ICTSD Project on Subsidy Reform

How Might the EU's Common Agricultural Policy Affect Trade and Development After 2013?

An Analysis of the European Commission's November 2010 Communication

By Alan Matthews,
Emeritus Professor of European Agricultural Policy, Trinity College Dublin

International Centre for Trade and Sustainable Development

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International Centre for Trade and Sustainable Development (ICTSD)
International Environment House 2
7 Chemin de Balexert, 1219 Geneva, Switzerland
Tel: +41 22 917 8492 Fax: +41 22 917 8093
E-mail: ictsd@ictsd.org Internet: www.ictsd.org

Chief Executive: Ricardo Meléndez-Ortiz
Programmes Director: Christophe Bellmann
Programme Team: Jonathan Hepburn, Marie Chamay Ammad Bahalim and Eugene James

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SUMMARY

The Commission's Communication on the CAP post 2013 published in November 2010 sets out three options for the future shape of Europe's Common Agricultural Policy. This paper explains the background and rationale for the debate on CAP reform at the present time. It describes the content of the preferred reform option and examines the implications for trade and for developing countries. Despite fears raised by the rhetoric of maintaining the EU's production capacity to guarantee food security, the proposals maintain the market orientation of previous CAP reforms. Virtually all the proposed changes concern measures which are classified in the Green Box in the EU's reporting of its WTO commitment obligations. Green Box measures must meet the criterion, inter alia, that they are not or only minimally trade-distorting. The absence of detail in the current Communication does not permit to quantify whether the proposed measures would be more or less trade-distorting than at present, but there are good reasons to think that they would be less trade-distorting. However, the overall impact cannot be assessed until the parallel negotiations on the EU's medium-term budget perspective are completed and the budget expenditure on the different instruments in the proposed agricultural policy toolkit are known.

1. BACKGROUND

The European Commission has published its Communication on *The CAP towards 2020* which sets out options for the further reform of the EU's Common Agricultural Policy post 2013 (European Commission, 2010a). The Communication comes in the wake of extensive discussion in the Council of Ministers on the possible future shape of the CAP kicked off under the French Presidency in November 2008 and continued under successive Presidencies. It also follows an own-initiative report (called the Lyons report after the Parliament rapporteur who drafted it) and resolution on the future of the CAP after 2013 adopted in the European Parliament in July 2010 (European Parliament, 2010a). The Communication builds on a public consultation earlier in 2010 which attracted considerable public interest. It remains a consultation document; definitive proposals for reform will not be made by the Commission until the middle of next year along with an Impact Assessment of the options set out in the Communication. In this paper, we identify the most important ways in which the proposed reforms might affect trade flows, looking in particular at the impact on developing countries.

The Communication should be read and interpreted in the light of other major EU developments and initiatives which are following parallel tracks. In June 2010 the EU Council adopted *Europe 2020* which is the EU's growth strategy for the coming decade (European Commission, 2010b). In this strategy, the EU has set ambitious targets for employment, innovation, education, social inclusion and climate/energy. It notes that all EU common policies will need to support these objectives. In particular, the Council recognized that "a sustainable productive and competitive agricultural sector will make an important contribution to the new strategy, considering the growth and employment potential of rural areas while ensuring fair competition".

The Communication is also published in the context of the debate on the size and composition of the next EU medium-term financial framework (European Commission, 2010c). The financial framework establishes the main budgetary parameters (revenue sources and expenditure headings) within which the EU must operate and is normally agreed for a seven-year period. The current financial framework runs from 2007-2013 and sets out the budget available for agricultural spending up to 2013. Spending limits after that date must be agreed in the context of the next financial framework whose duration remains to be decided but which is expected to cover the period 2014-2020. Even by 2013 the CAP will continue to be the largest single element in the EU budget and the amount available for EU agricultural spending after 2013 will be determined by any changes in both the overall size and/or the composition of this financial framework. These negotiations are being conducted under the fallout from the economic crisis and will be heavily influenced by it.

A third element to note in establishing the context for the Communication is that this CAP reform will be first in which the European Parliament, in the light of its new powers conferred by the Treaty of Lisbon, will be an equal partner with the Council in deciding on agricultural policy. This new role to be played by the Parliament makes it even more difficult than usual to predict what the outcome of the negotiations will be.

