The CAP and its Reform – Half a Century of Change?

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This article outlines how the Common Agricultural Policy (CAP) has evolved, from its establishment after the Stresa Conference to the present day. What follows seeks to highlight the key binding pressures for policy reform and how they influenced the direction taken. In trying to summarise half a century of evolution in a short article, choices have had to be made as to which aspects to focus on and what to omit. Guidance in this has been taken from two unchanging elements: the formal objectives of the CAP (listed in Box 1 in David Stead's Guest Editorial) and, underpinning these, the fundamental principle of providing collective financial support to agriculture.

As a result emphasis is given to transfers from the EU[1] budget which, as Figure 1 shows, have risen persistently over time; and the policy instruments used to direct these resources: for, ultimately, the CAP has been run primarily as a policy that has channelled financial resources to farmers in order to achieve economic, political and – increasingly – environmental, health, safety and welfare goals for or through them. Other important issues – such as the impact of the CAP on groups other than EU farmers, national budgetary transfers to agriculture and political economy explanations of policy formation and change – can, at best, be given only passing mention in the present article.

[FIGURE 1 ABOUT HERE]

The output and budget impacts of price support

As Stead shows in his Editorial, the CAP was established with price support at its centre. This supported farmers' incomes by enabling them to sell their output at prices higher than would otherwise prevail. It was known from the outset that the effect on output would depend on the price levels set. In the end, they were set high and subsequently increased further – even though they barely kept up with very high general inflation (Ackrill, 2005: 457-8). Furthermore, whilst all farmers benefited from higher prices, only some could boost incomes further by increasing production. This group, whilst relatively small in number, subsequently increased output considerably, partly through the adoption of advancements in science and technology, leading to the now almost-mythical statistic of 80 per cent of support going to 20 per cent of farms. (For some production data, see the Parlons Graphiques in this issue.)

The instruments of price support had a major impact on the EU budget. They generated revenues via a variable levy on imports, but generated expenditures through the need to keep surplus quantities of commodities off EU markets to maintain high prices. This spending – on export subsidies and intervention storage – rose as output and market imbalances increased (Figure 1). These costs, however, were not borne solely by the countries producing the surpluses, but shared by all member states (the principle of 'financial solidarity'). The CAP's border protection imposed a double cost on EU importers, since the price of intra-EU imports was raised above free-trade levels (Ackrill *et al.*, 1998). Thus net CAP-related transfers to net exporting countries were significantly higher than those to net importing countries (for example Germany and the UK), with the latter at the time also typically net contributors to the EU budget overall. These factors would later influence national positions on CAP reform.

Budgetary pressures for reform

Persistent surpluses had been present in the EU for some commodities, notably dairy, since the 1960s. By the late 1970s, surpluses emerged for other key commodities, with self-sufficiency for total cereals and beef exceeding 100 per cent from 1979. This drove CAP spending towards its one binding constraint at that time: the balanced budget rule on total EU spending. An essential co-requisite for budgetary crisis, though, was an amendment to the Treaty of Rome in 1970 which designated CAP spending as 'compulsory'. As a result, expenditure control was possible only via changes to expenditure-generating policy instruments.

In order to change the trajectory of CAP spending and ensure the budget balanced, the EU needed to reform the CAP. This did not require CAP spending to be cut, just that its growth be curtailed. Even so, policy makers faced significant constraints in how they could reform the CAP.[2] Spending was being driven by rising output, driven in turn by prices that far exceeded world market levels. Price cuts sufficient to curtail output growth, however, faced enormous political opposition, given the potential effect on farm incomes. Furthermore, farmers still opposed direct lump-sum payments, the principal alternative to price support, as 'social handouts' rather than support linked to output and effort (direct payments also reveal more clearly the full economic cost of support).

