Reform of the CAP. Will the real one come some day?

Florence Jacquet
Agricultural Economist
CIHEAM-IAMM / UMR Lameta
Montpellier
jacquet@iamm.fr

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Abstract

There are currently several reasons for reforming the CAP. First, EU-15 must now incorporate the wishes expressed by European citizens concerning the environment and food safety. Secondly, with regard to WTO requirements, the expiry at the end of 2003 of the 'Peace Clause' agreed in the Uruguay Round adds a further challenge for the reform of CAP farm subsidies. Finally, the eastern enlargement of the CAP raises the problem of the financial sustainability of European policy, necessitating in-depth reform.
The mid-term review proposed by the European Commission in July 2002 is probably not the end of the story but it is one of the available options and fairly consistent with previous reforms. The issues of CAP reform and the various possible scenarios for 2006 are examined in this paper.

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The crisis for the European Common Agricultural Policy began in the mid-1980s. The CAP was the victim of its own success. Production had increased considerably and stocks of the main agricultural products were accumulating. Furthermore, conflicts with the United States were increasing in the GATT and raising the need for a reform . A series of reform measures were undertaken, leading to the 1992 reform. This was a turning-point in the history of CAP with regard to the objectives and the means used. The reform had mixed results but was the beginning of a serious debate concerning the role of agriculture in the European area and society.

Another reform was implemented in 1999, continuing and deepening that of 1992. But it was again a transition reform, with intervention instruments seeking several objectives simultaneously and often giving contradictory results. The decisions taken were the result of a compromise among member-states while budgetary considerations often outweighed the choice of coherent instruments.

Today, three kinds of new issues condition the evolution of the CAP. First, in 2003, the end of the 'peace clause" signed in the Uruguay Round raises the problem of the continuation of blue box aid, that is to say direct compensatory payments, i.e. practically all the aid currently awarded by the CAP. Secondly, the enlarging of the CAP to the CCEE raises the question of the financial sustainability of the EU agricultural and socio-structural policy, making in-depth reform necessary. Finally, the new EU intervention instruments must encompass concerns of Europe-15 citizens with regard to questions of the environment and food safety.

In July 2002, the European commissioner Franz Fischler proposed a 'mid-term' reform, causing a general outcry. It is nevertheless in line with what has been taking shape for 10 years. Furthermore it is quite consistent with some ideas commonly used in the current debate of the economic theory. However, it is not certain that this reform is capable of presenting a new agricultural policy model, given the distinctive features of the European role of agriculture.

The evolution of the CAP during the past decade is presented in the first part of this paper. This is followed by an analysis of the difficulties involved in seeking a CAP capable of solving today's problems.

The evolution of the CAP

The CAP has been in crisis since the mid-1980s

The beginning of the crisis of the CAP was indeed the result of its success in the spectacular development of agricultural production (Jacquet 1993, Delorme 2001). The support of high price levels, as applied from the beginning of the CAP, combined with rapid technical progress enabled a substantial increase in productivity (per worker and per hectare) and in agricultural production. The European Union became the second largest exporter of agrifood products at the end of the 1970s. Problems then began to appear. The situation on world markets changed radically at the beginning of the 1980s. Falling demand from the Eastern countries and from developing countries marked the beginning of a period of stagnation of solvent demand, contrasting strongly with perspective a few years previously. Demand within the EU also stagnated in spite of the entry of Greece (1981), and then Spain and Portugal (1986).

A trade war then began between exporters on the international markets with the aim of maintaining or gaining market shares. This polarised between the United States and the EEC, resulting in the multiplication of export subsidies and aid of various kinds. The result was two-fold: firstly an increasingly high budgetary cost of marketing production and secondly increased instability and falling prices on the world markets.

The EAGGF budget nearly doubled from 1980 to 1984 from ECU 10 thousand million to nearly 20 thousand million. It represented 0.4% of GNP in the mid-1970s and reached 0.65% in the mid-1980s. Meanwhile, gross value-added in agriculture decreased from 4.5% to 3.5% of GNP.

This rise resulted from the increase in export subsidies which, together with storage costs, accounted for the bulk of EAGGF expenditure. The most costly sectors at the beginning of the 1980s were the dairy sector, accounting for 32% of the EAGGF financial guarantee budget, followed by cereals (17%) and beef (13%). Dairy sector surpluses increased steadily from the mid-1970s onwards, leading to an increase in stocks. The EEC became a surplus cereal producer in the early 1980s and exports required substantial export subsidies . Intervention stocks increased considerably from 1984/1985 onwards.

The EEC then announced its intention to change the trend. It first admitted that its high level price guarantee system was poorly suited to its position as an exporter. As had been done by the United States in the 1960s, the EEC envisaged the transfer of support for producers' incomes via prices to support by aid for income. The negative environmental effects of the productivist farming model based on the intensification of inputs per unit area of land then began to be stressed (Green Paper : COM 85-333) .

