ECONOMIC EFFECTS OF THE EU'S COMMON AGRICULTURAL POLICY

Viktorija Andonova

Abstract

Since its initiation, the Common Agricultural policy has made a profile as one of the most important policies in the EU. This paper will give an outline of the historic influences over CAP as well as the process of further reforms in order to gain a sustainable agricultural production. The economic effects, which were supported by subsidies and import limitations, have led the European union towards self-sufficiency, which certainly had an implication on the world trade flows. As a result of these situations, changes were necessary, in order to create a successful policy for reasonable leadership in agricultural industry through the maze of enlargement and trade negotiations guaranteeing healthy and safe food supply for the consumers and industries that rely on agricultural products. The economic effects of the policy are analyzed and the future impact on Macedonia is discussed.

Where did the high profile of agriculture come from?

Firstly, at the time when the Treaty of Rome was signed, the agriculture had a contribution of 12% in the GDP and 20 % from the labor force was engaged in agriculture and as a result of these conditions it was highly rated on the political agendas of many European governments. Also production was low because of the war and it was an essential to raise the productivity and production. People were suffering as a result of a decline in food consumption (Foreman - Pack), a high level of dependency on food imports was seen as political weakness, and finally foreign currency and especially dollars were a scarce source (Hoffmeyer, overview). Many farms in the 60-ties were small and vulnerable; so many national governments have made programs for protection of agriculture, which from political point of view could not have been stopped.

Secondly, agriculture as a key element in the trade flows between France and Germany when the EEC negotiations started. France believed that the Single Market, would have positive effects on German economy while the French economy would have less advantages, plus having in mind that in that period France had big and efficient agricultural sector in mid 50-ties which encouraged the French government to insist on a system of protectionism.

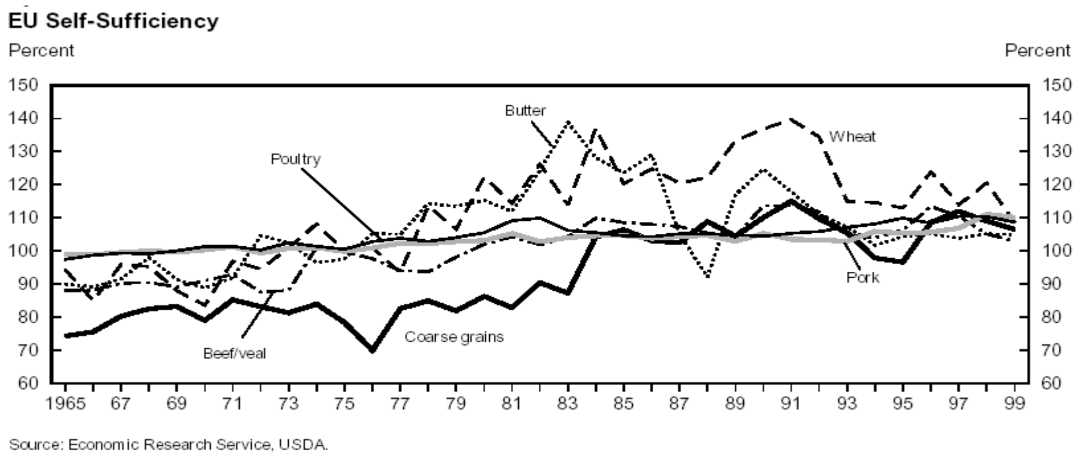
Thirdly, agricultural prices are more variable compared to the prices of other products and since Europeans spend about a quarter of their incomes on food, these variations can induce serious effects on economy. The increase of prices can cause inflation, while price reduction can make farmers debtors that probably can result with bankruptcy and unemployment.

