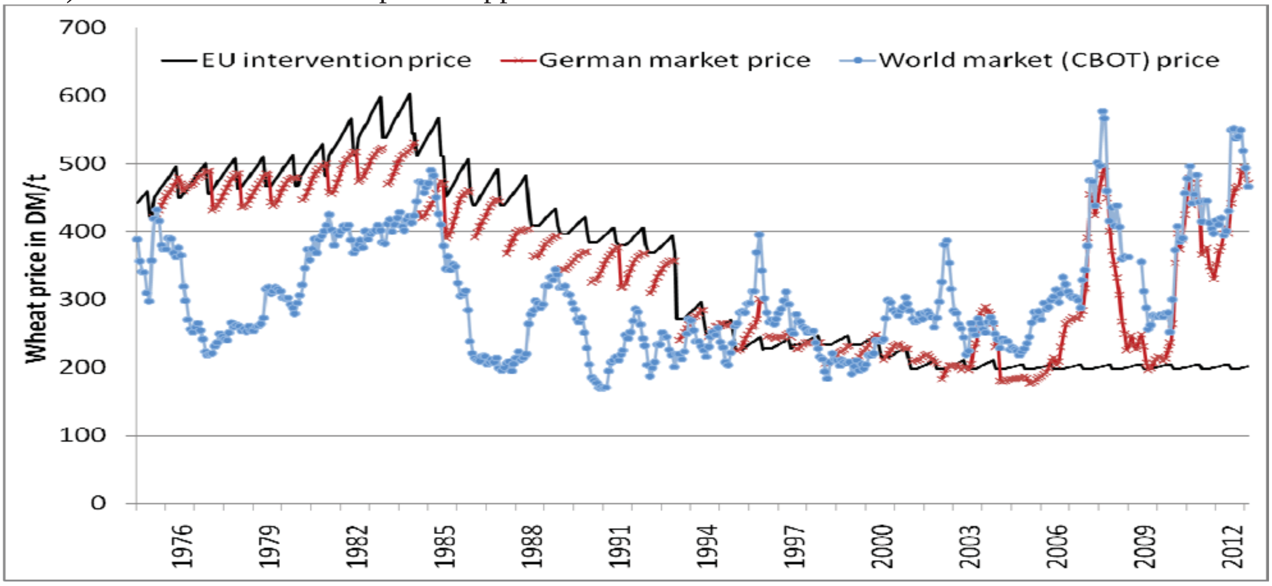

Figure 1. The development of wheat prices 1975-2012

3 The MacSharry Reform (1992)

Responding to these pressures, the EU Commissioner for Agriculture at the time, Ray MacSharry, proposed a radical reform of the CAP. Despite strong resistance, in particular from Germany, MacSharry's proposal was largely adopted by the EU in 1992 and implemented beginning in 1993. Intervention prices for many agricultural products were cut (see Figure 1), and farmers were obliged to set aside part of the area used for the cultivation of grains. As compensation for the resulting losses, farmers were granted direct. This led to a substantial reduction in EU expenditure on export subsidies and other market measures in the following years (see Figure 2) as both the gap between the intervention price and the world market price (see Figure 1) and the volume of agricultural exports fell. The resulting savings were used to finance the direct payments to farmers.