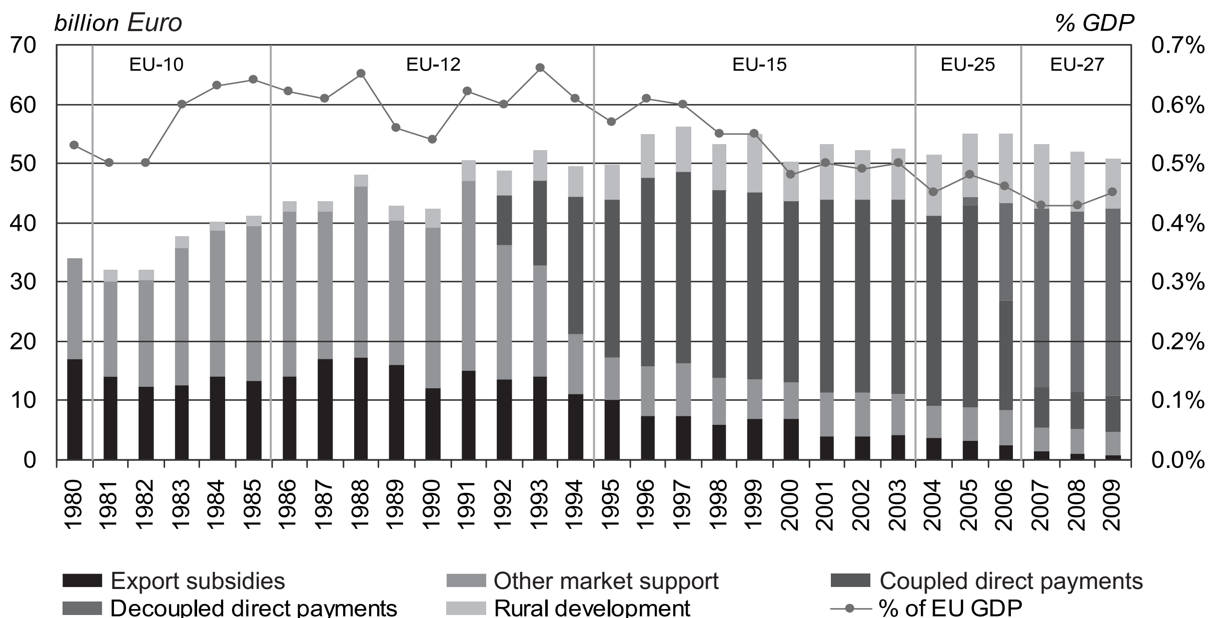
1.1 Commission Communication Builds on Previous CAP Reforms

The Communication builds on a series of CAP reforms going back to 1992. Following these reforms, the CAP is now based on a two-pillar structure. Pillar 1 is concerned with the economics of agricultural production - market and income support - and is fully funded from the EU budget. Pillar 2 focuses on improving the structural and environmental performance of agriculture and promoting local and rural development, and is co-financed by the Member States. Also, Pillar 2 expenditure is

programmed at the Member State or regional level and involves multi-annual commitments to beneficiaries, whereas Pillar 1 expenditures are paid on an annual basis. Finally, Pillar 1 measures apply across the EU as a whole, whereas Pillar 2 operates on a (constrained) menu arrangement where Member States have the ability to choose from among a list of measures that they think are of most relevance to them.

Over time, the role of market intervention under Pillar 1 has been reduced. Administrative support prices have been lowered, intervention costs have fallen and there has been a substantial reduction in expenditure on export refunds. Farmers were compensated for the reduction in support prices through increased direct payments. These were initially coupled to production, albeit with production limits including quotas on milk and sugar, but since the so-called Fischler reforms in the CAP Mid Term Review in 2003 which came into force from 2005 onwards, most of these direct payments are now decoupled from production. As a result, total expenditure on transfers to agriculture has stabilised over the past decade. However, the relative share of total CAP spending on Pillar 2 objectives has increased through mechanisms such as 'modulating' (transferring) a portion of the Pillar 1 direct payments to individual farmers to Pillar 2 expenditure. Figure 1 shows the impact of these previous CAP reforms on the allocation of EU budget expenditure for agriculture.

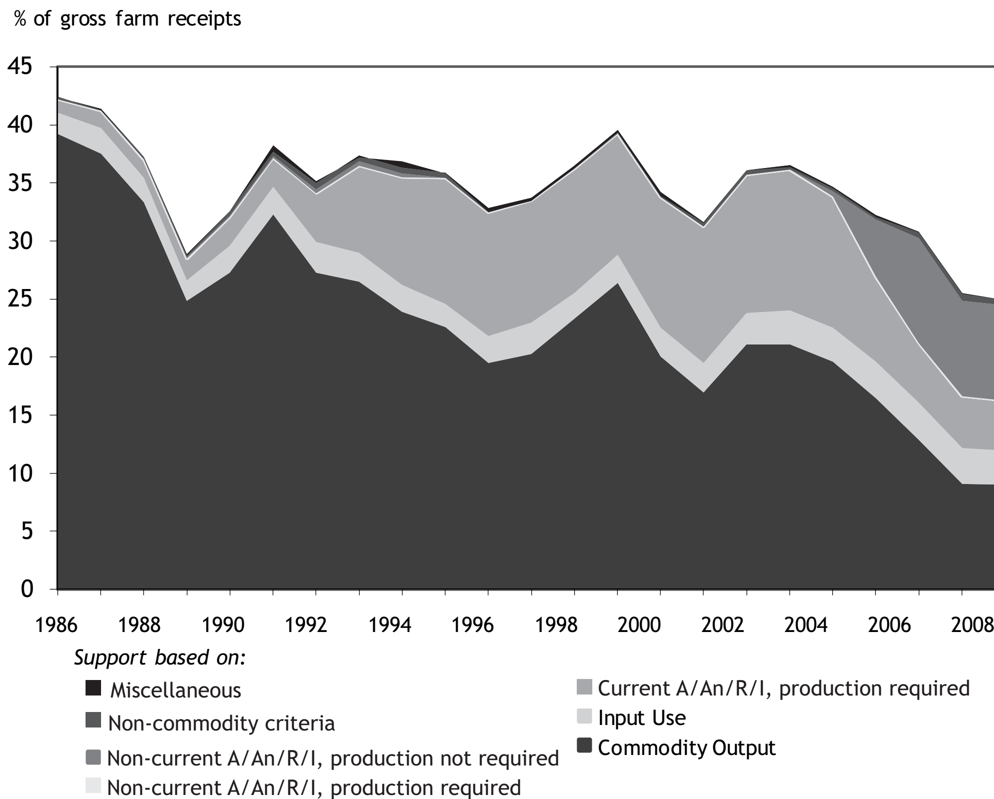
Figure 1. CAP expenditure and CAP reform path (2007 constant prices)