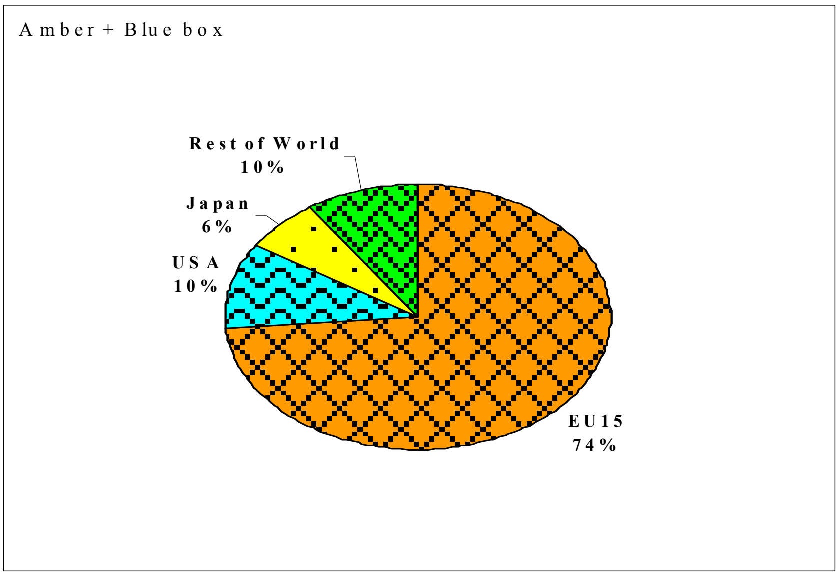
	Agriculture´s share of GDP, percent		Agriculture´s share of total employment, percent		Agriculture´s share of total trade, percent (average 1955-59)		Net foreign trade in agricultural products. in 1960 US$ (average 1955-59)
	1955	1960	1955	1960	Export	Import	
Belgium[a)]	7.9	7.3	9.3	7.6	5.4	17.2	-386.4
Lux.	9.3	7.6	19.4	16.4			
Holland	11.4	10.5	13.2	11.5	33.6	19.6	+310.0
Germany	8.0	6.0	18.5	14.0	2.8	32.9	-2,124.6
France	11.4	9.7	26.9	22.4	14.9	29.2	-836.0
Italy	20.7	15.1	40.0	32.8	22.6	20.6	-114.2
EEC (6)	11.5	9.0	21.2	17.5	15.9	23.9	
UK	4.8	4.0	4.6	4.3	6.5	41.8	-4,013.6
Denmark	18.4	14.4	24.9	21.2	65.7	20.3	+502.2

a) In the last three columns, the trade data for Luxembourg are included in the data for Belgium.

From 1962 to 1992 the CAP relied on a managed market system that relied on import restrictions so as to maintain internal market prices above a pre-determined administrative price; intervention buying to guarantee that every quantity produced would be sold at least at a pre-determined price; subsidies to export or to destroy access supply would have caused the internal price far below this administrative price. These mechanisms have succeeded to make the EU less dependant on foreign supply and to stabilize prices, avoiding a risk premium that would eventually been paid by consumers. The market management prevented major market crises, thanks to the open-ended intervention buying. Also the positive effect that CAP caused was the successful accompanying of one of the most dramatic economic transition in Western Europe, i.e. the rapid shift from an agrarian society to an economy of industries and services

However, many economists and researchers who are focused on this subject have long acknowledged that the Common Agricultural Policy, still mostly directed to support production, no longer fulfills the needs of a society that has changed more rapidly than the agricultural policy instruments. For years critiques have focused on the costs that the CAP imposes to consumers through extra food prices and even those who agree that farmers must be supported acknowledge that the CAP policy instruments are inappropriate and in spite of recent reforms, still lead to the production of large quantities of low quality products that are disposed with high cost on the world market. This creates conflicts with other exporting countries and these subsidized exports oppose the growth of the developing world by competing unfairly with local producers. In addition, the CAP arrangements disproportionably benefit a small number of producers. That is, the CAP has questionable distributional impacts in addition to a poor record in terms of economic efficiency. However, among the traditional explanations, it is often underestimated that in many EU countries there is a strong willingness to support the farm sector in the public opinion. The CAP would not have persisted for long if politicians had followed the vested interests of farmers only. Many citizens have seen the CAP as a successful story that made it possible to maintain small farms, while eradicating the ghost of food scarcity.





Some Important Reforms

MacSharry's Reform

There have been a number of 'reforms' of the Common Agricultural Policy. Some progress has been made. The CAP accounts for a smaller share of the EU budget, down from two-thirds at one time to around 46%. A start has been made on trying to reduce its trade distorting effects and discuss its environmental impact.

Under increasing pressure from the Uruguay Round, the first reversal reform-MasSharry Reform was initiated in 1992. For the first time, the basis for support has been changed fundamentally from price support to direct payment. The measures included: reduce guaranteed prices by up to 30% over 4 years; switch the CAP policy from price support to compensatory payment in the form of direct income supplements links to farm size and average yields.[25] All who produce more than 92 tones of cereals must set aside 15% of their arable land.