In sugar, however, the CAP had a precedent that preserved the principal structures of price support, supplemented by production quotas to control output, if not spending, directly. Sugar beet requires processing, offering a channel through which beet must pass and, therefore, where production can be controlled. This policy could not easily be extended to all CAP commodities but the immediate budget crisis in 1984, when the balanced budget rule was breached, could be addressed by reforming just a single sector – dairy. This represented approximately a third of CAP spending and a quarter of total EU spending. Most milk output, like sugar, is processed, offering a point where production quotas could be imposed. By containing the growth in production, growth in expenditure on this sector was contained – without the need to get agreement on reductions in support prices. Although the dairy sector had been in surplus since the 1960s, previously there had been no binding pressure for reform. This arose with the breaching of the balanced budget rule, and a single-sector response was feasible because, at the time, the dairy sector dominated CAP spending.[3]

Throughout the 1980s reform efforts seeking to forestall budgetary crisis were directed at other commodities but all sought merely to tweak the existing system of price support. Prices were reduced by, at most, only a tiny fraction of the EU-world price gap; production incentives and hence budget pressures remained fundamentally unaltered. The upwards trajectory of CAP expenditure was thus unaffected, driven by spending growth on commodities other than dairy. The 1988 reform included land set-aside measures but, introduced on a voluntary basis, this failed to alter the trajectory of spending.

Trade pressures for reform…

By the late 1980s, output growth led to a second binding pressure on the CAP. The emergence of the EU as a major agricultural exporter, largely on the back of price support, created significant tensions between the EU and other agricultural exporters. Figure 2 shows, for selected years, EU shares of world exports and imports for key (in budget terms) commodities. The position of dairy and the impact of the 1984 reform on export shares are dramatic. Less striking graphically, but crucial in budgetary and/or trade terms, is the growth of subsidised exports of cereals, beef and sugar over 1977-92.

[FIGURE 2 ABOUT HERE]

[Note, there seems to be two “2005 X” in the legend of this figure, the second pink one seems redundant?]

Trade issues came to a head in the Uruguay Round of talks in the General Agreement on Tariffs and Trade (GATT, now part of the WTO). GATT rules permitted limited subsidised agricultural exports, but these rules were ambiguous and, ultimately, proved unenforceable. The Uruguay Round Agreement preserved agriculture’s exception to key trading principles but clarified the terms of that exception. In particular, quantitative limits were agreed on the use of export subsidies and on trade-distorting domestic support. This provided a clearer framework within which national policies should operate.

Agreement in the Uruguay Round, however, required CAP reform. In order to make the policy less trade-distorting, price support levels had to be reduced significantly. Simply reducing prices, however, would have compromised the goal of income support: the EU had to alter *how* the CAP delivered support. The change from price support to direct payments, agreed in 1992, focused on the main spending sectors, especially arable and beef. In order to attempt to decouple support, that is break the link between levels of support and production, the unit values of the payments were fixed and, for arable producers, 'compulsory'[4] set-aside measures were incorporated to help to limit production – and thus contain exports and trade-distortion. Figure 2 shows the impact of these reforms on subsidised exports. Because farmers had to continue producing within established commodity areas to qualify for the payments, however, the link between support and production was not broken entirely. Whilst set-aside helped to contain the budgetary and trade-distorting effects of the CAP, the wider economic efficiency of the agricultural sector was further compromised, as productive inputs were removed from production but mostly retained in the sector (neither Various, 1973, nor Barbero *et al.*, 1984, suggest set-aside as a policy option).

Direct payments finally had been accepted, if only out of necessity, reflecting new political realities and GATT pressures. More recently, WTO concerns were central to shaping the 2003 reform (Swinbank and Daugbjerg, 2006). Here, subject to some exceptions, member states agreed to replace the existing direct payments with 'Single Farm Payments' which, by being further decoupled from production, should reduce still further the trade-distorting and inefficiency effects of the CAP. That said, this reform did nothing for price support, although the 2006 sugar reform partly addressed one of the last major problem sectors in that regard. Overall, though, the EU still provides significant support and protection to agriculture (Anderson and Josling, 2007).

…and the resolution of budget pressures?