Source: European Commission - DG Agriculture and Rural Development

Budget transfers make up only part of the support to EU agriculture. Market price support delivered through protection against lower-priced imports by means of import tariffs (and, to a decreasing extent, export subsidies) remains significant. Support to producers (as measured by the OECD percentage Producer Support Estimate (PSE) figure) decreased from 40% in 1986-88 to 27% in 2006-08 (Figure 2). The combined share of the most distorting types of support (commodity output and non-constrained variable input-based support) in the PSE fell from 92% in 1986-88 to 42% in 2006-08. During the same period the share of the least distorting types of support (payments with no requirement to produce) reached 33%. Prices received by EU farmers were 76% higher than those on the world market in 1986-86, but were just 15% higher in 2006-08 (OECD, 2009).

Figure 2. EU Producer Support Estimate: level and composition by support categories, 1986-2008



Source: OECD 2009

1.2 Impact on Supply Balances Magnified by Environmental and Regulatory Constraints

The impact on production of the gradual reduction in trade-distorting support in the EU has been magnified by the measures taken in response to the growing awareness of the negative environmental impacts of agricultural production. These include pollution of soil, water and air, fragmentation of habitats and loss of biodiversity. The EU has signed up to the UN convention on biological diversity which aims to achieve a significant decrease in biodiversity loss by 2010, and has an independent commitment to halt biodiversity loss in Europe by this date. The centerpiece of the EU strategy is the Natura 2000 network of protected areas which now covers approximately 17% of the EU territory. In these areas farming intensification is curtailed in order to protect their ecological value. The 1991 Nitrates Directive protects water quality by preventing nitrates from agricultural sources polluting ground and surface waters. Forty per cent of the EU's territory is now covered by action plans which set a maximum limit of 170 kg nitrogen per hectare from livestock manure thus implicitly also setting a ceiling on livestock densities. Over the rest of EU farmland farmers are encouraged to reduce intensification through voluntary participation in agri-environment schemes.[1]

Food safety, quality and animal welfare standards have also been increased, particularly following the BSE crisis in 2000, thus raising the cost base of EU producers. Where standards affect product characteristics, they also apply to imported produce. Standards which affect production processes, such as animal identification and registration regulations, or animal welfare standards, are not formally applied to imports. The impact of these regulations is sometimes exaggerated. In some cases, competitor countries implement similar standards. The costs of compliance may be offset by the willingness of consumers to pay a premium for domestic production because of the assurance that high standards have been met. However, for particular production systems stricter regulatory decisions have increased relative production costs in Europe and thus contributed to the changing supply balance within the EU.

1.3 Biofuel Mandates Have Diverted Feedstocks into Fuels and Away from Exports

A further complementary policy which has impacted on the EU's food supply balance is its renewable energy targets, which include a requirement on Member States that 10% of their transport fuels should be sourced from renewable sources, mainly biofuels, by 2020. The actual blend rate (mainly biodiesel in the EU) was 4.05% in 2010, compared to a target of 5.75%. The EU expects about 70% of the feedstock to be produced internally and 30% to be imported. The diversion of agricultural feedstocks to the biofuel market reduces supply availability in the food market, although the precise impact is disputed (in part because co-products are recycled back into the food market, and higher crop prices will encourage some yield response as well as bring additional land into production, so the diversion is considerably smaller than one for one).

