

The EU's Common Agricultural Policy at Fifty: An Outside View¹

by

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The Two Faces of the CAP

The Common Agricultural Policy (CAP) of the European Union played an important if controversial role in the political and economic integration of Europe fifty years ago. The choice to include agriculture within the free internal market was bold and unprecedented. Sicco Mansholt, among other early leaders of the European Economic Community, saw the need to involve agriculture along with other sectors of the economy in the rebuilding of the continent. The CAP has provided a degree of stability and profitability to agriculture that assisted the political process of integration. Its role in the economic integration is less clear-cut. By sheltering the sector from external competition by high border protection and from internal rationalization by the extensive market management, it proved to be an inflexible instrument for the encouragement of a modern agricultural sector. Production responded to artificial price incentives rather than to market needs. Costs, both economic and financial, continued to grow relative to benefits through the 1970s and well into the 1980s. These costs were imposed not only on EU consumers, taxpayers and non-agricultural industries but also, through the depressing impact on international food prices, on farmers in many other parts of the world.

The first 35 years of the CAP reflected the tension between the role that the CAP played in the construction of the European Union and the external impact on agricultural exporting countries, particularly Australia, Canada and the US but also North Africa and Latin America. This tension showed itself in commercial relationships, where the CAP proved an albatross around the neck of the EU. Trade policy was built upon the promotion of competitive conditions in which EU industry could develop its export potential, whereas agricultural policy was premised on the assumption that this sector could not face competition from abroad and could only export with considerable

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subsidies. The CAP put the EU on the defensive in trade talks from the Kennedy Round through to the Uruguay Round. A generation of politicians abroad came to think of the EU as at root protectionist, and the CAP as the embodiment of this inward looking trade stance.

The last fifteen years have seen the EU slowly shedding the burden of a highly protectionist agricultural policy. Starting in the early 1990s, the CAP evolved in a significantly different direction, away from managing commodity markets. The 1992 reforms, followed by further changes in 1999, 2003, 2004 and 2005, have shifted the main focus of support in two important ways: to direct payments that have a lower propensity to distort resource allocation and consumer choice, and to the encouragement of the production of higher quality goods for which affluent consumers in Europe and abroad are prepared to pay a premium. The policy change reduced somewhat the CAP's perverse incentives for overproduction of undifferentiated farm products for which demand has been stagnant. However, border protection has kept internal prices for several products above world market levels.

Even with the significant changes in the CAP, large questions remain. Have the reforms since 1992 resolved the underlying issues of overprotection of European agriculture? Or has the change in the method of support for farmers had little effect on the incentives? Have the successive enlargements of the EU tempered the protectionist tendencies of the original six members? Or have they merely spread a high-price blanket over more of the agriculture of the Continent? For answers to these questions, a long-term look at the changes in distortions created by agricultural protection is needed.

A forthcoming study by the World Bank has made it possible to address such questions with credible and consistent estimates of the rate of assistance to farmers since the 1950s, both absolutely and relative to assistance to producers of non-farm (tradable) goods. The results give a picture of the level of assistance given to EU agriculture over time, as well as a comparison between the EU and non-EU members in Western Europe and North America, Northeast Asia and Australasia (see below).² The results of this study offer a comparative contribution to the assessment of the first half-century of the CAP.

Trends in Assistance through the CAP

The level of support afforded EU agriculture since 1962 (when the EEC's CAP became operational) tells an interesting story. The measure shown in Figure 1 expresses support given to agriculture in *ad valorem* terms as a percentage of the border price or undistorted farm revenue.³ The composition of the EU varies over this period with successive enlargement, as indicated at the top of the figure.

² The study itself covers more than 80 countries, including most of the major developing countries. Details including the methodology paper can be found at www.worldbank.org/agdistortions, pending the publication next year of the book edited by Anderson (2008) which contains the Western European chapter by Josling and is the source of the three figures in this paper.

³ This measure is the nominal rate of assistance (NRA). The NRA is distinct from the OECD's producer support estimate or PSE, which presents support as a percentage of the assistance-inclusive price and so is always lower than the NRA. These new NRA estimates go back to 1962 when the EEC's CAP came into being, whereas the OECD's PSEs begin only in 1986. Although we have made use of OECD data, that organization is in no way responsible for any of our results or their interpretation.