[25] Guide to the European Union, Agrigulture,P154

There were a number of supply controls. The farmers were compensated for historic yields, thus no bonus for increased productivity and compensation for less intensive production methods, the agro-environmental program encouraging farmers to introduce conservation of reserves, ponds, hedgerows etc.

There are two gains for the EU with the expenditure under the new system. First, the expenditure will be much more stable and predictable than that on export refunds and intervention storage. Second, the total expenditure of CAP support will now be much more direct under the control of the EU.[26] Budgetary impact was positive at the beginning due to higher costs from compensation. In addition, the aim of long-term structural change was not achieved; the only success lied in reducing the export subsidies. The contradictions of price and market policy remained unresolved.[27] Much of the failure can be explained by the political obstacles to reform. Agricultural groups still had a strong lobby and thus prevented the effective execution of the policies.

Agenda 2000

The European Council of Berlin adopted the second major CAP reform as part of the Agenda 2000 package in March 1999. The European Commission set the guidelines for the medium-term future evolution of CAP through the Agenda 2000 proposals. With Agenda 2000 the Commission called for the biggest shake-up of the CAP since its birth in 1962. Under the new proposals, from the year 2000 cereal support prices will be cut by 20 per cent, beef by 30 per cent and dairy products by 10 per cent.

Main elements of the CAP reform under Agenda 2000 are: increasing competitiveness of agricultural products; ensuring a fair standards of living for the farmers; creation of substitute jobs and other sources of income for farmers; introducing a new policy for rural development (the second pillar of the CAP); more environmental and structural considerations; improvement of food quality and safety; simplification of agricultural legislation and decentralization of its application.[28]

Agenda 2000 is an extensive reform covering several commodities and areas (rural development, environment, modulation). The main thrust of Agenda 2000 is based on a continuation of the 1992 reform strategy: a further shift from price support to direct income support. It brought further reductions in support prices, offset by increasing direct payments. The aim is to reduce the price support mechanism, and shift into direct payments as a safety net for low-income farmers. Further decentralization will mean that funds can be distributed according to national preference. There are also further financial ceilings being introduced and lots of bureaucratic simplification.

One of the major challenges in future to the EU is agricultural enlargement to the countries of Central and Eastern Europe (CEEC). With the prospect of further enlargement of the EU to include CEECs with large agricultural industries, further

[26] Rober Ackrill, The common agricultural policy: its operation and reform. "The Economics of the new Europe" p217

[27] The MacSharry Reform 1992-1996. The common agricultural polity, continuity and change. 1997 Rosemary Fennell P172

[28] 'The Agenda 2000 for a stronger and wider Union', part 4 ' Further reform of the Common Agriculture Policy', europa.eu.int/ comm/ agenda 2000/ overview/en

reforms to reduce price support cost have become urgent. Agenda 2000 supposed to deal with the issue of eastern enlargement, laid out a budgetary framework for enlargement to support the new member countries through 2006. A new financial framework for the period 2000-06 was adopted in order to enable the Union to meet the main challenges of the beginning of the 21st century, in particular enlargement, while ensuring budgetary discipline.

Preparations must be made for the accession. CEECs are facing major difficulties in adapting to a rather complex Community acquis and completing the institutional process of privatization and transformation of agricultural structures. In Agenda 2000 the strategy of convergence between the EU and the CEECs has been stepped up. Responding to the challenge of enlargement new pre-accession instrument, SAPARD and ISPA were introduced. These two financial mechanisms were set up to strengthen the pre-accession strategy for applicant countries: a pre-accession structural instrument (ISPA) to support improved transport and environmental protection infrastructures and a pre-accession agricultural instrument (SAPARD) to facilitate the long-term adjustment of agriculture and the rural areas of the applicant countries.

This reform was supposed to pave the way for a smooth enlargement to the east. However the issue of direct payments to the farmers in the CEECs has not been solved in these negotiations.