A series of 'reform' measures was implemented from the mid-1980s. However, although they marked the appearance of true determination to reform the Common Agricultural Policy, they resulted in the multiplication of poorly linked intervention mechanisms. The setting up in 1984 of milk quotas and guarantee thresholds for other products may seem to be in contradiction with a desire to leave more room for 'market forces'. It resulted from pragmatic management by the Commission, which desired measures proposing changes that could be carried out from the political point of view and aimed at solving immediate problems (Petit 1987). It was very effective in fact.

The need for much more radical reform became clear at the beginning of the 1990s, and the procedures were dictated to a considerable degree by liberal pressure from the United States during the 1986- 1994 GATT Uruguay Round. The agreement signed in Marrakesh in April 1994 referred to as the 'Uruguay Round Agreement on Agriculture' planned for 1995-2001 a decrease in domestic support, customs duties and export subsidies (- 36% in value) on the basis of historical references (1986-1990).

The 1990s reforms

The 1992 reform[1] marked a turning-point in the history of the CAP by announcing a desire to break with the productivist approach and to incorporate environmental protection objectives.

The terms used in the announcement of this reform were very different from those that had previously governed the common agricultural policy (the development of productivity, supply security and low product prices for consumers, stabilisation and income support for producers).

New objectives appeared. Some resulted from recognition of the EU's exporter status with increased competitiveness of European agriculture on the international markets. Others took the form of measures aimed at encouraging the 'other' functions of agriculture; the term 'multifunctionality' was not yet used but there was a clear intention to encourage the dual functions of farming: production and protection of the environment and rural development (Ray MacSharry, in Jacquet 1993).

In the following years, one of the elements of discussion of this policy was the question of whether or not to separate the types of agriculture corresponding to these two categories of objective. There was discussion in particular in southern European countries of the increased duality of agriculture, with on the one hand the cereal and dairy farms in the favourable zones continuing to farm intensively and competitively, often for the world market, and on the other hand farms in underprivileged zones where farming (cattle farming, sheep farming and certain tree fruit crops) is often combined with other non-agricultural activities. These farms are asked to contribute to the development of declining rural areas and to the production of positive amenities, especially landscapes.

As the question had not yet been raised directly in terms of the type of agriculture that should be encouraged in the different regions, instruments were not targeted in this way. Nevertheless, from 1992 onwards distinction was made between two pillars of the CAP. The first consisted of intervention by Common Market Organisations and hence grouped market management mechanisms and product by product income support. The second pillar consisted of the agri-environmental and rural development programmes.

In practice, large-scale crops (cereals, oil, and protein crops) and beef were the main sectors concerned by the 1992 reform. Considerable changes occurred in Common Market Organisation (CMO) in these two sectors. The system in which support was provided to keep prices at a high level was abandoned and replaced by a system combining low domestic prices, direct per-hectare aid for cereals and per head of beef cattle, set-aside of farmland and extensification premiums for cattle farming.
A new reform was implemented in 1999[2], deepening and strengthening the mechanisms set up in 1992. Intervention prices continued to decrease, partly compensated by an increase in direct aid, mechanisms were slightly changed to achieve greater decoupling of aid for cereals and the criteria for beef attribution were modified.

Instruments of the second pillar were set up during the two reforms—in 1992 and then strengthened in 1999. The second pillar (called accompanying measures for the 1992 reform and rural development regulation in 1999) consists mainly of agri-environmental aid consisting of financial incentives awarded directly to farmers to cover the extra cost involved in a change in techniques enabling a positive environmental effect, whether this concerns actions aimed at increasing positive externalities or at reducing negative externalities. They consist of programmes for input reduction, conversion to organic farming and for the protection of biodiversity. Unlike the first pillar, the second is jointly financed in equal shares by member-states and the EU budget.

The third substantial change in the CAP dates from the 1999 reform. It is called 'horizontal regulation' in Agenda 2000 and applies to all the CMOs. They are not common rules set at the European scale but recommendations. States are encouraged to set up cross-compliance to ensure that the farmers who receive direct aid use practices that respect the environment. If the latter is not done, they can establish a penalty mechanism, such as a reduction in the amount of aid paid. It is also recommended that states should establish aid modulation mechanisms to set limits to the total amount of aid awarded to the largest farms.

[1] Called the MacSharry reform after the European commissioner .
[2] The Agenda 2000 reform adopted by the Council of Ministers in Berlin in March 1999 after two years of discussion following the July 1997 proposal by European Commission President Jacques Santer.

The funds thus saved by one or other of the two procedures can be used by the Member-states for 'second pillar' actions.

The budgetary consequences of these changes are shown in the table below. The dairy sector now forms only 6% of the EAGGF guarantee budget. Large-scale crops and then beef account for the largest proportion of the budget. The second pillar used to finance agri-environmental actions has increased from 1.5% of the budget in 1994 to 10% today.