Two patterns emerge from the figure. First is the variability of the level of support, reflecting the stability of domestic support prices relative to the erratic world price movements over the bulk of this period. The variable import levies and export subsidies were aimed at reducing shocks to internal prices when international prices were high (1973-74, the early and late 1980s, 1995) or low (early 1960s, mid-1980s). They succeeded, but at the expense of masking the underlying price signals themselves. In particular, the period of the retreat of world prices from their high points in the early 1970s was not reflected in a roll back of protection levels as the “world food crisis” gave way to a resumption of surpluses. The opportunity to reorient the policy towards world markets was squandered over the next decade, as institutional prices were ratcheted up in an agricultural “scala mobile”. The result was a much higher (and unsustainable) level of support and protection through the mid 1980s. This was the period where the conflict with trade policy objectives was the most apparent. Price restraints at the end of the 1980s and policy reforms of the 1990s helped to reverse the trend, and to at least partially reconnect European agriculture to the global market place.

The second pattern that emerges from the figure is the impact on the trend of assistance of the policy shift in 1992, when some support began to be made by direct payments rather than provided through price supports. The lower line in the figure shows the support that still comes through the higher market prices (including as a result of tariffs and export subsidies), and the upper line from 1992 includes the direct payments. Over the fifty-year period there appears to be a general downward trend in the *ad valorem* rate of assistance given through market price support. But if the direct payments are included the trend over the past twenty years is flat. From the high support in the 1960s, hovering at about 80 percent, the level in the 1990s was still 50-60 percent. So the question for analysts is to judge to what extent the direct payments still encourage over-commitment of resources to agriculture in Europe. The extent of the decoupling of those direct payments from production is not easy to assess: farmers had to maintain some production on their land to qualify for the payments, but there was also a set-aside requirement in most years for large farmers. The EU’s Single Farm Payments (introduced in 2003 but not yet fully implemented) relaxes the obligation to produce particular crops, but still requires “cross-compliance” with environmental standards and hence is not totally unrelated to production (see Thompson, Dewbre and Martini 2007).

The link between the level of assistance and the size of the EU is somewhat ambiguous, as demonstrated in the figure. Certainly the original six countries gave generous support to agriculture through the 1960s, as a part of the deal that allowed the establishment of the EEC. Has the CAP lured new members into its protectionist web? The “enlargement effect” is mixed. In 1973, the UK had to abandon its somewhat more liberal agricultural policy, and its accession allowed the EU to delay reform by helping to finance the CAP. Ireland and Denmark enjoyed switching from the lower-priced UK market to the more lucrative Continental market for their export products. In the 1980s, Spain received a boost in agricultural support by adopting the CAP, though Portugal had to reduce many of its prices.⁴ When the Nordic and Alpine countries joined, support levels in those countries generally declined, so the CAP can be credited with some

⁴ Greek membership in 1981 had little impact either on the EU or on Greek agriculture, as its production of the main temperate zone products was small.

restraint on Austrian and Finnish policy.⁵ The most recent enlargement has already and will continue unequivocally to increase both the nominal and the relative rates of assistance among the new members (Anderson and Swinnen, 2008) but correspondingly constrain assistance in the CAP as a whole as a result of the considerable increase in the number of farmers who have to share a fixed budget.

Europe and other high income countries

Europe is by no means alone in supporting agriculture well beyond the modest levels that might be warranted by the external benefits of softening adjustment costs, stabilizing markets for foodstuffs or providing ecological goods and services. How does Europe stack up against other industrial countries that have faced similar problems of structural adjustment and similarly made significant transfers to their farm sectors? Is the CAP still excessive and out of line with the policies of its trading partners?

To compare directly the overall aggregate level of support to EU farmers relative to farmers in other OECD countries, a judgment is needed on the degree of decoupling associated with different forms of direct payments (i.e. support other than through the market). Direct payments in the United States under the 1996 FAIR Act, for example, were still commodity specific, but they related to the historical base acres of the farm rather than current production. The 2002 US Farm Bill added counter-cyclical payments which are less decoupled than the previous Act's direct payments as they reflect current average prices. But meanwhile the US Conservation Reserve Program continues to keep land out of production and so probably more than offsets any production-expanding effects of the direct and counter-cyclical payments (Gardner, in Anderson (2008)). For current purposes, we simply assume that the production impacts of the direct payments under the 1996 FAIR Act and the counter-cyclical payments under the 2002 Farm Bill in the United States are offset by the Conservation Reserve Program. Direct farm payments from 1992 to 2002 in the EU, and to a lesser extent those under the EU's single farm payments program from 2003, are not fully decoupled nor offset by acreage retirement programs, but we also exclude them from Figures 2 and 3.⁶