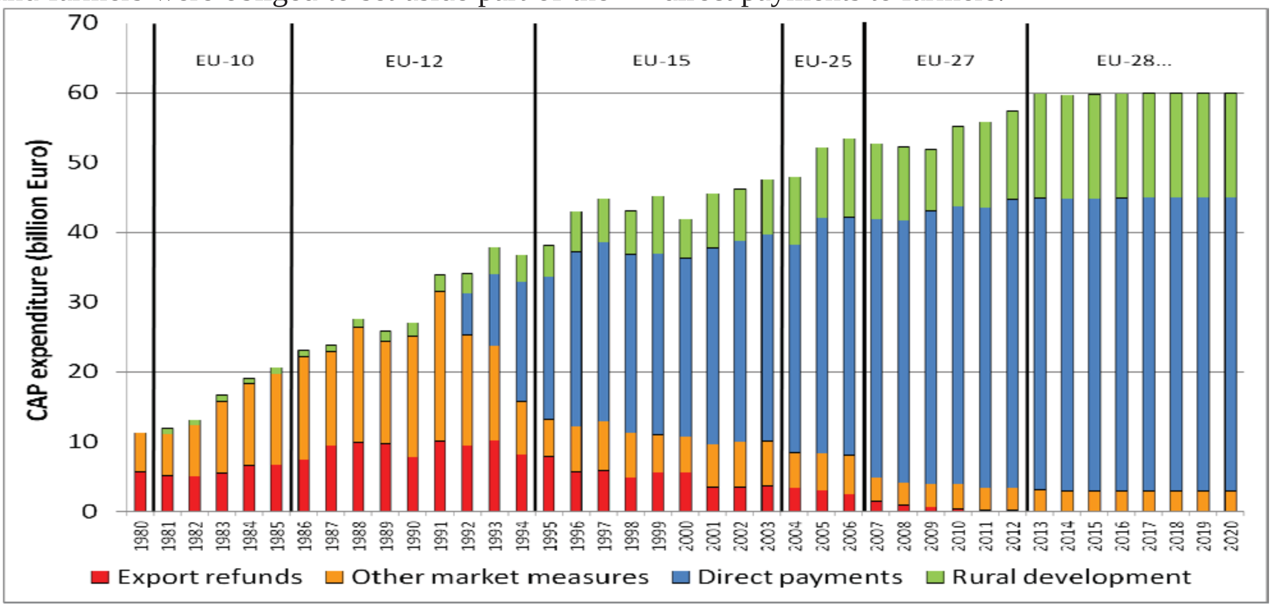

Figure 2. Evolution of Common Agricultural Policy expenditures 1980-2020 (current Euro)

As can be seen in Figure 2, the MacSharry reform did not lead to an overall reduction in expenditure on the CAP, which has continued to grow until today. However, this growth is not due to increasing levels of support for farmers in the EU. Data compiled by the OECD clearly demonstrate that EU support for farmers has fallen since the MacSharry reforms[1]. Instead, the CAP budget has continued to grow because the EU has expanded. The EU today comprises 28 member states and an agricultural area that is roughly 50 per cent larger than it was when Commissioner MacSharry made his reform proposals to 12 member states in the early 1990s (European Commission, 2014a). But regardless of the overall level of CAP expenditure, the key point is that the MacSharry significantly changed the nature of this expenditure, replacing export subsidies and other market support measures by direct payments to farmers. As a result, the CAP became more efficient and subject to less criticism from other WTO members.

4 Further CAP reforms

The MacSharry reform fundamentally changed the direction of EU agricultural policy. Further steps in this new direction were implemented in 1999, 2003, and 2008. As can be seen in Figure 2, one important outcome of these reforms has been the gradual growth of the budget for the so-called ‘second pillar’ of the CAP, which funds spending on rural development measures. Especially worth mentioning is the so-called 'Fischler reform' of 2003. This reform converted most of the direct payments to farmers that had been introduced by MacSharry into so-called ‘decoupled’ payments.[2] To receive decoupled direct payments, farmers do not have to produce specific crops such as grains or oilseeds. They merely have to maintain their land in what is referred to as “good ecological condition”. This means that they must ensure that the land can be used to produce crops in the future (i.e. that it does not become overgrown with brush or trees), and that they fulfil a series of basic regulations designed to protect the environment and animal welfare (e.g. regulations on the use of fertilisers and pesticides). If a farmer violates these regulations, he/she is subject to the usual legal sanctions <u>and</u> a reduction in his/her decoupled direct payments.