Table 1 The evolution of EAGGF guarantee expenditure by sector of activity (%)

Percentage	1994	1995	1996	1997	1998	1999	2000
Arable crops	37.7	42.1	41.9	42.9	46.3	45.2	41.2
of which cereals	*21.9*	*26.3*	*27.7*	*29.9*	*34.4*	*30.2*	*30.4*
Beef	10.3	11.3	17.4	16.4	13.3	11.6	11.2
Dairy products	12.7	11.3	8.8	7.3	6.7	6.3	6.3
Sugar	6.1	5.1	4.4	4.0	4.6	5.3	4.7
Olive oil	5.4	2.3	5.1	5.4	5.8	5.3	5.5
Fruits and vegetables	4.6	5.1	4.0	3.8	3.9	3.7	3.8
Sheep and goat meat	3.8	5.0	4.3	3.5	4.0	4.8	4.3
Agri-environmental measures**	1.5	2.3	4.7	5.1	4.8	6.5	10.3
Total in %	100	100	100	100	100	100	100
Total in million euros*	32,970	34,501	39,108	40,673	38,748	39,541	40,304

* million ecus until 1998
** 'accompanying measures' until 1999; 'rural development' in 2000
Source: European Commission http://europa.eu.int

Although the control of expenditure is often highlighted in reforms (in both 1992 and 1999), the transition from price support to support by aid leads to a transfer of part of the cost of support from consumers to taxpayers. The EAGGF guarantee budget increased from ECU 30 thousand million in 1992 to 40 thousand million in 1996. However, this level of 40 thousand million has almost remained constant after 1996.Direct aid is becoming preponderant, now accounting for 60% of the EAGGF guarantee budget.

In parallel with the agricultural policy, the second major European Union policy— socio-structural policy—plays an important role in aid for rural development in the poorest countries of the Union. Changes have also been made to this domaine in recent years.

This policy has existed since the Treaty of Rome (through the European Social Fund) and initially became much stronger with the entry in the EU of the Mediterranean countries in the 1980s (Greece, Spain and Portugal). In the face of the unequal development of these countries in comparison with the rest of the Union and the differences in the structures and performance of their agricultures, the European Union performed the first 'structural fund reform' in 1988 by setting up a European regional development fund and allocating substantial resources to it. This funding was intended for the countries or regions considered to suffer from backwardness in economic development or handicaps resulting from natural territorial or socio-economic characteristics. This turning-point in common policy corresponds partly to the abandoning of the idea that the common agricultural modernisation policy could alone ensure the convergence of European agricultures towards a single model. This trend was continued in 1992 with the creation of a new so-called cohesion fund that currently benefits Greece, Spain, Portugal and Ireland.

A reform of structural funds was also included in Agenda 2000 and aimed at simplifying procedures and objectives. Two objectives are now associated with two categories of region that can receive aid: regions whose GNP is lower than 75% of the European average (referred to as Objective 1 regions) and regions that are underprivileged with regard to natural conditions or that are undergoing economic reconversion (referred to as Objective 2 regions). The Objective 1 regions receive approximately 70% of the funds.

The socio-structural policy is thus currently the second European Union policy, in terms of budget expenditures, as can be seen in the table below.

Table 2 European Union Budget for 2002 in million euros

EAGGF-Guarantee	46,587
Structural and cohesion funds	33,638
Internal policies	6,558
External actions	4,873
Pre-accession aid	3,328
Administration – Reserves	5,688
TOTAL commitments	**100,672**

Source: european commission, general budget of the european union, for the financial year 2002, january 2002

Inequalities of development among member states and differences in production orientations mean that some states benefit more than others from European policy. In agricultural aid, the major cereal producing and cattle rearing countries are the main CAP beneficiaries (France, Spain, Germany and Italy). Structural funds are awarded mainly to regions that a behind with regard to development: Spain, the East German Länder, Italy, Greece and Portugal (Table 3).

Table 3. Distribution of European Union expenditure in 2000 by country

	Agriculture (EAGGF-G)		**Structural funds**		**Total**	
	Million euros	Percent of total	Million euros	Percent of total	Million euros	Percent of total
France	8,982	22.29	2,089	7.35	11,071	16,11%
Germany	5,642	14.00	4,022	14.16	9,664	14,07%
Spain	5,469	13.57	7,75	27.28	13,219	19,24%
Italy	5,002	12.41	4,069	14.32	9,071	13,20%
United Kingdom	4,059	10.07	2,234	7.86	6,293	9,16%
Greece	2,597	6.44	3,432	12.08	6,029	8,77%
Ireland	1,678	4.16	544	1.92	2,222	3,23%
Netherlands	1,397	3.47	376	1.32	1,773	2,58%
Denmark	1,305	3.24	106	0.37	1,411	2,05%
Austria	1,019	2.53	210	0.74	1,229	1,79%
Belgium	955	2.37	261	0.92	1,216	1,77%
Sweden	798	1.98	273	0.96	1,071	1,56%
Finland	728	1.81	262	0.92	990	1,44%
Portugal	652	1.62	2766	9.74	3,418	4,97%
Luxemburg	21	0.05	11	0.04	32	0,05%
EU-15	40,304	100	28,405	100	68,709	100%

Source: European Commission http://europa.eu.int

The budget balance thus differs from one state to another, some being net beneficiaries and others net contributors, as shown in Table 4. It is seen that Germany and the United Kingdom are the largest net contributors. Spain (receiving both much structural fund aid and agricultural aid) is the main beneficiary followed by Greece, Portugal and Ireland.