With these caveats, we are able to compare the aggregate values of price-distorting assistance across high-income countries, as in Figure 2. From that figure it is apparent that, with the downward trend in the nominal *ad valorem* rate of assistance in the EU and its rise in other Western European and Northeast Asian economies, the EU's share of the total value of assistance has been falling over the period to 2004. The trend for non-EU Western Europe reflects the fact that the countries that have chosen to remain outside (Switzerland, Iceland and Norway) have among the highest rates of assistance of all OECD countries. In the early 1960s the share of the EU was about one half of all OECD assistance, by the latter 1970s it was two-fifths, and by the first half of the present decade – at least prior to absorbing twelve new members – it was only around one-third. Including the other Western European countries, the share of aggregate nominal assistance has fallen from 80 percent to 40 percent over the period of four decades.

⁵ Sweden had reformed its own policy in 1990 and therefore had to undo those reforms on joining the EU

⁶ Similarly, the direct payments in use in Norway and Switzerland are excluded from the “Non-EU Western Europe” total.

A further indicator is useful to compare the relative rate of assistance (RRA), which takes into account assistance to producers of non-agricultural tradables as well.⁷ Thus the measure tracks the extent to which levels of assistance for agriculture exceed those for other sectors of the economy. Five-year averages are reported in Figure 3 to show more clearly the trends in support for farmers relative to non-farm producers (again assuming that the direct payments do not distort resource allocation among sectors). The values are shown not only for the EU but also for other OECD countries back to the mid-1950s.

The comparison shows some dramatic changes over the fifty-year period. The EFTA countries⁸ start the period with the highest levels of assistance, followed by the EU, Japan and Korea at a lower level. EFTA, the EU and Japan and Korea each had roughly similar levels of support relative to other sectors by the early 1980s. Japan and Korea converged from below to those rates during that period. By that time policies were favoring agriculture over non-agricultural tradable sectors by 60 or more percentage points. Meanwhile, North America and Australasia raised their RRAs over that period, but from a very low base. Indeed the RRA averaged less than zero for Australia and New Zealand, because the rate of manufacturing protection there was well above the agricultural assistance rate. Rates rose in all countries in the 1980s in the wake of the agricultural export subsidy war between the EU and North America (which drove international food prices to their lowest level ever in real terms). Since then RRAs have come down significantly for the EU and less so for EFTA and Japan and Korea which have continued their generous support to agriculture through market prices when the EU began to reign in its policies and switch to direct payments. By 2004, the EU had broken away from the high levels of protection of Japan, Korea, Norway and Switzerland and approached the lower levels of Canada and the US. Australia and New Zealand have moved from supporting industry more than agriculture to a position of rough parity.

The “New” CAP and its Future

The recent changes in the CAP mentioned above have been to a significant extent been a response to pressures from outside, particularly from other exporters of temperate zone farm products. The Uruguay Round of the GATT began in 1986 in part to head off a US-EU agricultural export subsidy war. In the Uruguay Round talks the 1992 reforms allowed the EU to agree to constraints on spending on export subsidies and on trade-distorting support. The combination of internal policy reform and external commitments under the WTO changed the trajectory of the CAP. However, the CAP continues to support major unproductive sectors of European agriculture, notably through high levels of border protection. This has helped to frustrate the World Trade Organization’s on-going Doha Development Agenda and to embarrass the EU’s broader commercial policy agenda. Once again, the EU is on the defensive, and had to agree (in Hong Kong) to the elimination of export subsidies by 2013 in order to keep the talks alive.

It is unfortunate that the opportunity afforded by the Doha Round to eliminate export subsidies and lock in low levels of domestic support (and halve the EU’s external

⁷ The Relative Rate of Assistance is calculated as $RRA = 100[(100+NRA_{ag})/(100+NRA_{nonag}) - 1]$.

⁸ The countries in this “non-EU” European aggregate can be taken to represent the EFTA countries, as the composition of that trade group changed as the EU was enlarged. The trend can be thought of as an average “EFTA” support level.

bound tariff on farm goods) seems to be slipping away. But even without further pressure from the WTO, there is a chance that the reform of the CAP will continue. If the political attraction of the “new” elements of the CAP, emphasizing quality foods and environmental sensitivities, remains strong, then a reversion to the explicit trade-distorting support of the past is unlikely -- although some elements of trade distortion are sure to remain in the form of overly cautious non-tariff barriers ostensibly for food quality and environmental protection.

