Common Agriculture Policy in European Union

COMMON AGRUCULTURE POLICY IN EU
INTRODUCTION

The Common Agricultural Policy (CAP) is comprised of a set of rules and mechanisms, which regulate the production, trade and processing of agricultural products in the European Union (EU), with attention being focused increasingly on rural development.

Among the EU's policies, the CAP is regarded as one of the most important policy areas. Not only because of its share of the EU budget, the vast number of people and the extent of the territory directly affected, but also because of its symbolic significance, and the extent of sovereignty transferred from the national to the European level. The significance of the CAP, nowadays, is also portrayed by the fact that it is directly related to the Single Market and the EMU.

The Treaty of Rome defined the general objectives of a common agricultural policy. The principles were set out at the Stresa Conference in July 1958. In 1960, the CAP mechanisms were adopted by the six founding Member States and two years later, in 1962, the CAP came into force.

To explore the different aspects of this very significant EU policy, we will start by explaining the very first reasons of the creation of the CAP. Then, we will describe its objectives, its functionment and the way it is financed. We could thus make an assessment of the first consequences of the CAP for the EU and for the world that reached to important reforms of the policy. Finally, we will set out the different problems to be solved.

WHY THE COMMON AGRICULTURAL POLICY?

The Common Agricultural Policy was created primarily as a result of the Second World War and its effects on agriculture in Europe. Due to the post-war shortages it was realized that assistance was urgently required by the agricultural sector for development and investment purposes within this area. Agriculture was a main concern for Europe after the war with every country experiencing shortages and wishing to reach a level of self-sufficiency where-by they could produce all there agricultural produce needs by themselves. To aid the pursuit for self-sufficiency and correct the damage done to agriculture done by the war the Common Agricultural Policy was established.

Unfortunately the problem of agriculture has not disappeared and is not just a short-term problem attributable to the war but rather is an ongoing problem that is still getting worse. The problem that now exists is the declining importance of the agricultural sector and people who have remained within farming have been receiving ever-decreasing incomes. It is therefore necessary for governments to practice some sort of control over the agricultural market with methods such as price supports and subsidies. These two methods fall under the Common Agricultural Policy.

Farmers are also subject to uncertainty, which is inherent and unavoidable in agriculture. For example a farmer cannot accurately predict his output and can only provide a 'planned' output. If the actual output is more or less than expected then this will have an effect on the price due to the effects on supply and demand. The farmer cannot guarantee his own income without any support such as the CAP and in this situation will not invest in new machines and equipment that will help agriculture in the long run. The uncertainty might also make people decide to leave the agricultural sector.

Another problem with agriculture and a reason for the existence of the CAP and its renewed use is that in modern economies people spend less on agricultural produce. As incomes rise, as is the case in most modern economies, people focus more on luxury items and spend less on more mundane agricultural goods. This means that the CAP is very much still a necessity and will continue to be well into the future as incomes are likely to continue to rise. This is also a 'double-edged sword' for the agricultural sector as whilst the average wage is increasing theirs is likely to be decreasing as consumers buy less and less agricultural produce. For this reason incomes within the agricultural sector will always lag behind those of other sectors.

OBJECTIVES OF THE CAP

The legal basis of an agricultural policy for the whole Community is defined in Articles 32 to 38 in title II of the EC Treaty.

The objectives of the cap are clearly defined in Article 33. They are as follows:
· To increase agricultural productivity by promoting technical progress and by ensuring the rational development of agricultural production and the optimum utilization of all factors of production, in particular labour.
· To ensure there by a fair standard of living for the agricultural community, in particular by increasing the individual earnings of persons engaged in agriculture.
· To stabilize markets.
· To provide certainty of supplies.
· To ensure supplies to consumers at reasonable prices.

To be able to achieve the objectives of the Common Agricultural Policy (CAP), the Member States came together in a conference in Stresa in 1958, and decided the three underlying principles of the CAP:
· A single agricultural market, whereby products move freely between Member States, and a common frontier exists for goods imported into the EU. Also common sanitary and veterinary regulations, common prices and common competition rules to mention but a few.
· Community preference, which is the price advantage granted to EU produce. The prices of agricultural products within the EU have traditionally been higher than those on the world market. Therefore, to achieve this principle, custom duties have been imposed on imported agricultural products to bring them closer to EU prices. In parallel, export refunds have compensated the difference between EU prices and those on the international market and have thus helped European products remain competitive.
· Financial solidarity, according to which all Member States contribute to the costs and share the benefits of the CAP.