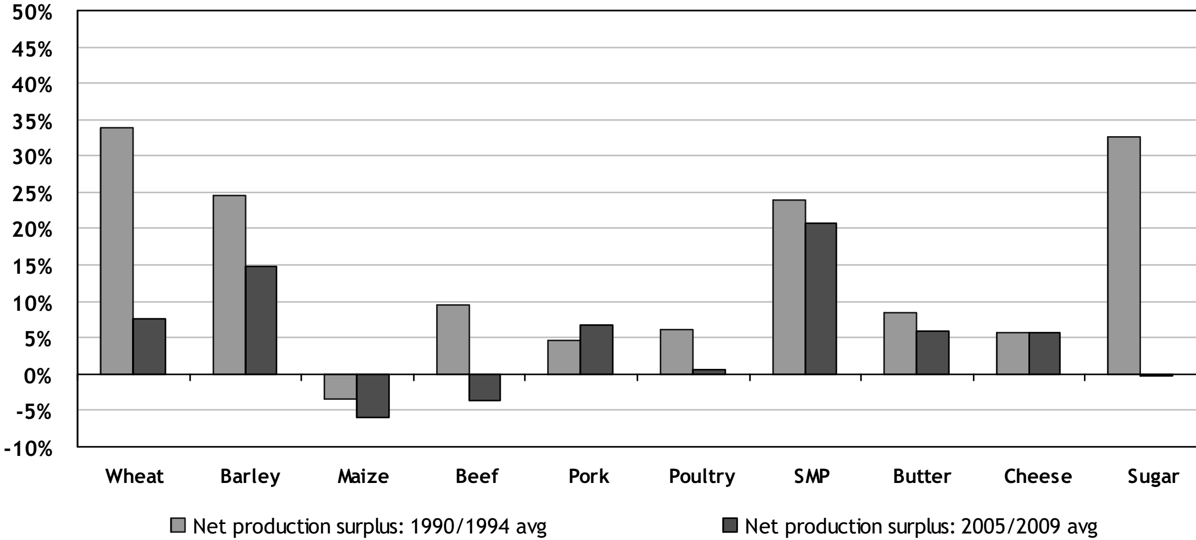
From the global price perspective, it does not matter whether the EU mandate is met from domestic or imported supplies (although feedstocks originating in third countries may be more efficient in converting plant energy into food energy than using EU domestic supplies and thus have a smaller resource footprint as a result). Although small in magnitude compared to the US programme, the EU renewable energy mandate has already had an impact on agricultural markets. The required feedstock for the anticipated biofuels production in 2010 is estimated at about 9 million metric tonnes (mmt) of cereals, about 10 mmt of sugar beets and about 10 mmt of vegetable oils (crushed from about 17 mmt domestically produced oilseeds, mainly rapeseed). Offsetting this, total production of by-products from bioethanol and biodiesel production is forecast to reach nearly 3.3 mmt (mainly dried distillers' grains) and 10 mmt (mainly rapeseed meal), respectively (USDA, 2010).

1.4 Changes in EU Self-sufficiency

The EU is broadly self-sufficient in agri-food trade as a whole. Exports are predominantly processed and value added foods, and the EU has either reduced its net export surplus or moved to a net importer status for an increasing number of basic commodities. This shift in the net trade status of the EU has played an under-appreciated role in the strengthening of food commodity prices in recent years.

Although this change in the net trade status of the EU is the outcome that developing countries have sought and negotiated hard for in the WTO Uruguay Round and Doha Round negotiations, the resulting rise in food commodity prices met with very mixed reactions, with many development NGOs calling for measures which would reduce world price levels again. Whereas developing countries had been successful in making the association between depressed world food prices arising from EU and OECD protectionism and poverty in the early part of the 2000s, the headlines in the latter half of the 2000s stressed instead the connection between high world food prices and hunger. There is little doubt that this apparent confusion fed into the changed discourse on agricultural policy objectives within the EU, and has given ammunition to those calling for an ambitious CAP to ensure food security both at home and abroad (Swinnen, 2010).

Figure 2. Impact of CAP reforms on EU net production surplus



Source: European Commission - Eurostat and DG Agriculture and Rural Development

2. CAP POST 2013 REFORM

2.1 Why Another CAP Reform Now?

There is no legal requirement to review the CAP's agricultural market management mechanisms, the design of direct payments or rural development programming rules at this time, but a number of factors make it opportune to do so. First, spending limits for the two CAP Pillars are only in place to the end of 2013. Agreeing new spending limits inevitably raises the question of how this money is being spent and allocated between the Member States. This must address the legacy of the 2004 and 2007 enlargements when 12 countries of central and eastern Europe became EU members and thus eligible for CAP support. Their support rates turn out to be much lower on a per hectare basis than in the old Member States and they have pressed to have this issue addressed. It is a certainty that greater equity in the distribution of direct payments between Member States will be one outcome of the next CAP reform.

More broadly, there is an awareness within agricultural policy-making circles of growing criticism of agricultural spending as being unfocused, untargeted and hard to justify on any rational criteria. This puts the Agricultural Commissioner in a very weak position to defend the CAP budget in the budget review negotiations. Thus the Communication is part of a strategy designed, first, to provide greater legitimacy for CAP spending in the future and thus, second, to enable the Agricultural Commissioner to make a stronger case for a large CAP budget in the next financial framework. The extensive public consultation which preceded the Communication which was designed to elicit public expectations for agricultural policy in the coming years was designed to feed into this strategy.

The context for this process is also important. In recent years there has been growing volatility in agricultural prices as the EU phased out the use of its traditional market management instruments. A short-lived drop in milk prices in late 2008 and 2009 which particularly affected the powerful dairy sector underlined this new vulnerability of EU farmers to price fluctuations. The 2007-08 price spike for food commodities on world markets, and the association made between high prices and increased hunger in developing countries, reintroduced the rhetoric of food security into EU agricultural policy discourse, even though on any objective basis this is not a cause for anxiety as far as the EU itself is concerned.[2] However, it is used in the Communication to argue that "it is essential that the EU maintains its production capacity and improves it" even if this is qualified by adding "while respecting EU commitments in international trade and Policy Coherence for Development". Evidence that when commodity prices rose consumer prices followed suit but the reverse failed to happen when commodity prices fell again has highlighted the declining farmers' share of total food chain value added and raised concerns about the market power of retailers. Furthermore, the Communication highlights the drop in the ratio of agricultural to non-agricultural incomes in 2009 as a result of the economic crisis.