It is the regulatory aspects of the New CAP that give competing exporters (including many developing countries trying to sell to the EU market) concern. To exchange trade barriers and subsidies for regulations that are too restrictive or costly to meet would be a hollow victory for outside suppliers. And yet new EU food regulations are at the heart of the shift to emphasize quality improvement. Regulations can also restrict trade and “protect” incomes of domestic producers. Other countries therefore will continue to have an interest in how EU regulations are set and administered.

Four types of regulations stand out as having potential impacts on other countries. Regulations on GM products (including labeling) have already changed the pattern of world trade for corn, soybeans and rapeseed, favoring imports into the EU from GM-free countries. The EU has been keen to establish its own regulations on GIs (PGIs and PDOs) as standards for those who wish to trade with it: many of the bilateral trade agreements that the EU is negotiating contain clauses that oblige trade partners to adopt the EU GI system. Similarly, regulations on production methods (organics, animal welfare) are having an impact in other countries, as they gear up to meet the exacting “production and processing method” requirements for the EU market. And even regulations on the environmental impacts of farming (including carbon emissions, eco-labeling) are causing some concern among countries that may not have the capacity to monitor such matters.

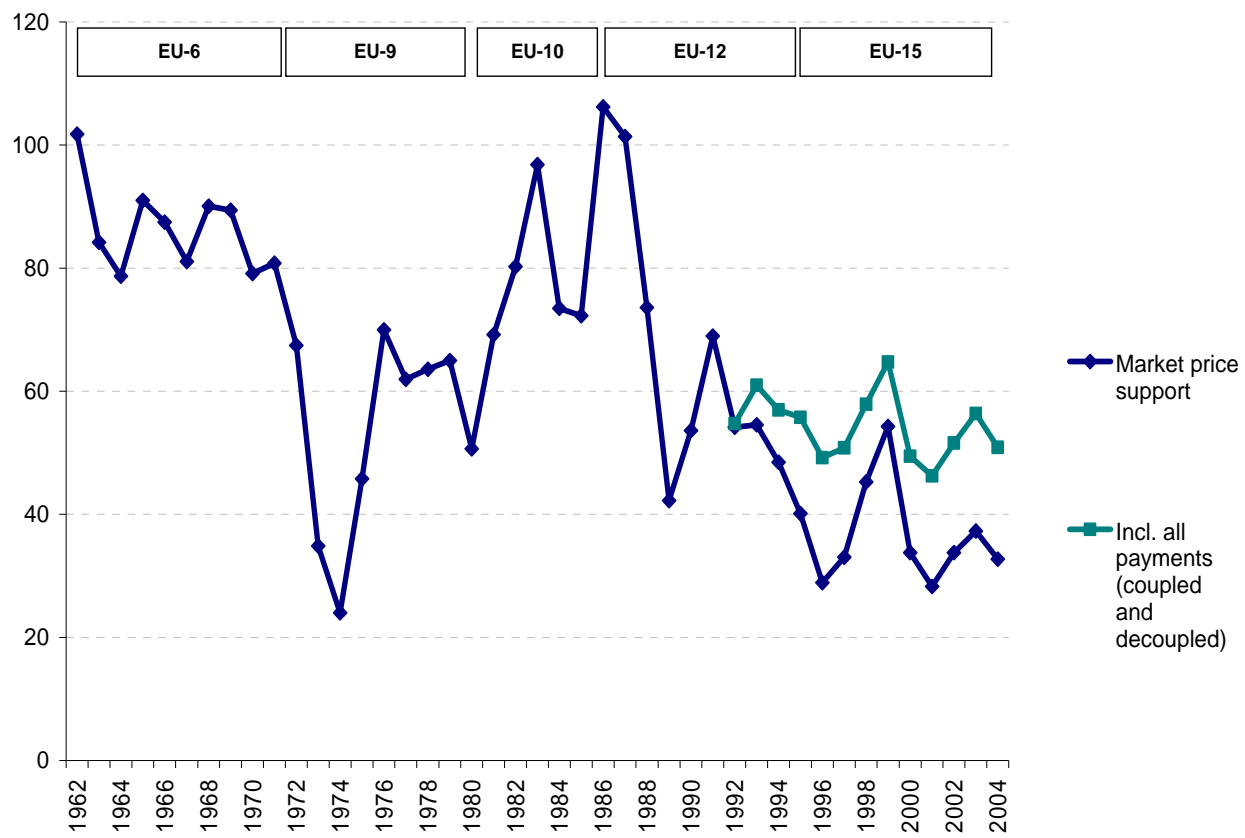
The issue is not whether the EU can institute such regulations but whether it is imposing unwarranted costs on other farm-exporting countries. This is influenced by the extent to which the EU regulations differ from those of other importers, including the US. The use of agreed multilateral standards can help to reduce this conflict, though the negotiation of such standards is not easy. The EU has a significant stake in the development of an open global market for agricultural and processed food products. But developing a specific “European” set of standards can pose problems if they differ greatly from that of other major markets. Competition between an EU and a US set of regulations, in the areas of GMOs, GIs, animal welfare, organics, eco-labels, etc. would have negative consequences for world trade and for developing countries. Enlightened EU leadership will be needed to prevent such developments and at the same time transform EU agriculture into a competitive, high quality producer of foods and agricultural products. Then the first fifty years of the CAP can be confined to the history books and chalked up to the lack of political vision to pursue the original conception by Mansholt and the early pioneers of a well-structured agriculture that could stand on its own feet.