Table 4
Budget balance by member-state in 2000
(thousand million euros)

Member-state	Budget balance	Share of national GNP (%)
Sweden	-1.177	-0.50
Germany	-9.273	-0.47
Netherlands	-1.738	-0.44
Luxemburg	-0.065	-0.35
Austria	-0.544	-0.27
United Kingdom	-3.775	-0.25
Belgium	-0.327	-0.13
France	-1.415	-0.10
Italy	+0.713	+0.06
Denmark	+0.169	+0.10
Finland	+0.217	+0.17
Spain	+5.056	+0.86
Ireland	+1.675	+1.83
Portugal	+2.112	+1.93
Greece	+4.374	+3.61

Source : European Commission http://europa.eu.int

The situation is fairly similar for the contributors (Germany and the United Kingdom) with regard to the agricultural budget balance alone. In contrast, France is among the beneficiaries, as are Belgium and Luxemburg. These differences among countries condition their positions in discussion of reforms and enlargement to the east.

In search of a new CAP

It has just been seen that since the mid-1980s and especially since the 1992 reform the CAP has taken a new direction maintaining its old market and income management role and integrating new environmental and social objectives. This is subject to a two-fold constraint—the undertakings already made at the WTO and future negotiations and the planned enlargement to the CCEE.

The reforms of the past 15 years have been remarkably effective in terms of market balance. Public cereal stocks have decreased as a result of the setting aside of farmland and increased use in animal feedingstuffs. Beef stocks have also decreased. In milk production, the maintaining of the quota system has also made it possible to control production.

The state of the markets had strongly affected the decisions taken in 1992 and 1999. The aim was first of all to reduce the stocks that were difficult to clear by increasing outlets and controlling supplies. The decrease in price should on the one hand stimulate consumption and make access to export markets easier and also encourage the extensification of production. Furthermore, the setting aside of land at a variable rate according to stocks was to regulate cereal supply from one year to the next.

An increase in cereal production and yields was observed from the early 1960s; it was not slowed by the fall in prices in 1992 and then 1999. EU-15 production of total cereals is some 200 million tonnes today, of which some 10% is exported. The yield in Europe (5.7 tonnes/ha in 2001) has increased at the rate of one quintal per hectare per year since 1960 and this has remained true since 1990. The extensification of production might have been expected as a result of the fall in prices. However, although a slight decrease in input consumption has been observed at European Union level, this is more the result of gains in technical efficiency without a change in the volumes produced. There is not for the moment a change in the technical model of European cereal growing; high-yield varieties are still those most commonly used, to a great extent because of the role played by agricultural supply firms in the subsector. In contrast, the fall in price has considerably enhanced the use of cereals in animal feeds and especially for pigs, poultry and dairy herds. This increase in animal intra-consumption has been greater than that of production, thus enabling the reduction of stocks. EU exports have been stable or slightly down in recent years to the benefit of Argentina, Australia and new exporters (the Black Sea area).

The decrease in export subsidies imposed by the Marrakesh agreement has been a strong constraint for beef, causing a decrease in meat exports (from 1.19 million tonnes in 1995 to 0.66 in 2000, i.e. 8% of production). The internal market has been disturbed by the BSE crisis and falls in market prices have been compensated by aid for producers. In the dairy sector, the quota system applied since 1984 has proved perfectly effective in solving the over-production problem and maintaining producers' incomes.
The market problems have now been fairly well solved. Cereal stocks have shrunk and the butter and powdered milk mountains of the 1980s have disappeared. Other questions must now be addressed.

A social legitimacy crisis

When prices were guaranteed, nobody was concerned by the scale of public support for the agricultural sector and only specialised rural economists were aware of the side-effects of this successful growth. The switch to the direct aid system made this specialist subject a "citizens' concern". Citizens thus found out that farmers were subsidised, some of them heavily. Furthermore, the coupling of aid per hectare for cereal farmers and aid per head of cattle for livestock farmers meant that the largest farmers received the most aid (about 80% of the EAGGF goes to 20% of EU farmers).