	Original CAP	Current CAP	"Emerging model" for future of CAP
Type of support	Price supports Linked to production	Direct payments Linked to production	Direct payments Decoupled from production
Environmental and rural economy aspects	No environmental conditions No rural development & environmental measures	Some environmental conditions Some rural development measures	Many environmental conditions More rural development & environmental measures
Trade aspects	Export subsidies Import barriers	Export subsidies Import barriers	No export subsidies Reduced import barriers
Administration	Centrally run Less bureaucratic	Centrally run, with some national and regional discretion More bureaucratic	More national and regional discretion More bureaucratic
Who pays?	Shoppers	Shoppers and taxpayers	Taxpayers
Visibility of support levels	Low	Medium	High
Objectives	Increase food production; ensure stable prices; boost farm incomes	Boost farm incomes; encourage environmental protection	Develop rural economies; protect rural environment; reward good farming practices
Economic distortion	High	Medium to High	Low
WTO green box compatible	No	Partially	Yes
EU food prices	Above world prices	Above world prices	Closer to world prices
Budgetary cost	Low to medium	High	Medium to high
Financial Commitment	Open-ended	Budget ceilings	Budget ceilings

The economic effects on new Member States from CAP reform

One major development is the introduction of a new direct payment system, i.e. a single farm payment or a single regional payment. Nearly all Member States decided to implement a single area payment system, resulting from a similar simplification.

The Decoupling of payments from farmers' production decisions makes the sector more market-oriented and allows farmers greater freedom to adjust production to market requirements. This is fundamentally important for the majority of new Member with their entry to the Single Market. Simultaneously it will make the sector more economically effective and competitive, making better use of the opportunities created by European integration.

Agricultural holdings in the new Member states should not encounter huge problems adjusting to the requirements introduced by the cross-compliance rule as their production is less intensive than in the EU –15. The application of the modulation mechanism in the EU-15(it is not applicable to new Member States while full direct payments are being phased in) will reduce differences in direct support intensity among Member States as small farm are excluded from the payment reduction. This favors countries with a disadvantageous agrarian structure and less intensive production. In addition, part of the saved funds will be redistributed according to cohesion principles, which will also benefit these countries. Compared to the original European Commission proposals, the effectiveness of the modulation mechanism has been reduced significantly and with it the amount of fund reallocated from countries with intensive agriculture to those with more extensive agriculture. For new Member States the application of modulation will facilitate a more rapid reduction of differences in direct support between the existing member states and new members n the period of phasing in direct payments. As n the case of modulation it is also vital that the financial discipline mechanism is applicable in new Member States until full direct payments are introduced in 2014. In the coming year agriculture n the new Member State will face numerous challenges in the field of restructuring and developing rural areas, including the creation of non-agricultural jobs. In this context, new Member States feel positive about the proposal to increase thee volume of funds available under CAP to be distributed among the Member States. These are granted according certain criteria, in particular, the area of agricultural land, the level of employment and affluence in the Member States concerned.

Increasing the volume of funds available under CAP creates new challenges for the new Member State with respect to their administrative and financial capacity to absorb them efficiently. The scale of these challenges is indicated by difficulties in the full use of funds in existing Member States. In this context, each proposal aiming at an easier absorption of funds should be supported.

It was thought that the extension of the CAP to new member states in the CEECs would both incur very substantial additional budgetary costs and also encourage production in those countries, leading to new surpluses. According to estimates by Commission (Agenda 2000) the budgetary impact in the hypothetical scenario of al ten accession countries and fully applying the CAP in its current form would be an additional cost to the Guidance Section of FEOGA by 2005 of approximately 11 billion ECU per year, in direct payment, arable and heading payment close to 7 billion ECU and 1.5 billion ECU in accompanying measures. Market support measures to the CEECs would cost up to 2.5 billion ECU, largely absorbed by the dairy sector. It was recognized that long transition periods would be necessary for the new member states.

The integration of the accession countries into the CAP is one of the most difficult problems of EU Enlargement. EU enlargement will greatly increase the agricultural area of the EU. It would add 60 million hectares to the agricultural areas of Union, bringing the total to nearly 200 million hectares. The number of people working in the agricultural sector estimated at 6.6 million in the current EU in the year 2000- would at least double. However the relatively high workforce and the small average farm size in the CEECs will result in a reduction in the average available area per person employed in the sector. [29]

The EU is the most important agro-food trade partner for many of the accession countries. All of the CEECs, except Hungary, are increasing net importers of agricultural food products from the EU. If significant price differentials between acceding countries and the EU prevail at the time of accession, the sudden introduction of CAP price levels would result in higher consumer prices in the CEECs, where a relatively large proportion of household budgets is already spent on food. In addition, the food industry in these countries would encounter increased raw material costs at the same time, as they had to face increased competition from existing member states.