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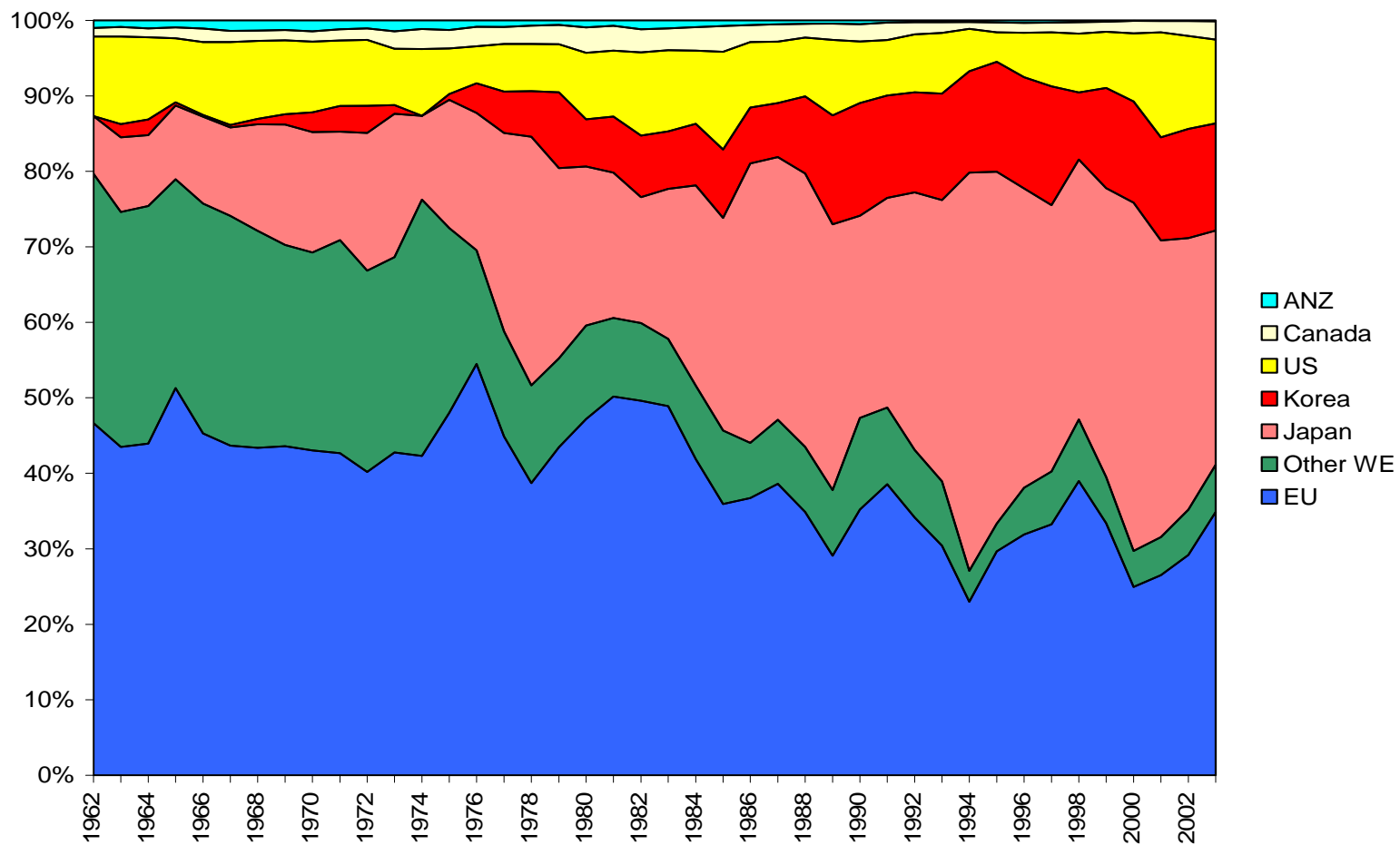
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Figure 1: Nominal rate of assistance to agriculture, EEC/European Union, 1962 to 2004 (percent)