This discovery of the scale of subsidies for agriculture coincided with a series of sanitary problems in food (BSE, dioxins) and the development of environmental concerns (preoccupying at first for reasons of impact on health: pollution of water by nitrates coming from intensive livestock or cereals farms and of the atmosphere by pesticides, etc.). A social debate then began, centred on the functions of agriculture and the role of agricultural policy. It was considered that the latter should ensure the production of quality products and conserve the environment and the landscapes.

Behind what is now referred to as new social demand, the problem of what type of agriculture should be encouraged is now raised for the European Union. What kind of agricultural policy should be installed to encourage farmers to produce quality products using techniques that are more environment-friendly?

The instruments set up in 1992 and 1999 were clearly not enough to reverse trends for the degradation of the environment caused by productivism. Direct aid for large-scale crops were calibrated in 1992 (and renewed in 1999) with distinction made between rainfed and irrigated areas. As direct aid was higher for irrigated areas, it increased, with disturbing effects in particular in the Mediterranean regions of Europe. The problems in northern Europe are related above all to the still high consumption of nitrogen inputs and pesticides for large-scale crops as the encouragement of extensification formed by lower prices was not accompanied by the providing of farmers with varieties and crop management sequences enabling them to benefit from this, even if it could be profitable from the economic point of view.

In the dairy sector, although milk production stabilised, the intensification of production continued partly as a result of the increased amount of cereals and forage maize in feeds. Productivity per dairy cow increased steadily, as did farm concentration. However, the quota system applied that distributed production rights on a historical basis made it possible to ensure balanced territorial distribution of herds, thus limiting the negative effects that geographical concentration would have caused to the environment. (Chatellier, 2002)

In beef production, very intensive technical models (fattening units for young beef cattle in northern Europe, Italy, etc.) using a diet based on cereals and concentrates and problems resulting from a high concentration of cattle in a small area coexist with grazing suckler farming in numerous regions. However, in a general manner, the evolution of European cattle herds has been marked over the past 15 years by the reconversion of many(?) dairy herds to meat-producing suckler farming. This trend is partly the result of the milk quota policy and partly the result of aid for suckling cows and has had a beneficial effect on territories. The previous steady decrease in the area of permanent grassland was halted in certain regions (Ireland, the Massif Central area of France and several parts of Italy, Spain and Portugal).

The suckling cattle rearing sector is perhaps the clearest example of the contradictions of the present CAP and the difficulties involved in reform. On the one hand a number of very interesting instruments have been installed with good results, and on the other the absence of a common project for reform of the CAP and the point-by-point negotiation process of states concerned above all about their budget returns led to contradictory compromises. Thus, during the negotiation of Agenda 2000 from July 1997 to March 1999 , the Commission proposed a number of instruments for the reform of the Common Market Organisation of beef in order to encourage extensification of the sector: increase of the suckler- cow premium, lower Livestock Unit/ha thresholds to be respected to qualify for aid, an extensification extra payment for low stocking density holding, a change in the livestock unit calculations to approach the technical criteria for extensive systems, etc. Almost all these instruments were adopted. However, the countries in which cattle farming is most intensive were keen to defend the 'rights' of the latter and in return negotiated opposing kinds of aid—slaughtering premium, maintaining of the silage maize premium, removal of the ceiling of payment for special beef premium, etc. Today, the CAP provides as much aid for intensive as for extensive operations (Aumand, 2002).

Although the 'first pillar' measures discussed above seem little able to stimulate a true change in the production techniques used by farmers, the cross-compliance principle that is part of 'horizontal regulation' could form a lever. It is difficult to assess its effect, given the slow implementation by states seen so far. Only five countries have immediately set up compliance programmes (Denmark, Finland, Austria, the Netherlands and Greece). (Dwyer, 2000). In the first three, cross-compliance is considered as an extension of existing agri-environmental regulations. In contrast, the two others consider it as the beginning of the incorporation of environmental concerns in agricultural policy. Some countries, and especially Sweden and Ireland, consider that their environmental regulations are already sufficient to ensure that farmers use good practices. The United Kingdom is planning cross-compliance concerning in particular the landscape components of livestock systems and the maintenance of fallow.

It is difficult to understand the lack of eagerness of countries to set up cross-compliance measures as it is nevertheless an instrument that can make possible the respect of existing rules.

This is the case for example of the rules for the maintenance of fallow. The setting aside of 10% of the land under cereals and oil and protein crops is 'free', that is to say it can be in a single field or included in a rotation but is subject to rules concerning plant cover and maintenance—some set at the European level and others at the national level. Fallow is in itself a condition for direct aid and is accompanied by obligations concerning practices. Including it in cross-compliance does not change anything in farmers' obligations although it does perhaps (and this is not negligible) make the sanctions or penalties applied clear and perhaps progressive in case of failure to respect these obligations (this is planned in the United Kingdom).