The role of agriculture in producing public goods has received increasing attention in Europe over the past two decades, and this is again underlined in the Communication. A new challenge here will be facilitating the role of agriculture in meeting the ambitious EU energy and climate change agenda. Agriculture will need to reduce GHG emissions through improved production efficiency, biomass and renewable energy production, but also needs to be incentivized to exploit its potential for carbon sequestration and the protection of carbon in soils.

The Communication also emphasises the role for agriculture to contribute to territorial balance and social cohesion. It recognizes that the growth dynamic in many rural areas is now driven by factors outside of agriculture, but in predominantly rural areas and in the new Member States where agriculture continues to have a significant share of employment and

economic activity there is a need to allow for structural diversity in farming systems and to improve conditions for small farms.

Awareness of these new challenges has also fed into the reform proposals presented in the Communication.

2.2 CAP Instruments Post 2013 – Direct Payments

Against this background, what does the Commission Communication propose? As a consultation document, it actually sets out three options. The first option would continue the status quo apart from a correction to the distribution of direct payments across member states. The second option, which is widely seen as the Commission's preferred option, contains proposals for some greater targeting of the Pillar 1 payments plus an extension of the menu of Pillar 2 measures to include, for example, climate change mitigation and risk management instruments. The third option would be a more far reaching reform of the CAP with a strong focus on environmental and climate change objectives, while moving away gradually from income support and most market measures. For the purposes of this note, we analyse the proposals in Option 2 in greater detail.[3]

All options accept that the current allocation of direct payments between Member States is no longer tenable and should be replaced by a more equitable distribution which might take into account both economic and environmental criteria. However, the Communication is silent on the formula that might be used and what implications this might have for the distribution of payments between Member States. It poses but does not answer the question "how to reach an equitable distribution that reflects, in a pragmatic, economically and politically feasible manner, the declared objectives of this support, while avoiding major disruptive changes which could have far reaching economic and social consequences in some regions and/or production systems". Given the politically-determined nature of the historical allocation, it appears that any use of solely objective criteria would lead to unacceptable swings in the payments made to at least some Member States. The one hint given in the Communication is that a possible option could be a system that limits the gains and losses of Member States by guaranteeing that farmers in all Member States receive on average a minimum share of the EU-wide average level of direct payments.

There is a proposal that in future direct payments would be confined to 'active farmers'. This is a response to criticisms from the Court of Auditors that non-farmers were in receipt of direct payments by virtue of the fact that they owned land yet carried out no farming activity, but there is as yet no attempt to provide a legal definition of an 'active' farmer.[4] It seems likely that any new legislation will offer a range of definitions but will leave it up to Member States to choose the definition which best suits their structural characteristics. It will be important to ensure that the criteria used will not put into question the WTO compatibility of the direct payments, for example, by requiring recipients to engage in agricultural production.

The Communication also proposes greater targeting and greening of direct payments in Pillar 1. Basic income support would be provided by a uniform decoupled direct payment to all farmers in a Member State or region, based on transferable entitlements that need to be activated by matching them with eligible agricultural land, and with eligibility also dependent on fulfilling cross-compliance requirements. This would be a continuation of the Single Farm Payment (SFP) scheme now operated in the 15 old Member States and Slovenia. These payments would be capped to improve the distribution of payments between farmers. It is not clear why the Communication opts for the SFP scheme rather than the simpler Single Payment Scheme now operated in most of the new Member States and which does not require the concept of eligible land (European Parliament, 2010b).

Member States would be required to offer, in addition, a scheme of green direct payments focused on environmental measures applicable across the whole of the EU territory, and paid to all farmers meeting the relevant criteria. Priority

would be given to actions addressing both climate and environmental policy goals. These would be simple, generalised, non-contractual and annual environmental actions that would go beyond the cross-compliance requirements. Examples are given of permanent pasture, green cover, crop rotation and ecological set-aside. In some cases, it would seem that farmers would be eligible for these payments on the basis of their current activity; in other cases, farmers might incur additional costs in order to participate, a distinction which might affect the classification of these payments in WTO reporting of the EU's domestic subsidy commitments.

A third component of these Pillar 1 payments would be additional income support to all farmers in areas with specific natural constraints in the form of an area-based payment. Currently, the EU makes payments to farmers in Less Favoured Areas defined as mountain areas or other areas with handicaps to ensure continued use of land and thus maintenance of the countryside as part of Pillar 2. In an earlier draft of the Commission Communication, the intention was to move all of the LFA payments from Pillar 2 to Pillar 1, while also allowing Member States to make a voluntary top-up payment to beneficiary farmers. In the published Communication, it is merely proposed that this third component would be paid as a complement to the support given under Pillar 2.

The Communication provides for the continuation, where Member States desire, of a limited scheme of coupled direct payments to maintain particular types of farming considered particularly important in certain regions for economic and/or social reasons. It also proposes a new support scheme for small farmers in Pillar 1 with simpler eligibility conditions as a substitute for the standard basic income support scheme.