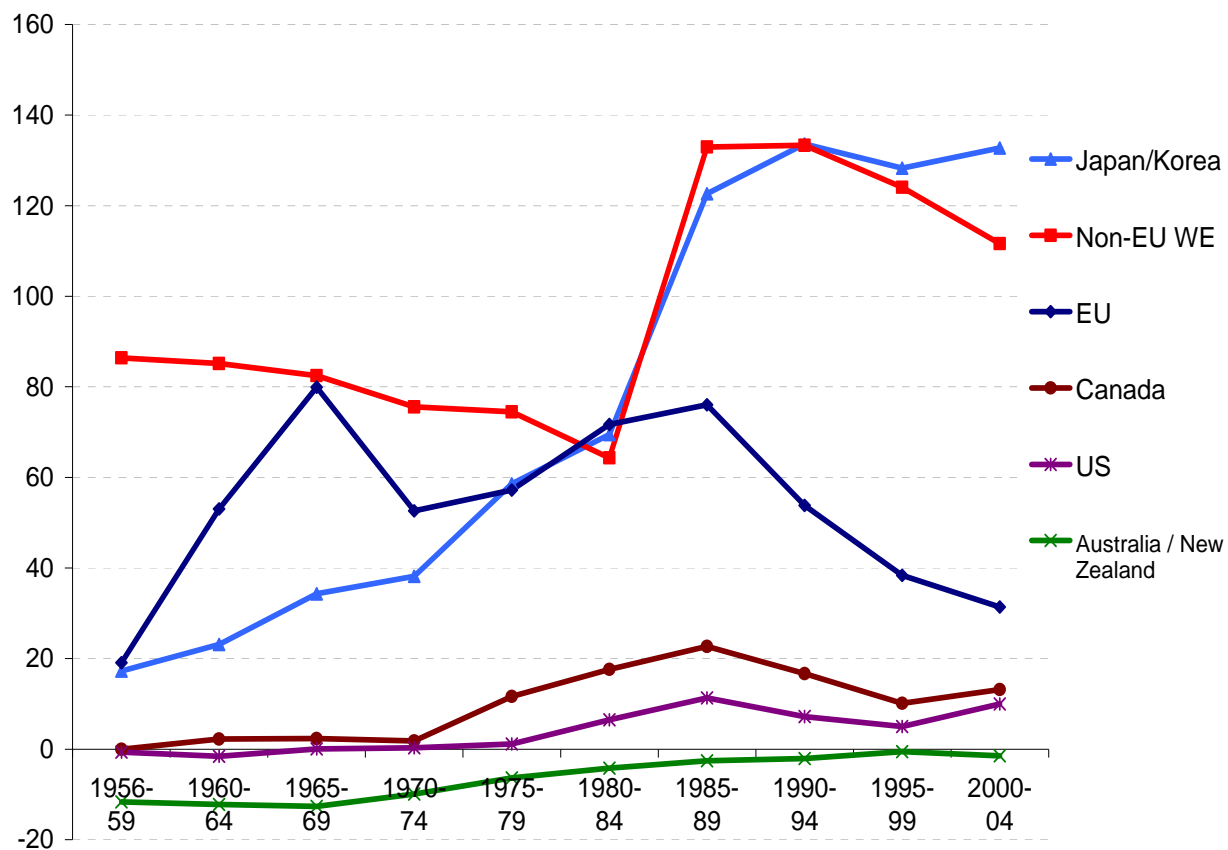
Source: Anderson (2009).

Figure 2: Shares of aggregate nominal assistance to all OECD agriculture, EEC/European Union and other high-income country groups, excluding decoupled payments, 1962 to 2004 (percent)



Source: Anderson (2009).

Figure 3: Relative rate of assistance to agriculture, EEC/European Union and other high-income country groups, excluding decoupled payments, 1956 to 2004 (percent)



Source: Anderson (2008).