Another example is that of nitrate fertilisation reduction programmes. Indeed, the 'nitrate directive' exists and should alone form an obligation of results for states, who have to find the appropriate means. Some countries have profited from the occasion to make respect of the maximum of 50 mg nitrate per litre of water in accordance with the directive[3] an obligation of means. This is the case in Denmark and Finland. France is a bad pupil in this respect, in spite of disturbing nitrate pollution of water (the water from 25% of water-catchments contains more than 50 mg/l). Control of the consumption of resources seems to have been its only preoccupation, with the obligatory installation of water meters for irrigators. The French government's priority from 1999 to 2002 on the implementation of *Contrats Territoriaux d'Exploitation* (local farm grant contracts considered by some as a model of second pillar instruments) and on modulation doubtless explains why little effort was made on cross-compliance.

The mechanisms proposed by Denmark and Finland within the framework of the reduction of nitrogen pollution are interesting as they represent two markedly different ways of handling cross-compliance.
In Finland, fresh constraints are added to farmers' practices: the following of a fertilisation calendar, grass-covered strips along watercourses, etc. In Denmark, the performance of a nitrate balance will be needed for

[3] Council Directive 91/676/EEC of 12 December 1991 concerning the protection of waters against pollution caused by nitrates from agricultural sources

the awarding of all aids and aid for cattle can be reduced if the amount is too high. The difference thus lies in the procedures for farmers. In the first case a specification is to be respected and in the second an environmental appraisal is to be conducted. Although the control procedures are substantial in both cases, acceptability by farmers might be better in the second system.

'Second pillar' measures are often comparable to those that have just been mentioned, with the difference that in this case the farmers are remunerated directly for the efforts made in the modification of techniques. The main limit so far is the difficulty of generalising actions that are often local, with a high control cost. It is nevertheless true that the two directions 'conditions for first pillar aid' and 'transfer of aid from the first to the second pillar' (sometimes given as an alternative) remain the most widely shared prospects of change of the CAP.

WTO constraints and the prospect of enlargement of the EU

The two main undertakings that will affect the evolution of the CAP in the coming years are firstly the end of the WTO 'Peace clause' and then the current WTO negotiations and secondly the enlargement of the European Union.

Article 13 of the Uruguay Round Agreement on Agriculture, also called the 'Peace clause' tolerates the existence of a 'blue box' until 2003. As the Doha agreement did not cover this aspect directly, it still applies although resumption of discussion in the “Doha Development Round” can still be envisaged. This is France's position.

The 'blue box' must disappear at the end of 2003 and the aid it contains transferred to either the 'amber box' or the 'green box'.

The WTO 'boxes'

The **blue box** contains 'semi-decoupled' aid awarded per hectare or per head of livestock but linked to a programme limiting production. In practice, this is mainly direct aid awarded since the 1992 CAP reform and deficiency payments in force in the United States until 1996.
The **amber box** contains all the undesirable aid and hence especially all market intervention and export refunds or subsidies (tolerated minimum clauses exist: aid for a product representing less than 5% of the value of production or general aid of less than 5% of the total value of agricultural production is not subject to reduction). Amber box aid is used for calculating the overall support measures subject to reduction.
The **green box** contains aid causing nil or very slight distortion of trade competition. This aid must be financed by states and not be in the form of price support. It must be decoupled from production, that is to say independent of the volume and nature of production.

Source: WTO http://www.wto.org

Unites States agricultural aid has been in the green box since the 1996 Fair Act.. Farmers' subsidies are awarded in the form of a fixed sum calculated using historical references and independent of future production. Also called 'Freedom to Farm', the Fair Act was presented as the movement towards the definitive liberalisation of the agricultural sector. However, “emergency” AMTA payments have been introduced later, and have been classified as “amber”. The theoretical foundation of the 1996 reform is the support of producers' income without intervention in price formation and balance between supply and demand. This decoupled aid model guides reflection by the European Union today, and especially the July 2002 Mid-Term Review proposal. Indeed, this decoupling is necessary to allow the switching of CAP aid from the blue box to the green box.

EU enlargement is another aspect affecting the future of the CAP. Among the 13 candidates, 10 countries (Czech Republic, Poland, Hungary, Estonia, Lithuania, Latvia, Slovenia, Slovakia, Cyprus and Malta) may complete negotiations by 2005 or 2006 and three others (Romania, Bulgaria and Turkey) are still in the preliminary negotiation phase.

Enlargement to include the 10 counties will certainly bring considerable political and economic advantages with the arrival of more than 100 million consumers (+28%), but the great unknown feature is the effect of this integration on the economies of the countries concerned and on the capacity of the European common agricultural policy to withstand the shock.