These proposals appear to blur the distinctions between Pillar 1 and Pillar 2 in terms of their objectives, contrary to the desire expressed elsewhere in the Communication that "the separation between the two pillars should bring about clarity, each pillar being complementary to the other without overlapping and focussing on efficiency". Farmers would be eligible for agri-environment payments under both Pillar 1 and Pillar 2. Farmers in areas with specific natural constraints would also be eligible for payments from both Pillar 1 and Pillar 2. Presumably these payments would continue to be made under different administrative arrangements (non-contractual annual payments under Pillar 1, contractual multi-annual payments under Pillar 2). The Communication is silent on whether some element of national co-financing would be introduced in Pillar 1 so we must assume that it is intended that Pillar 1 expenditure would continue to be wholly funded from the Union budget.

One consequence of this strategy is that it implicitly, rather than explicitly, transfers funds from traditional Pillar 1 income support payments to objectives traditionally supported by Pillar 2. It might even be the deliberate intention of the Commission. It has attempted to increase the relative share of Pillar 2 spending in total CAP spending in the current financial framework period through 'modulation'. Under this arrangement, a portion of direct payments were siphoned off and transferred to increase the budgetary resources available to Pillar 2. While it would be open to the Council and Parliament to transfer funds directly between the two Pillars in the next financial framework, the Commission may have felt that this was unlikely to happen and opted instead to broaden the scope of the support payments under Pillar 1. Indeed, the withdrawal of the proposal to move all LFA payments from Pillar 2 to Pillar 1 shows the strength of the political forces wanting to retain Pillar 1 payments as much as possible for 'pure' income support.

2.3 CAP Instruments Post 2013 – Market Management

Despite the rhetoric around food security and the need to maintain EU production capacity, the Communication does not reverse the move to a greater market orientation of previous EU reforms. However, the current architecture of market management tools would be maintained. These include safety net intervention, recourse to private storage and the use of market

disturbance clauses to address periods of price crises. A risk management toolkit is proposed (to be funded under Pillar 2, and thus left up to Member States whether they wish to adopt these measures or not). The toolkit would address both production and income risks, and will include measures such as a new WTO green box-compatible income stabilisation tool as well as support for insurance instruments and mutual funds. The removal of dairy quotas after 2015 is underlined and, given that the quota regime in the sugar and isoglucose sectors is set to expire also in 2015, the option of a “non-disruptive end of quotas at a date to be defined” will be examined. The Communication also highlights the imbalance of bargaining power along the food chain and points out the importance of the level of competition at each stage, contractual relations, transparency and the functioning of agricultural commodity derivative markets, but leaves concrete proposals in these areas to another occasion. The Commission intends to adopt a first package of legislative proposals as a follow up to the work of the High Level Expert Group on Milk in December 2010.

2.4 CAP Instruments post 2013 – Rural Development

Little change is foreseen in the Communication in Pillar 2 although a greater focus on the environment, climate change and innovation is promised. Criticism of the value of some expenditure under Pillar 2 is recognised by promising a more outcome-based monitoring with the possibility of a performance-based reserve as an incentive for Member States to take outcomes more seriously. A key internal issue is the need to come up with an acceptable distribution key, based on objective criteria, for allocating the Pillar 2 budget among Member States. The need for more coherence between Pillar 2 rural development expenditure and the other EU structural funds is underlined, possibly through developing a common strategic framework for all EU funds.

3. TRADE AND DEVELOPMENT ASSESSMENT

The Communication is published in the context of the debate on the shape of the EU budget in the next financial framework post 2013 (European Commission, 2010c). Its rationale is to propose reforms which would improve the legitimacy of agricultural spending in an attempt to maintain as large a share of CAP spending in the forthcoming negotiations on the EU budget as possible. From the trade and development perspective, the action takes place within the domestic support pillar of the WTO Agreement on Agriculture (AoA). The Communication has little to say on issues which fall under the market access pillar of the AoA.

3.1 Trade and Development Impacts Through the AoA Market Access Pillar

Nonetheless, a number of issues can be highlighted from a market access perspective. Under market management instruments, no reference is made to the future of export subsidies. As part of its negotiating offer in the Doha Round, the EU offered to eliminate export subsidies after 2013, provided other countries eliminated similar forms of export support. While the Commission wants to reduce its use of export subsidies, they were activated in the dairy and pigmeat sectors in response to the price difficulties in these sectors in 2008 and 2009. It remains uncertain whether the EU intends to unilaterally abandon its use of export subsidies after 2013. This would certainly be a positive step from a trade and development perspective.

The discourse on food security in the Communication could make it more likely that the Commission will use its powers to actively manage its applied tariffs to moderate the impact of world price fluctuations on EU consumers. For example, during the price spike of 2007-08, the EU suspended import duties on the import of cereals and has done the same for sugar in 2010. Like the imposition of export restrictions or taxes (which also are not disciplined by WTO rules), the effect of such actions is to amplify the extent of price volatility faced by other trading partners, including developing countries.

The Communication proposes to maintain safety net intervention. This means that the EU will continue to have an applied administered price for cereals, sugar, dairy products and beef which will feed into the Market Price Support component of its Aggregate Measure of Support. However, these prices are fixed in nominal terms and their real value is eroded over time with inflation. Put another way, if nominal prices (in euros) on world markets are likely to increase then the value of these minimum support prices in providing support becomes less significant over time.