Since the direct payments were decoupled roughly ten years ago, the intensity of agricultural land use in the EU has been determined not so much by the amount of subsidies, but rather by the level of current world market prices. Farmers receive the decoupled payments regardless of whether they produce crops. Hence, they will only produce crops if it is profitable to do so. Otherwise they will simply make the minimum effort required to maintain their land in “good ecological condition”, and collect the direct payments. World market prices for grains and oilseeds increased sharply in 2007/08 and have remained high since. Domestic prices in the EU, for example for wheat, have followed these trends (see Figure 1). Thus, the EU’s surplus production – which is no longer an artificial surplus stimulated by subsidies, but rather a reflection of the EU’s competitiveness in crop production – can be sold on the world markets without the use of export subsidies.

Reforms in some areas of EU agriculture, such as milk and sugar, have not been as rapid as in the area of grains and oilseeds, but here too major steps have been taken. Price support for beef was reduced by the MacSharry and subsequent reforms. The system of production quotas for milk will be eliminated in 2015, and the sugar quota system will be eliminated in 2017. None of these reform steps has been easy to adopt and implement; farmers’ unions and other interest groups have consistently lobbied hard to block or slow the pace of reform. Nevertheless, it is safe to say that no other industrialised nation has reformed its agricultural policies as dramatically and thoroughly as the EU over the last two decades.

5 Current CAP reform

In June 2013, the European Council of Ministers, the EU Parliament, and the EU Commission reached a political agreement on the key elements of the most recent reform of the CAP. It required several additional months for the EU to put the finishing touches on this reform, and the member states are currently in the process

[1] See http://www.oecd.org/agriculture/agricultural-policies/producerandconsumersupportestimatesdatabase.htm #summary.

[2] As of 2013, 92% of all direct payments were decoupled. See http://ec.europa.eu/agriculture/direct-support/direct-payments/index_en.htm.

of finalising the national legislation that is required to implement it. For this reason, this new reform will not come into force until January 1, 2015, one year later than originally intended. The new reform is composed of three main categories of measures (“redistribution”, “greening” and “other measures”), which we review in the following sections.

Redistribution of direct payments

The most recent CAP reform will lead to four types of redistribution of direct payments:

- First, the reform foresees a redistribution of direct payments among the member states, from those member states in which farmers receive above-average payments per hectare (mainly old member states) to those in which the farmers receive less than 90 per cent of the EU average (mainly new member states, especially the Baltic countries).
- Second, the reform also foresees a redistribution of direct payments within individual EU member states. Some countries, such as Germany have already in the past decade redistributed direct payments so that each farmer receives more or less the same amount per hectare. In other member states (such as France), however, this internal redistribution has not taken place and some farmers, for historical reasons, receive much more per hectare than others. The reform calls for the member states to begin dismantling these internal imbalances.
- Third, a progressive redistribution of direct payments from large to small farms has also been proposed. The final agreement foresees a mandatory tax of at least 5 per cent on direct payments of over 150,000 EUR. This so-called “degressivity tax” will not apply to the 30 per cent of a farm's direct payments that are linked to greening (see below). Member states are free to apply higher tax rates up to 100 per cent, which would effectively cap direct payments at 150,000 EUR.
- Finally, although the 5 per cent “degressivity tax” described above is called mandatory, it will not apply to member states that choose instead to apply so-called “redistributive payments”. A member state that opts for this alternative must hold back 5 per cent of its entire direct payment budget and redistribute the proceeds to the first hectares of all farms. In Germany, for example, the federal and regional ministers of agriculture have agreed to implement “redistribution payments” instead of the “degressivity tax”. Specifically, in Germany (where the average farm size is 46 ha) the first 30 ha of each farm will receive an additional direct payment of 50 EUR/ha, and the next 16 ha will receive an additional payment of 30 EUR/ha (Agrarministerkonferenz, 2013). As a result of this measure, German farms with over roughly 100 hectares will receive less direct payments in total.