The main differences between the 15-member European Union and the applicant countries are the productivity level of agricultural labour and the proportion of the working population employed in farming (Table 5)

Table 5
Comparison of agriculture in EU-15 and the 10 applicant countries
2000

	EU-15	10 countries
Agricultural area (1000 ha)	130,443	38,381
Agricultural employment/total employment (%)	4.3	21.5
Agricultural GNP/GNP (%)*	1.7	7
Production of the agricultural sector (million euros)*	274,768	16,734
Agricultural foreign trade balance (million euros)	-122	-2,287

* 1999
Source: European Commission

Accounting for 63% of the labour and 70% of production, Poland strongly affects the overall equation with its 27% of the working population in agriculture and labour productivity only 10% of that of the European Union. Apart from a few large former state farms, 90% of production is in smallholdings. In Poland, and to a lesser extent in Hungary and the Czech Republic, entry in the European Union risks causing a major social problem through the inability of small and medium-sized farms to withstand competition from the West, especially in the animal husbandry sector. The decrease in agricultural production that would result from a change in agrarian structures would run up against unemployment of some 10% (Pouliquen 1999, European Commission 1998). In the medium term, there is considerable potential for the development of cereal production, especially on large farms, and this worries EU-15 cereal growers, especially in France.

In fact, the European Union is faced with two problems related to the integration of new countries in its policy. The first concerns the structural funds. It was chosen in Agenda 2000 to favour structural aid for infrastructure, institutions and education in the support provided first for the newcomers, given the serious backwardness in the economic development of these countries. However, the present criteria for the allocation of the structural funds and cohesion funds make practically all the new entering regions eligible and may very rapidly cause a budget problem for the net contributor countries. The second concerns the procedures for awarding CAP aid. It has been seen that the present system of aid per hectare or per head of livestock has a strong effect on the concentration of farms and would risk causing an unmanageable decrease in farm employment in the eastern countries. Meanwhile, the applicant countries legitimately request the income aid received by EU farmers.

For European policy, the enlargement prospect thus carries a risk of the break-up of the Union or the renationalisation of policies. In its July 2002 proposals, the Commission is attempting to find a way out of the crisis in a decrease in agricultural aid and a change in their functions.

It has the support of the net contributor countries (Germany and also the United Kingdom, the Netherlands and Sweden, see table 4) who are worried about the consequences of enlargement without prior CAP reform. In contrast, the French government criticises the 'tactical logic' of these countries 'who use enlargement as a pretext and hold the Central and Eastern European countries hostage in a debate that is not theirs'. It says that these countries too should benefit from the existing system. France wants to postpone any in-depth reform to post-2006 and hopes that Spain, Portugal, Italy, Greece, Finland and possibly Denmark and Austria will be on its side.

What scenarios for 2006 ?

In July 2002, the European Commissioner Franz Fischler proposed a 'mid-term reform' in 2003 (European Commission 2002a), laying the foundation of what could be a reform meeting the challenges just described. The key components of the proposal are in line with the previous reforms, but going a step further.

- Payments would be entirely decoupled and entitled per farm according to historical references and independently of future production (with the exception of a few particular plant crops). Milk policy reform is postponed until 2008.
- Payments would be reduced progressively (dynamic modulation) by an annual 5% over the next five years to achieve a 20% decrease in 2006, on a compulsory basis for all member states. The amounts saved would be transferred to the second pillar (farms receiving EUR 5,000 or less are not concerned by this measure).
- Reinforcement of environmental cross-compliance, with obligatory farm audits for all farms receiving more than EUR 5,000.
- The budget of the second pillar would increase progressively (and the share of European co-financing would increase by 85% in objective 1 regions and 60% in the others).
- The overall budget would remain constant.

The main components of this proposal extending the 1992 and 1999 reforms are shown in Table 6 below.

Table 6
Ten years of CAP reform

	1992 reform	**1999 reform**	**2002 mid-term proposal**
Decrease in prices	-35%	-15%	-5%
Payments	Total compensation for loss of income	Partial compensation	Payments covering 50% of total price decrease
Decoupling/ inputs	Partial: Payment per hectare or head of livestock	Partial: As in 1992	Single Payment: Calculated per farm and then conversion to per hectare
Decoupling/products	Weak: distinction between cereals/oilseeds dry farming/irrigated farming different types of livestock	Weak: little change in comparison with 1992	Almost total: Payment independent of the nature of production
Modulation of payments		At the initiative of states	Modulation set at the European level
Cross-compliance		At the initiative of states	Following a common European framework
Agri-environmental measures	4% of the budget	10% of the budget	20% of the budget

Based on European Commission (1991, 1999, 2002a)

With this proposal, the European Commission is seeking to generate the internal discussion required for an in-depth reform.

It is also seeking to profit from the new situation at the WTO resulting from the US Farm Act of May 2002. Indeed, this act considerably increases the United States agricultural budget (+76%) by consolidating the emergency aid that has existed since 1998. Aid is still awarded on the basis of past references (and so the largest farmers still receive more aid) but the emergency aid awarded in recent years is perpetuated. The 2002 act thus breaks with the idea of decreasing, transitory aid featured in the 1996 act. A new payment is also introduced; referred to as 'counter-cyclical', the amount increases when prices fall.