The 1992 shift from commodity price support[5] to direct payments reduced the costs borne by consumers (as prices paid were reduced), but raised the budget (taxpayer) cost as direct payments were phased in: the cost of the latter – borne by the public purse – exceeded the savings on export subsidies and intervention storage. After years of reforms motivated by budgetary pressures, it is paradoxical that a reform raised budget costs – especially as the balanced budget rule was again threatened in 1992. But whereas price support-related expenditures rose persistently as surpluses increased, the new payments were fixed in individual and total value. Thus the reform led to a one-off rise in spending, since when the budget cost of the CAP has been more stable (but see below). Furthermore this reform complemented earlier budgetary reforms, where 'Financial Perspectives' set in advance for multiple years also contributed to EU budgetary restraint.

Not since 1992 has the balanced budget rule been threatened, even though the 1999 reform, repeating the pattern of 1992, saw prices cut further and direct payments rise. Enlargement in 2004 had the potential to destabilise the budget, but an overall spending limit was agreed. The EU-15 could have reformed the CAP such that their receipts from the policy would have fallen and the policy applied uniformly across the EU-25. Instead, they left the policy unchanged, effectively ring-fenced their own budget receipts, and set accession terms which imposed on the new members such restrictions as necessary to respect the overall budget constraint. Direct payments in these countries are being phased in over ten years, and will be of lower unit value than in the EU-15 because of lower past yields: a solution only possible because of the shift in the basis of support in 1992. Enlargement will thus have an ongoing, but *controlled*, impact on spending.

New policy concerns

Output-based support has had another impact on policy. The pursuit of quantity, in some cases, compromised quality, safety and the environment. Following various human health crises and animal health concerns, attention has been paid increasingly to animal, plant and environmental health and the quality and safety of food. These issues have not forced reforms in the same way as binding budget constraints or international trade commitments: rather, within overarching budgetary and trade bounds, this emergent policy concern has influenced where and how the CAP and its financial resources are directed.

This shift was perhaps most evident with the 1999 reform, which created the second 'Pillar' of CAP support, rural development. This introduced a clear structure and doubling of the related budget (albeit from a low base of about five per cent of total CAP spending) for these policy measures. Some of the measures reflect the need to continue improving the efficiency of some farms (for example via farm re-structuring), but now resources are also targeted at measures addressing the new multifunctionality agenda (such as promoting agri-environmental initiatives and economic diversification of rural economies). Through post-2003 cross-compliance obligations, even eligibility for the 'main' direct payments is now conditional on achieving environmental and welfare goals. Whilst the formal objectives of the CAP have remained unchanged since 1957, the 1992 Maastricht Treaty required environmental protection to be incorporated into all EU policies; the 1997 Amsterdam Treaty likewise introduced consumer and animal welfare interests.

The 1999 reform led to other developments in the nature of CAP support. Whilst the Pillar II policy framework and core budget allocation are determined collectively, member states can choose measures to implement from the policy 'menu'. It has also seen the first systematic use within the CAP of national co-financing of EU policy initiatives (although cynics might suggest this is a way of increasing spending on CAP measures within a tight EU budget constraint).[6]

Overall, as Figure 1 shows, the growth in CAP spending has slowed, but not reversed in nominal terms. The effect of those reforms implemented to reflect GATT/WTO priorities can also be seen in Figure 3, showing total CAP percentage Producer and Consumer Support Estimates (PSE/CSE). These present the shares of producer receipts and consumer spending attributable to agricultural support policies (with the CSE expressed as a negative number). There has been a modest fall in the PSE as CAP support has been steadily decoupled. With the shift away from price support, however, the CSE has fallen significantly.[7] The structural changes in CAP spending, as described above, are depicted in Figure 4.

[FIGURE 3 & FIGURE 4 ABOUT HERE]

Farmers and CAP reform

CAP reform has not been without opposition. Since the introduction of dairy quotas, farmers have often opposed precisely those changes ultimately agreed by politicians. This author has thus long-questioned the idea of a closed agricultural ‘policy community’ shaping the CAP. Given that, along with the objectives of the CAP, levels of spending have been sustained it is perhaps more appropriate to think of a *budgetary* policy community. This will include agricultural interests (farmers continue to be the main target for financial transfers), but also wider fiscal and political constituencies, for whom preserving national transfers from the EU budget is of profound political significance.