In the light of these principles, the main mechanisms of the CAP were created between 1960 and 1962. These mechanisms are still in place today.
Firstly, there are the Common Market Organisations, or CMOs. These are not organisations of people, but of the regulations that cover the different sectors of production. Their purpose is to support the markets through appropriate mechanisms that vary according to the product covered. Initially, a CMO was set up for approximately half of the agricultural products. This number has progressively grown, and today we have a CMO for all products except potatoes, honey and certain spirits.

Secondly, there is the European Agricultural Guidance and Guarantee Fund, or EAGGF, the agricultural budget, a necessary corollary of the principle of financial solidarity. It is a portion of the total budget of the EU, and is used to finance all the expenses of the CAP and certain expenses for rural development measures.
Now I' m just going to focus on the Common Market Organisations, in another point we will explain the FEOGA.

We can find two classifications to explain the mechanism of the COM:

COM classification by support mechanism
Changes in the aims and means of organising the markets resulting from the 1992 and 1999 reforms have changed the design of the COMs, which may now be classified in five categories according to the support mechanisms they use.
1. COMs with guaranteed prices and automatic intervention
These apply to sugar and dairy products, affecting just over one fifth of Community final production. Minimum or guaranteed prices are paid to farmers by public intervention agencies in exchange for delivery of their products, where market prices are too low.
2. COMs with guaranteed prices and conditional intervention
These apply to wine, pigmeat and some fresh fruit and vegetables, affecting approximately one fifth of Community final production. They involve a guaranteed price scheme, although it is applicable only in the event of a serious market crisis.
3. Mixed COMs with guaranteed prices and direct aids to complement production
These apply to cereals, rice, sheep meat, bananas, milk (from 2005-6) and beef (although from 2002 a conditional intervention scheme with a 'safety net' will be set up).
4. COMs with direct production aids only
At a flat rate or proportional to the quantities produced or yields, these COMs apply to oilseeds, protein crops, feeding stuffs, tobacco, textiles, peas and beans, hops, processed fruit and vegetables, some fresh fruit and vegetables (asparagus and nuts), olive oil and olives, and cover approximately 10% of Community final production.
5. COMs without direct production support
This mechanism offers only customs protection.

COM classification by supply control mechanism

Following the most recent CAP reforms, there are four coexisting mechanisms for controlling production quantities.
1. Production quotas as such
Quotas are fixed at national level for milk and sugar and allocated to farms or enterprises. Producers exceeding the quotas in each Member State face penalties.
2. National guaranteed production quotas
These quotas (Maximum Guaranteed Quantities - MGQ -, Maximum Guaranteed Areas - MGA - and premiums per head of cattle) cover a long list of products and are equivalent to direct aid to producers, reduced proportionally if predetermined thresholds are exceeded.
3. Guaranteed production quotas at Community level
These quotas, which are calculated on the basis of overall EU production, are being phased out and at present only apply to some processed fruit and vegetables, pulses and bananas.
4. National quotas for surpluses
These quotas are for some Mediterranean products (wine, using approved distillation volumes) and some fresh fruit and vegetables (using thresholds for withdrawal from the market).

MAIN MECHANISMS

The CAP price support mechanism

The original CAP machinery did not apply to every product and, in the cases where it did; it varied from one product to another. Although major changes is par have since been introduced, the mechanism still applies to some products and shed light on some of the disastrous consequences of the policy earlier on.
Where the original system still applies, the farmers´ income support is guaranteed by regulating the market so as to reach a price high enough to achieve this objective. The DOMESTIC PRICE is partly maintained by various protective devices. These prevent cheaper world imports from influencing the EU domestic price level.
The basic features of the system can be represented by that originally devised for cereals, the first agricultural product for which a common policy was established.

A ´target´ price is set on an annual basis and is maintained at a level, which the product is expected to achieve on the market in the area where cereal is in shortest supply (Duisburg). The target price is not a producer price since it includes the costs of transport to dealers and stores. The target price is variable, in that it is allowed to increase on a monthly basis from August to July in order to allow for storage costs throughout the year.