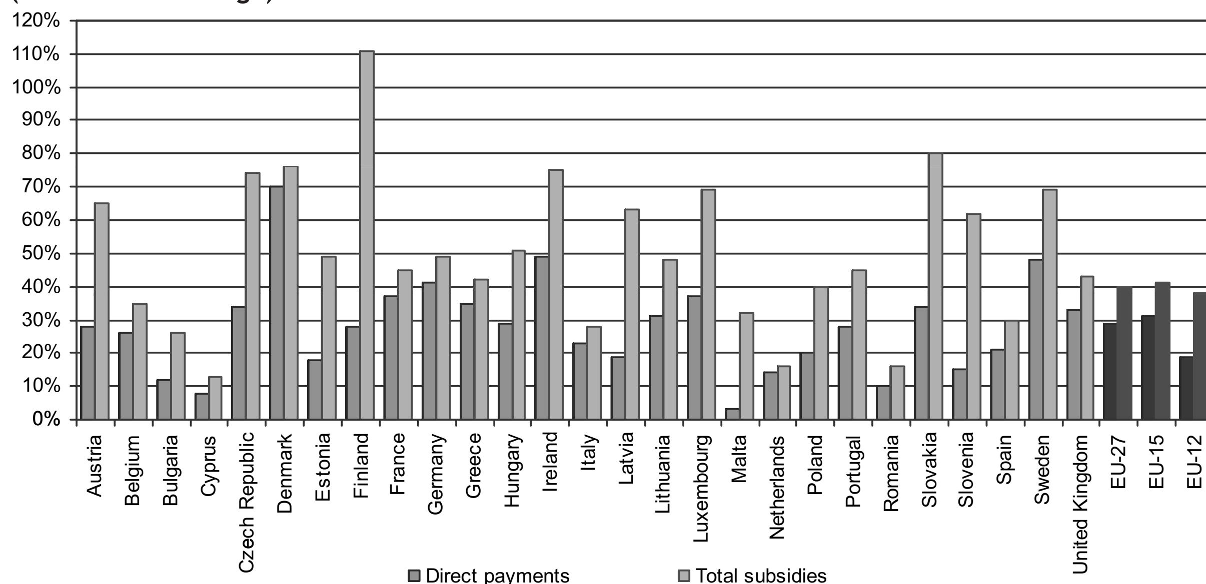
The removal of quotas on milk production after 2015 will lead to increased production of dairy products and a lower internal EU price.[5] This will tend to lower global dairy products prices (other things being equal). The possible removal of sugar quotas after 2015 also needs to be kept in mind, given its greater ramifications for developing countries both as exporters and importers.

3.2 Trade and Development Impacts through the AoA Domestic Support Pillar

In its latest notification to the WTO regarding its domestic support commitments for 2006/07, the EU reported the following breakdown of its domestic support: Green Box €56.5 billion, Blue Box €5.7 billion and Amber Box or AMS €26.6 billion. Green Box expenditures must comply with the overall requirement that they have no or minimal trade-distorting effects as well as specific rules which apply to different types of payments and which are set out in Annex 2 of the WTO Agreement on Agriculture (AoA). EU Green Box expenditures are exempted from discipline under the AoA, but many developing countries have raised concerns that the sheer scale of these payments, including the decoupled income support payments, may have a non-negligible trade-distorting effect

(Meléndez-Ortiz et al, 2009). Indeed, EU figures show that the share of direct payments and total subsidies in agricultural factor income is 28% and 40% respectively for the EU-27, suggesting that much EU agricultural production would not be economically sustainable with current farm structures in the absence of this support. However, removal of this support would lead to a substantial structural adjustment in EU agriculture. One modelling study (SCENAR 2020-II) suggests that even combining the removal of support with the elimination of all trade and market management measures would have more effect on agricultural income and the number of farms than on agricultural production (Nowicki et al., 2009). Lower land prices and, to a lesser extent, agricultural wages would play a key role in absorbing the shock of the removal of support and contribute to mitigating the fall in production levels.

Figure 4. Share of direct payments and total subsidies in agricultural factor income (2007-2009 average)



Source: European Commission - DG Agriculture and Rural Development

The Communication could influence this argument in two ways: first, by altering the composition of Green Box expenditures and, second, by altering their scale. The targeting and greening of direct payments in Pillar 1 described earlier could shift direct payments from decoupled income support to environmental and regional assistance programmes which would reduce concerns about the trade-distorting impacts of Green Box payments. Whether the scheme of green direct payments proposed to be financed from Pillar 1 would qualify as a payment under an environmental programme under the AoA would depend, inter alia, on whether the payment would be dependent on the fulfilment of specific conditions and would be limited to the extra costs or loss of income involved in complying with the government programme. However, regardless of the precise WTO classification of these measures, in principle attaching additional conditions or greater targeting to the receipt of direct payments will always lower their trade-distorting impact.

Within Pillar 2 some expenditures will be switched from other Green Box measures to WTO-compatible government financial participation in income insurance and income safety-net programmes measure in those Member States which might avail of this option. Other expenditures will be switched to the proposed measures to address climate change issues. Whether on balance these changes in the composition of Pillar 2 expenditure would make it more or less trade-distorting is difficult to say a priori.