Greening

The second main element of the current CAP reform, so-called “greening”, refers to the fact that 30 per cent of each member state’s direct payment budget will be linked to the delivery of environmental benefits. Farmers who wish to continue to receive these 30 per cent will have to comply with following three criteria:

- Crop diversification: Farmers with between 15 and 30 ha of land (excluding grassland) must cultivate at least two crops, none of which covers more than 75 per cent of the farm’s total available area. Farmers with more than 30 ha (excluding grassland) must cultivate at least three crops, none of which covers more than 75 per cent and no two of which together cover more than 95 per cent of the farm's total area.
- Maintenance of permanent grassland: Farmers are not permitted to convert more than 5 per cent of their permanent grassland to cropland, unless there is less than 5 per cent conversion at the national level.
- Ecological Focus Areas (EFAs): Farms with more than 15 ha of land (excluding grassland) must establish EFAs on at least 5 per cent of their arable land. Subject to a review, this share will increase to 7 per cent by 2017. A variety of measures/uses qualify as EFAs, including field margins, hedges, buffer strips along waterways, forest and fallow land.

Other Measures

Beyond redistribution and greening, the recent CAP reform also includes some changes to market intervention policies in the EU. The elimination of the sugar quota, originally planned for 2015, has been delayed until 2017. Policy makers have also agreed to a provision that will make it easier for producers to form organisations to increase their bargaining power vis-à-vis input suppliers and processing firms.

In addition, the scope for using coupled direct payments has been increased. Member states that currently spend less than 5 per cent of their direct payment budget on coupled payments will be permitted to increase this to 8 per cent; those spending between 5 per cent and 10 per cent will be permitted to increase this to 13 per cent. Moreover, member states will be permitted to spend an additional 2 per cent of the direct payment allotments on coupled aid for protein feed crops.

Finally, the latest CAP reform also includes a mandatory support scheme for young farmers. According to this scheme, up to 2 per cent of a member state's direct payment budget will be used to finance 25 per cent top-ups on direct payments to new farmers under 40 years of age for five years or until they turn 40. At least 25 ha but no more than 90 ha per recipient will be eligible for these top-ups. This scheme will encourage young farmers to establish farms and/or speed up the transfer of existing farms to younger operators.

6 Outlook

Since world market prices for agricultural products have increased substantially in recent years, many in the EU are questioning whether farmers need any support whatsoever, even decoupled direct payments. Direct payments were proposed 20 years ago by Commissioner MacSharry to compensate farmers for the losses that they incurred when support (intervention) prices were reduced. But in recent years the prices that EU farmers have received on world markets have often been higher than the support prices that they received in the 1980s (see Figure 1). Hence, some question whether farmers should be "compensated" for losses that have since been eliminated by market developments. Early in the debates that led to the recent 2013 reform of the CAP, proposals to eliminate or phase out the direct payments were made. But in the end, the farmers' unions and other interest groups succeeded in having these proposals replaced with the "redistribution" and "greening" measures described above. Hence, the current system of direct payments appears to be safe at least until 2020, when the next comprehensive review and reform of the CAP is scheduled to take place.

Whether "redistribution" and "greening" will suffice to justify continuation of direct payments beyond 2020 cannot be predicted with certainty. Environmental interest groups argue that the "greening" measures are too weak and provide too little environmental protection to justify direct payment expenditures of roughly 40 billion Euro per year. From an environmental and economic perspective, the link between the level of direct payments that a farmer receives for a hectare of land and the environmental and social benefits that are produced on that hectare as a result is also weak. Finally, the direct payments are controversial from an equity/distributional perspective because they accrue primarily to the owners of land, and not necessarily to farmers, who often rent the land that they farm. Hence, in many cases, direct payments are flowing to individuals who are comparatively wealthy and not in need of any "compensation". All of these points are sure to come up again in several years when the debate on the reform of the CAP after 2020 heats up.

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