The `threshold price´ is calculated in such a way that when transport cost incurred within the EU are added, cereals collected at Rotterdam should sell at Duisburg at a price equal to or slightly higher than the target price, the consequence being that adding the levy and transport costs to Duisburg would make it unprofitable to sell cereals anywhere in the EU at less than the target price. An import levy is calculated on a daily basis and is equal to the margin between the lowest priced consignment entering the EU on the day and the threshold price. This levy is then charged on all imports allowed into the EU on that day (this information we can see in the next figure).
The EU is experiencing excess demand for this product, the market price is held above the target price by the imposition of import levies. Moreover, import levies would be unnecessary if world price happened to be above the threshold price since in this case the market price might exceed the target price.
If target prices result in an excess supply of the product in the EC (see figure), the threshold price becomes ineffective in terms of the objective of a constant annual target price and support buying becomes necessary. A ´basic intervention price´ is then introduced for this purpose. This is fixed for Duisburg at about 7% or 8% below the target price. Similar prices are then calculated locations within the EU on the basis of costs of transport to Duisburg. National intervention agencies are then compelled to buy whatever is offered to them of the ´proper´ product at the relevant intervention price. The intervention price is therefore a minimum guaranteed price.
Moreover, an export subsidy or restitution is paid to EU exporters. This is determined by the officials and is influenced by several factors (world prices, amount of excess supply, expected trends) and is generally calculated as the difference between the EU intervention price (P2) and the world price (Pw).

Fig.1 CAP product prices

The "green money"

The various agricultural support prices were fixed by the Council in units of account. For each Member country, there was a "green rate" at which the support prices were translated into national prices.

Green rates are needed for administrative convenience, the problem coming from the volatile bilateral exchange rates. This implies that if a member country devalues/revalues its currency, its farm prices expressed in terms of the national currency would rise/fall.
The "monetary compensatory amounts" (MCA) is the system of border taxes and subsidies to compensate for changes in relative prices of agricultural products across member countries from devaluations/revaluations.
But since the Euro became the single currency for almost all Member States, green rates have not been needed any more. But it's still important for the European countries that not use the single currency.

Financing the CAP

The Common Agricultural Policy (CAP) is funded by an EU central fund called the European Agricultural Guidance and Guarantee Fund or EAGGF. When the CAP was first introduced it was expected that the revenues collected from extra import duties imposed on non-CAP members would be sufficient to fund the EAGGF. However a rapid rise in agricultural output has led to a reduction in EC imports and therefore to a reduction in receipts and therefore revenues from imports.

The cost of the CAP has increased far beyond expectation and of the EU's $72 billion budget 48% was required solely to fund the CAP whilst agricultural imports make up a deficit of just 2.4%. The Common Agricultural Policy is a very expensive form of protection; more expensive than was ever initially envisaged. The high cost of the CAP has led to member countries being required to make a contribution to the EAGGF and so in effect it is the members themselves that are funding the CAP through their own contributions to the EAGGF.

GAINS AND LOSSES

Positive aspects

The CAP succeeded in reaching its initial goals: it encouraged both production and productivity, stabilized the markets, secured supplies and protected farmers from fluctuations in world markets. Indeed, the production really grew due to the genetic progress, the improvements of the farming and management methods, and the assurance of outlets at profitable prices. The CAP has been an important instrument for national and regional land use development. Farms have had to modernize, leading to new industrial activities such as farm mechanization, fertilizers, animal feeds, etc.
The EU has reached the auto-sufficiency. In 1962, the Community produced only 80% of its food consumption; this has now risen to 120%. The growth in production led to the expansion of the food-processing industries in terms of both quantity and quality and to increased trade with third countries, so that the EU has now become the second largest exporter of agricultural products in the world, while remaining the leading importer.
As for consumers, they have seen great changes taking place in their supply conditions. Along with food security has come real price stability. Today, food represents only 15% of the spending of European households.
However, the CAP has been in some ways a victim of its own success and has gradually had to face numerous problems…

Pressures for change.

European surpluses
EU farmers were producing more than the market could bear, creating excessive surplus. Indeed, some consequences of the original support mechanism were very negative. The system of helping farmers through increased prices and agricultural levies resulted in the highly publicized embarrassing surpluses: the butter and beef mountains; the wine lakes; earlier on, the grain and sugar surpluses; and later on, the milk lakes.