Indeed, regardless of the reforms implemented, until the 2004 enlargement the distribution of spending across countries remained remarkably stable. Price support established a pattern of transfers that favoured larger farms and net-exporting member states. Subsequent reforms changed the basis of support towards direct payments, but based payment size and entitlement on either price cuts and losses incurred (in 1992), or on previous payment receipts (in 2003). The result has been a system that has continued to direct most money to the largest and, arguably, most efficient and affluent farmers.[8] Even with member states now required to 'modulate' some of their payments – that is, to top-slice a small percentage and recycle it into rural development measures – most of the money modulated must remain in the 'home' country (for a broader analysis, see Ackrill and Kay, 2006).

A final issue to address in this article is the question of farming incomes. The observation was made above regarding the centrality to the CAP of financial transfers seeking to achieve the Treaty objective of a 'fair standard of living for…persons engaged in agriculture'. Despite this, there is such a lack of adequate data on farm and off-farm incomes that 'it is not possible to describe and monitor the incomes of farmers and their families, to show how many of them receive low incomes that may place them in poverty, and to distinguish between those that…temporarily have low or negative incomes and the smaller core where the situation is endemic' (Hill, 2008: 12).

More problematically, there is a lack of demand for better statistics. In particular, Eurostat data 'showed farmers as a group in most EU-15 countries [at the turn of the millennium] to have average incomes broadly on a par with those of households in general in the same country (except for Portugal). This finding did nothing to further political support for the statistics, at least among agricultural households.' (Ibid: 15.) Other concerns Hill notes include farming groups, in some countries, opposing the publication of data showing members' total incomes; and variations in farmers' total incomesdifferent countries undermining the 'national interest' in political debates.

The nature of policy support can also affect whether the ultimate beneficiaries are 'persons engaged in agriculture' or, for example, the owners of factors of production other than labour, notably land; although an analysis of this is beyond the scope of the present article. Overall, the CAP still does not emphasise individual income needs when determining policy disbursements (see also Allanson, 2008). Indeed, with such a paucity of data, this is not surprising – even though income needs have been the primary justification for CAP transfers for most of the last fifty years. A recent discussion with a senior Commission official revealed that, in their opinion, the big issue facing the CAP today was what exactly the member states want to achieve from direct payments (now the dominant form of budgetary support). This, it is to be hoped, will be a central part of the 'Health Check' (see elsewhere in this issue).

The puzzle, however, is why it has taken so long to ask this basic question – and how long it might be before data are provided to allow for answers to be given and policy change implemented. Moreover, if farm income problems and the wider policy concerns discussed above are to be tackled, the cross-country, cross-farm size and cross-commodity distributions of CAP spending will have to change, despite considerable political opposition to the redistribution of EU funds that would be needed to achieve the broader agenda now expected of the CAP.

Notes

[1] 'EU' is used throughout for simplicity, although in the past this entity was known as, *inter alia*, the European Communities.

[2] Economists, critical of the efficiency and welfare impacts of the CAP, have long debated policy reform and possible directions. What is interesting about, for example, Various (1973) and Barbero *et al.* (1984) is that many of the measures proposed were introduced, albeit a long time later. This suggests timing matters for policy reform as much as the 'objective' merits of economic arguments.

[3] Subsequent quota cuts meant that dairy became the only sector to experience a sustained fall in the absolute level of nominal spending.

[4] Strictly speaking, set-aside was not compulsory, but if 'large' farmers did not set-aside land, they would not receive direct payments.