This change in US agricultural policy gives the European Commission the occasion to attempt to regain control in the WTO negotiations. Casting doubts on the credibility of the position of the US, which does not do at home what it recommends elsewhere, the European Commission now intends to push its mid-term reform proposal to defend its positions and put the United States in difficulty in the negotiations:

'Leadership requires example. The US is no longer a credible force for farm policy reform in the WTO. This view is widely held across the world. US policy reform could not be in greater contrast. It is unpredictable and incoherent (in that policy designed to support farm revenue will be likely to lower market prices and raise farm rents), and flies in the face of consensus in WTO.' (European Commission, 2002b)

'The new system of production-neutral income support [the mid term proposal] does not distort trade, with all the negative impact this has on developing countries. Unlike in the Uruguay-Round, the EU would be in a position to actively shape the negotiations on the WTO agriculture chapter under the "Doha Development Round", with a strong negotiating hand and enjoying a level of credibility forfeited by the USA as soon as it introduced its Farm Bill. It would be fundamentally wrong to use the deplorable Farm Bill as a pretext for following the American lead in returning to stone-age, trade-distorting agricultural policies. Policy of this type helps nobody - not farmers, not taxpayers, not consumers, not enlargement and not even the WTO. I am firmly convinced that our approach is without doubt the more sensible - reconciling agricultural policy with social expectations and clearly establishing the rewards for additional services, thereby justifying budget outlay - these are all messages the public will understand.'(F.Fischler, European Commission, 2002c)

We can discuss whether or not this position will succeed and how deeply the coalition pushing for liberalisation of agricultural policies in OECD countries will be significantly weakened (Petit 2002), but it is sure that the credibility of the US government in WTO agricultural trade negotiations will be damaged.

However, it is highly probable that the mid-term reform proposal will not be accepted as it is, but it is one of the scenarios that could form the 2006 reform. Indeed, the new WTO “Doha Develoment Round” agreement may be known in 2006, EU enlargement will have begun in earnest, and it will be possible to formulate the financial prospects 2006/2010. In spite of the outcry that it is causing, this first scenario formed by the July 2002 proposal is already a compromise scenario, taking these constraints into account.

Other no less realistic scenarios are possible. The second consists of the pure and simple renationalisation of the CAP. The pressures in this direction are not negligible. Politically, it is difficult to achieve agreement between member-countries with different interests. Ideologically, the liberal view encourages the separation of market liberalisation and agrifood competitiveness on the one hand and rural development and environmental policies on the other and the latter can lead to directives but with difficulty to a common policy.

The third scenario is that of agricultural policy incorporating the new environmental and social issues. The July 2002 proposal is not sufficient for this. The decoupling of aid is not an answer from this point of view. That is, maybe, the weakest point of the proposal. The theoretical literature contains studies showing that no direct payments can be without impact on production, through wealth and risk effects (Henessy 1998, OECD 2000). Empirical studies show that decoupling direct support implies an impact on farmers behaviours, that could lead to an increase of intensive techniques (Ridier, 2002).

On the contrary, coupling with the various functions of agriculture could be envisaged : coupling with farming activities that produce amenities in the case of links between farm production and environmental services, payment for the environmental services supplied by farming households, payment per agricultural worker to support the territorial function, support to the promotion of quality products, etc. (Massot-Marti, 2002). 'Multifunctionality', the term for defending this type of policy in WTO negotiations has already been invented. But the policy remains to be developed.

Conclusion

For ten years, CAP has been in a perpetual reform process. Now, the enlargement perspective presses to achieve a more radical reform, because of the financial constraints that would follow. To conclude in a prospective way, I would like to emphasize three points.

First, one of the main changes that occurs during the last years is that the CAP is becoming more and more a “contract” between farmers and society. That is illustrated by the “first pillar” cross-compliance principle, and by the increase of the agri-environmental “second pillar”. In consequence, CAP faces new issues: how to force and control the farmer to do the work for which he is being paid? How to determine the optimal level of contracts? ... If those questions are relevant issues in the “agency theory”, they are quite new for agricultural economists and few empirical studies have already been done.

Secondly, decoupled farm payment is often presented as the better income support system. It may not always be the case. The frequent jointness between agricultural production and environmental production form the theoretical base of the “multifunctionality” idea. Because of this jointness, it could be cheaper to maintain coupled payments than to replace them by decoupled agricultural payments and environmentally focused incentives. That is in particular the case for the grass-eating livestock sub-sectors (beef and sheep), which are the main producers of landscapes and activities in marginal areas. Further research in this field is merited.

Finally, the problem of equity in payment distribution remains unsolved. The “dynamic modulation” proposed by the Commission would certainly have an impact for those farmers who received currently a large amount of payments. That is the reason why it will be politically difficult to adopt it. But it doesn’t lead to any rule for future distribution. It is also a point that needs to be solved before the EU enlargement.

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