Fig. 2. Illustration of surpluses
The analysis of surpluses can be done from the figure n.2 . A target price P3 would result in a surplus ad which the EU authorities have the obligation to buy from the farmers. Assuming that the world price is P1, a subsidy (or restitution payment), equal to area andj would be needed to dispose of the surplus in world markets. At an intervention price of P2, the surplus would be fg and the costs to the EU would be area fgmk. However, the actual cost would be in excess of these amounts since there would also be storage and/or disposal expenses.
As a consequence of this situation, EU spending in agriculture increased exponentially. Indeed, in the middle of the 80's, most of the important products (cereals, milk, wine) have worrying sized stores. The volume of the exchanged stagnates. Hence, agriculture expenditures increase more and more although the own resources of the Community are insufficient. The EAGGF budget is multiplied by 2 between 1980 and 1984. And the CAP represents around 50% of the global European budget, even to 65% some

years. Currently, the part of the CAP expenditures are trying to be diminished.

Saturated world market
The economic and technical progress of the agriculture field concerns not only the Europe but it transforms the agriculture in many other countries. This leads to a moderately but continuously increasing supply.
As the EU production increases a lot, the internal market becomes saturated. In 10 years, the European Community passed from the deficit to the auto sufficiency, then, in the middle of the 70's to the surpluses. In the same time, consumption and outlets on the world market became rarer.
The raising power of the EU increased the competition between the largest world exporters of agriculture products and especially the United States. Even if the Single Market is for them an attractive outlet, the Community preference appears like hindering their exportations. This point of view created some difficulties during the WTO negotiations. The external demands, especially by the US during the Uruguay round of the GATT negotiations, were directed mainly against the export restitution payments, which were regarded as serious obstacles to the promotion of fairer international trade since they enabled the selling of EC products in third markets. The relations with the US concerning the CAP are a problem the EU will have to solve in the future.
As a result of these pressures, the CAP has undergone several reforms.

REFORMS
The first attempt at reform came just ten years after its creation. In 1968, the Commission published a "Memorandum on the reform of the CAP", commonly known as the Mansholt Plan, named after Sicco Mansholt who was Vice-President of the Commission and responsible for the CAP at that time. The Plan sought to reduce the number of people employed in agriculture and to promote the formation of larger and more efficient units of agricultural production.
In 1972, structural measures were introduced into the CAP, with the aim of modernising European agriculture. But despite continued structural changes in the following years, problems persisted; the supply and the demand of agricultural products were not in balance, resulting in ever-growing surplus.
In 1983, the Commission made a proposal for fundamental reform, which was formally expressed two years later with the publication of the Green Paper on "Perspectives for the Common Agricultural Policy" (1985). The Green Paper sought to bring supply and demand into balance, to introduce new ways of reducing production in problem sectors and, generally, to analyse alternative solutions for the future of the CAP.
In 1988, the European Council agreed on a package of reform measures, including the "agricultural expenditure guideline", which limited the percentage of CAP expenditure in the overall budget.
In 1991, the Commission, with Ray MacSharry as the Agriculture Commissioner, put forward two discussion papers on the development and the future of the CAP. These papers were the basis for a political agreement on the reform of the CAP, adopted by the Council on 21 May 1992. The reform of 1992 marked a major change in the CAP and had as its principal elements: the cutback of agricultural prices to render them more competitive in the internal and world market, the compensation of farmers for loss of income, as well as other measures relating to market mechanisms and the protection of the environment.
The reform of 1992 was generally regarded as successful, with positive effects on European agriculture. However, developments in the ensuing years - international trends, the enlargement towards Central and Eastern Europe, the preparation of the single currency causing budgetary constraints, the increasing competitiveness of products from third countries and a new round of World Trade Organisation negotiations - forced further adaptation of the CAP, in other words, a new reform. Agenda 2000 was a step in this direction.
AGENDA 2000
In July 1997, the Commission proposed the reform of the CAP within the framework of Agenda 2000, which was a blueprint for the future of European Union policy, in view of the expected enlargement. Negotiations on Agenda 2000, and thus the agreement on the CAP reform, were concluded at the Berlin European Council in March 1999.
Agenda 2000 has been the most radical and comprehensive reform of the Common Agricultural Policy since its inception. It built on the process begun in 1992 and it provided a sound basis for the future development of agriculture in the Union, covering all functions of the CAP: economic, environmental, rural.
In particular, the reform comprises measures for:
· the reinforcement of the competitiveness of agricultural commodities in domestic and world markets;
· the promotion of a fair and decent standard of living for the farming community;
· the creation of substitute jobs and other sources of income for farmers;
· the formation of a new policy for rural development, which becomes the second pillar of the CAP;
· the integration of more environmental and structural considerations into the CAP;
· the improvement of food quality and safety;
· the simplification of agricultural legislation and the decentralization of its application, in order to make rules and regulations clearer, more transparent and easier to access.
The reform, as envisaged in Agenda 2000, will create conditions for the development of multi-