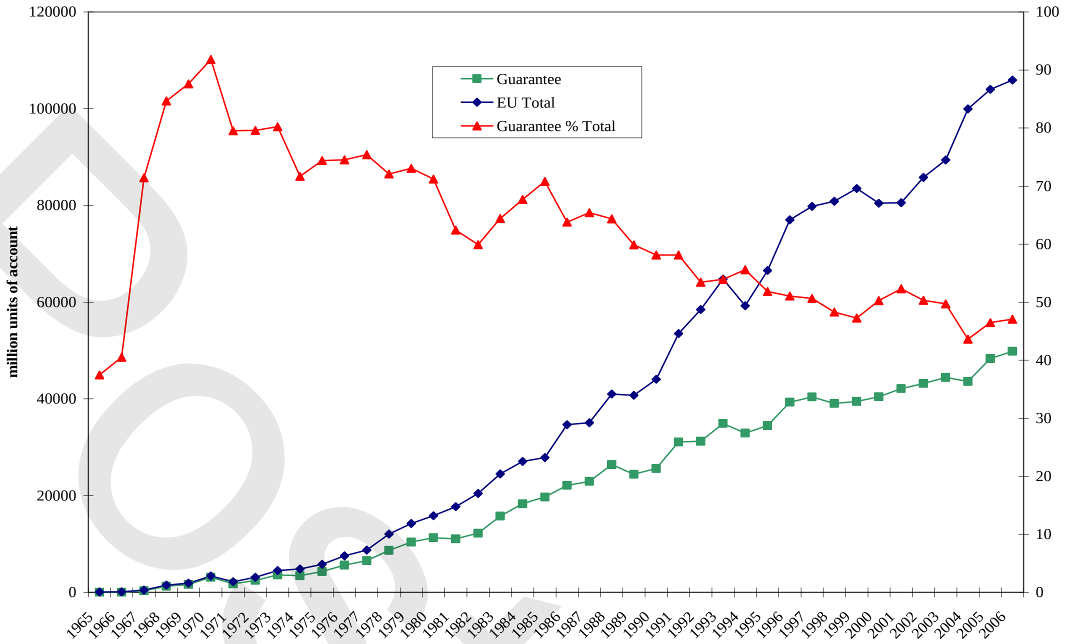
[5] Key institutional prices were cut, notably the intervention price, at which surpluses were bought by national authorities and which, in a situation of over-supply, represented more or less a floor price for the market. As this was cut so over-supply drove down market prices.

[6] It is a moot point whether this constitutes re-nationalisation of the CAP. I believe it does not, as the agenda, specific measures and core budget are determined collectively. Time will reveal how this approach to policy develops.

[7] The PSE and CSE are not the only alternative indicators of agricultural support. See, *inter alia*, Anderson and Josling (2007); Legg (2007).

[8] Analogously, the arable and beef sectors have remained the costliest under the CAP.

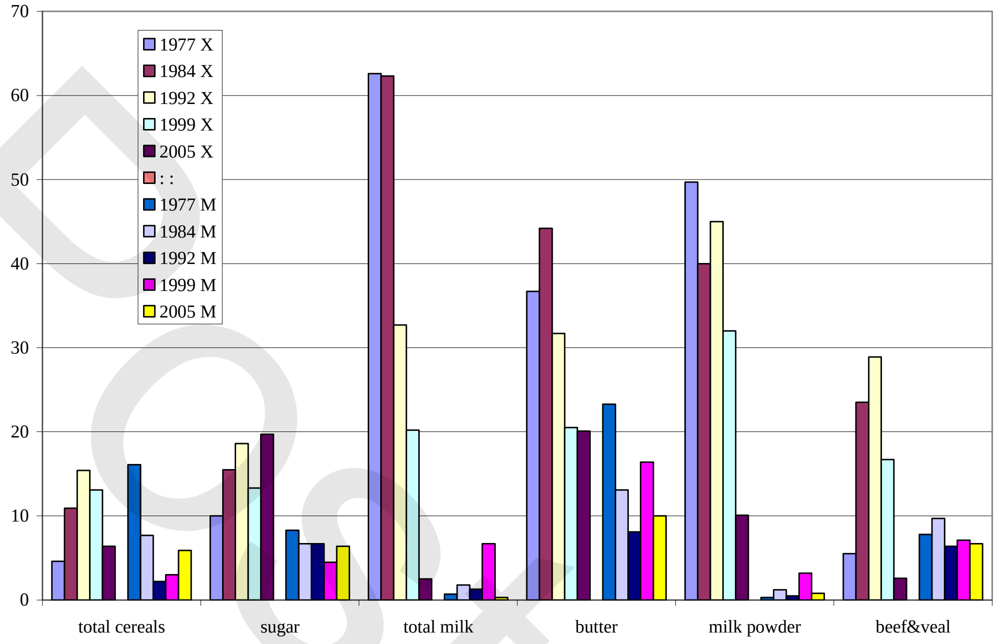
Figure 1: Total EU spending and CAP Guarantee spending, 1965-2006 (million units of common currency; percentage share)