These composition effects will be less important than the decisions made about the overall budget envelope to be made available

for the CAP and how this is divided between Pillars 1 and 2, and in turn how the Pillar 1 envelope is divided between the basic income payment, the green payment and the natural handicaps payment. These parameters will not be decided until the very end of the negotiation processes involving both the future of the CAP and the future of the EU budget, and thus will not be known for some time.

3.3 Impact of the Commission Communication on Developing Countries

It is significant that the Communication accepts that the measures proposed for the CAP post 2013 should respect the EU's Policy Coherence for Development commitments. This means that when the Impact Assessment of these proposals is undertaken, there is an explicit mandate to explore the impact on developing countries. Any impact on developing countries would be mediated through changes in world market prices brought about by the implementation of the reform. However, developing countries are no longer a homogenous group, and any impact assessment would have to distinguish between at least three different groups of developing countries: exporters without preferential access; exporters with preferential access; and net importers.

Nonetheless, it is possible to draw some tentative conclusions from this qualitative review of the proposals. The Communication is unlikely to make any significant difference to market access conditions to the EU agri-food market and therefore any global price effects are likely to be of a secondary order of magnitude. The failure to make a commitment to ending the use of export subsidies after 2013 is a disappointment. The Commission sees this as an integral part of the Doha Round negotiations which, like improvements in market access, should wait until there is a successful outcome to the Doha Round. However, the EU has made some improvements in market access due to unilateral changes in its trade (rather than agricultural) policy. Here the significant improvements in EU market access that have already occurred since the start of the Doha Round negotiations should be highlighted. These include the grant of duty-free quota-free access to all least developed countries in 2001, and the extension of duty-free quota-free access in 2008 to all African, Caribbean and Pacific country signatories to the Cotonou Agreement which signed an interim Economic Partnership Agreement with the EU. Importantly, all of sub-Saharan Africa (with the exception of South Africa) can now potentially enjoy unrestricted access to the EU agri-food market and some of these exporters benefit in addition from the rents created by the protection against third country exporters to the EU market.[6] Further changes will flow from the Global Europe trade policy announced in 2006 (European Commission, 2006) and reiterated in the recent Commission Communication on EU trade policy (European Commission, 2010d) which foresees a new activism in concluding bilateral free trade agreements. However, the degree of additional market access granted to agri-food exports in these agreements remains limited.

The proposal for greater targeting of direct payments should also be welcomed as a step towards reducing any remaining trade-distorting impacts of these payments, even if the preferred option in the Communication still leaves in place universal and undifferentiated basic income payments. A new risk management toolkit is proposed which will comply with WTO Green Box requirements, but these will be national schemes rather than an EU-wide measure and triggering these instruments is left to the discretion of individual Member States. Crucially, the Communication is silent on the overall envelope for CAP spending in the coming financial framework and how this will be divided up between the two Pillars and across measures within each Pillar.

4. CONCLUSIONS

The Commission Communication on the CAP towards 2020 is a consultation document which proposes possible options for the shape of the CAP after 2013. Much can change as consultations now take place on these proposals. The Commission has now invited submissions for the Impact Assessment which will be published alongside the legal proposals in mid-2011. The adoption of these proposals is expected around mid-2012.

This will be the first CAP reform in which the European Parliament will have equal powers with the Council of Ministers in determining the outcome as a result of the coming into force of the Treaty of Lisbon. It is as yet unclear how the involvement of the Parliament is likely to influence the outcome of the debate. Traditionally, the Agriculture Committee of the Parliament has strongly supported farmers' interests, and its Opinions were generally approved by the Parliament as a whole during the period when the Parliament had a purely consultative role. The debate on CAP reform is now running parallel to, and is an integral part of, the debate on the future EU medium-term budget framework. This means that a much larger range of interests are in play in the Parliament. Whether the Agriculture Committee will get its way is no longer so certain. What does seem clear is that the negotiations will be exceedingly tortuous, and it will not be surprising if agreement is still elusive in 18 months' time.

ENDNOTES

1 See Matthews, A. 2010, Production effects of agri-environment programmes, http://capreform.eu/production-effects-of-agri-environmental-programmes/, posted 29 July 2010.

2 Zahrnt, V., 2010, Can the EU rely on world food markets? http://euobserver.com/7/30865, accessed 18 November 2010.

3 See European Parliament (2010b) for a comparison of the proposals in the Communication with those in the Parliament's Lyons report.

4 The Court of Auditors' criticisms were made in its Annual Report on the 2008 Financial Year. As part of the CAP Health Check the Commission had proposed that Member States should exclude natural or legal persons from the direct payment schemes whose business objects do not consist in agricultural activities or whose agricultural activities are insignificant. However, the Council made this provision optional for Member States (Article 28(2) of Regulation (EC) No 73/2009).

5 See Matthews, A., 2008, Milk quota removal could cost EU farmers €4 billion, http://capreform.eu/milk-quota-removal-could-cost-eu-farmers-e4-billion/, posted 11 May 2008.

6 Three Sub-Saharan African countries, Nigeria, Gabon and the Democratic Republic of Congo, have chosen not to sign interim EPAs and currently their agri-food exports (which are limited) enter under the GSP.

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