functional, sustainable and competitive agriculture in the EU. Furthermore, its long-term objectives will not only have an effect on the applicant countries but are also intended to benefit future generations.

PROSPECTS FOR THE FUTURE

External pressures:
With the Uruguay Round Agriculture Agreement, the EU has already done a lot to satisfy WTO commitments. Subsidies to exportation have been reduced, even more than the EU was expected to. So, in 1998, EU expenditures for export restitutions were up to 9,4% of the total value of the agricultural exportations, although it was 55% in 1992.
But, even if the EU has so far had no major problems meeting WTO commitments, with further reductions it could have more problems to do it. Moreover, the WTO commitments on export subsidies will be negotiated in future rounds, and the EU will be the primary target. Indeed, the USA and the Cairns group (small and medium sized agricultural exporting countries which championed the causes of better access to the markets of advanced nations and less market disruption from their policies during the Uruguay Round) have already committed themselves to negotiating substantial reductions, even complete elimination, of export subsidies during the next round.

Eastern Europe enlargement:
The enlargement of the union is well underway. Accession negotiations have been formally opened with 12 candidate countries. The accession of the Central and Eastern European countries is significant from an economic perspective in general. In terms of agriculture, the enlargement is expected to double the agricultural labor force as well as the arable area of the EU, and to add over 100 million food consumers to the internal market. It is important to say that the EU is already the most important trade partner in agricultural products for many of the candidate countries.
Enlargement will offer considerable opportunities to the candidate countries and help them to use their potential for agriculture production efficiently. However, candidate countries have a long way to go before reaching this point. Agriculture in the applicant countries has many deficiencies and requires substantial restructuring and modernization.
The EU has intensified activity to support the restructuring process in the candidate countries and, among other measures, has introduced pre-accession instruments. The agricultural instrument for pre-accession aid is SAPARD (Special Accession Programme for Agriculture and Rural Development), developed in the framework of Agenda 2000. SAPARD, which is designed to assist the candidate with agricultural development, will have an annual budget of 520 million euros for the period 2000-06. The objectives of this programme are:
§ To establish a Community framework for supporting sustainable agricultural and rural development in the applicant countries during the pre-accession period;
§ To solve problems affecting the long-term adjustment of the agricultural sector and rural areas;
§ To help implement the acquis communautaire in matters of the agricultural policy and related policies.
The adjustment of agricultural policies in candidate countries is a complex undertaking but the ongoing reform of the CAP, within the framework of Agenda 2000, facilitates this process.
But, currently, the problem is the debate between Brussels and the candidate countries (especially Poland). This country does not accept the way the EU wants to apply the CAP on their territory. According to Brussels, this debate could slow down the process of enlargement.

Ecological problems
In 50 years, the agriculture in the EU has been completely changed: a real revolution in the number of farmers and agricultural workers, in its structures, markets and the technical modernization have increased a lot the outputs. But to obtain costs compatible with the markets, productions were intensified, landscapes and grounds were modified, and the agriculture used more and more water and a lot of chemicals fertilizers.
That's why the Member States have made every effort to harmonize their national regulations concerning the environment: rules and norms about protection are mostly from the Community. These deal with the natural, industrial and urban environments.
The EU trend to reinforce the protection of the environment should go on in the future. The Europe will now valorize the positive functions of the agriculture concerning the environment (space and landscape management, biodiversity…).