Source: European Commission, *Financial Report 2006*; own calculations.

Note: Guarantee expenditures traditionally focused on income support measures. Since the 1999 reform, some rural development measures also fall under this heading.

Figure 2: The changing EU shares of world agricultural exports (X) and imports (M), selected commodities and years



Sources: European Commission (various years), *Agricultural Situation in the Community*; *Agricultural Situation in the European Union*.

Note: 'Milk powder' includes whole and skimmed.

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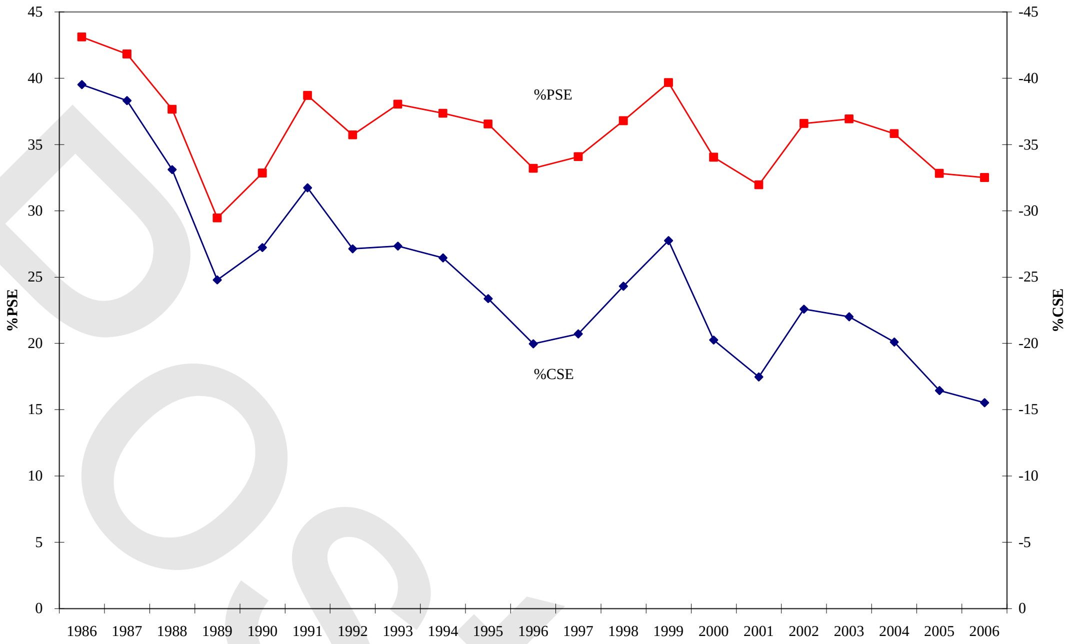
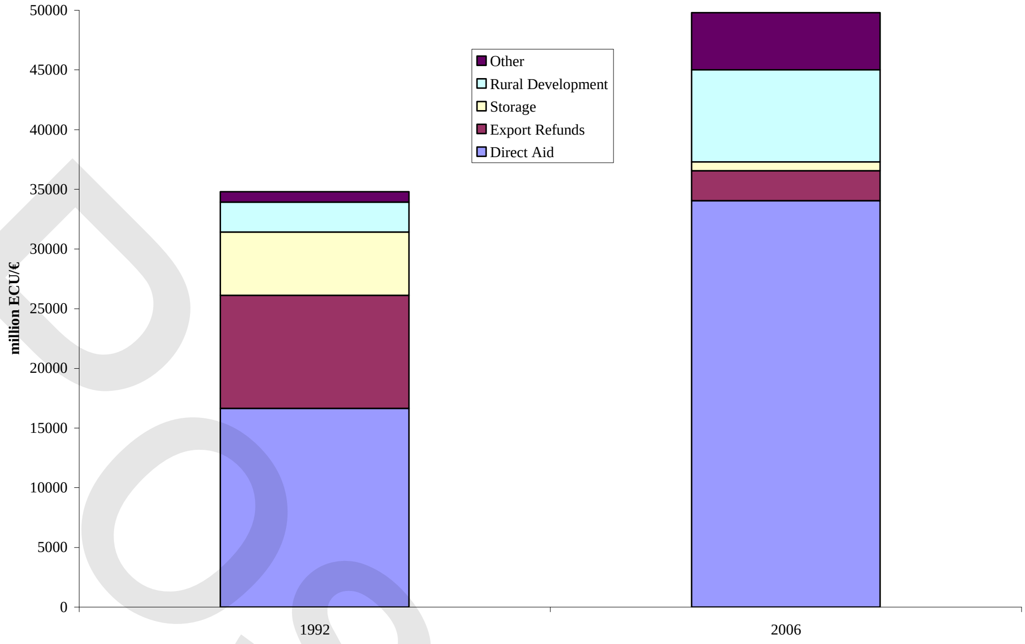
Figure 3: Total EU percentage Producer and Consumer Support Estimates, 1986-2006



Source: The OECD PSE/CSE database, available online at: www.oecd.org.

Figure 4: The changing structure of total CAP spending, 1992 and 2006



Sources: 1992 – based on data from the Court of Auditors Annual Report for 1992, OJ C309, 16 November 1993; 2006 – European Commission, *Financial Report 2006*. *Note:* 1992 'Rural Development' spending is actually EAGGF Guidance section expenditures, included for approximate comparative purposes.

Further Reading

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Various (1973). Wageningen Memorandum on the reform of the European Community's Common Agricultural Policy. *European Review of Agricultural Economics*, 1(2): 151-60. [As with Barbero *et al.*, this paper is in a special edition devoted to an economic analysis of CAP reform issues.]

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Intended photos:

1. Colour photograph of red crop sprayer.

Caption:

Photograph © European Community.

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2. Colour photograph of grass and red flowers:

Caption:

Photograph © European Community.

3. Colour portrait of MacSharry.

Caption:

Ray MacSharry, European Commissioner for Agriculture at the time of the 1992 CAP reform. Photograph © European Community.

4. Black and white photo of protesting Irish farmers.

Caption:

Irish milk producers demonstrating in Brussels in 1984. Photograph © European Community.

Summary

In the fifty years since the Stresa Conference, the CAP has undergone many changes. Its presence, however, has been one of the most prominent and constant features of the 'European project'. This article outlines how the policy has changed and identifies the key pressures driving that change, in the context of unchanging formal objectives for the policy. Having established price support as the primary means of supporting farm incomes, crucial elements of the EU budget process then combined with rising production and surpluses to put the CAP on a path that led inexorably to financial crisis. As the EU began to deal with these pressures, so price support was already taking the policy towards another pressure point – growing subsidised exports and, ultimately, clashes in the GATT over trade-distorting policies and their effects on other countries. In the reforms since 1992, designed to address both budget and trade concerns, the direction the policy has taken has also been influenced by newly-emerging issues, notably the welfare and health of the environment, animals and consumers. Yet despite all these changes and the vast sums spent, the extent to which the farm income problem has been resolved remains unclear. Despite the centrality of income concerns to the CAP, data on farm household incomes remain limited – and there exists considerable political opposition to changing this situation.

Pullquote

"Despite all the changes to the CAP and the vast sums spent, the extent to which the farm income problem has been resolved remains unclear".