Extension of the CAP to the CEECs without prior reform would expect to result in increased surpluses in production for most commodities. In addition, constraints on subsidized exports by the World Trade Organization (WTO) would prevent the EU from disposing these surpluses on the world markets.

A serious problem for the EU15 is that the cost of operation of the EU's CAP could very nearly after the enlargement. Expansion of production and the decline in consumption could lead to a steep rise in the cost of disposal of surplus production. That is clear is that the EU will not be able to apply the policies operating in the EU15 to EU 25 without serious increasing production and budgetary burdens.

In order to help the countries prepare for accession, EU introduced two new financial instruments into the EU budget, these will be discussed in more detail below.

Year 2000	Unit	Czech R.	Estonia	Hungary	Latvia	Lithuania	Poland	Slovakia	Slovenia
Population	1000	10278	1439	10043	2424	3699	38654	5399	1988
Utilised Agricultural Area (UAA)	1000ha	4282	1001	5854	2488	3489	18220	2444	491
Employment in griculture	1000	244	42	246	140	281	2711	145	85
GDP (PPS)	€bn	139	12	119	16	24	338	58	32
Share of agriculture in GDP	%	3.4	5.7	3.9	3.9	2.5	2.9	2.7	4.3
Share of agric. in employment	%	5.3	7	7.2	14.4	18.4	18.7	7.5	9.6
Share of analysed agric. production	%	77%	74%	89%	67%	64%	57%	82%	80%
% househod consumption in food	%	23.2	30.7	25	34.6	39.3	31.2	27.7	21.2
Year 2000	Unit	Cyprus	Malta	CC8	CC10	CC8/CC10	EU15	CC8/EU15	C10/EU15
Population	1000	755	388	73924	75067	98.5%	376455	19.6%	19.9%
Utilised Agricultural Area (UAA)	1000ha	11	101	38269	38381	99.7%	130443	29.3%	29.4%
Employment in griculture	1000	27	2	3894	3923	99.3%	6770	57.5%	57.9%
GDP (PPS)	€bn	14	5	738	756	97.5%	8526	8.7%	8.9%
Share of agriculture in GDP	%		9.1				1.7		
Share of agric. in employment	%	8.9	1.6				4.3		
Share of analysed agric. production	%			67%					
% househod consumption in food	%	17.0	21.5	29.2			17.0		
Source = EU Commission DB, internet http://europa.eu.int/comm/agriculture/agrista/2001/table_en/index.htm, and OECD Database									

[29] EU Enlargement Implications on the Common Agricultural Policy

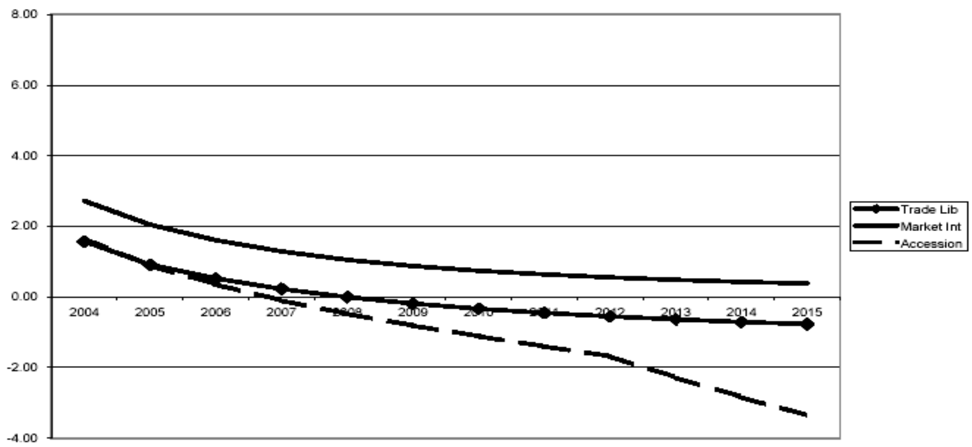
Table 7. Trade Liberalisation: effects on the rest of CEECs

« Market integration » : Output per firm

Sector	Eurozone	Rest of EU15	Poland	Hungary	Baltics	Rest of CEEC
Agriculture	-	-	-	-	-	-
Machine and tools	-0.37	-0.05	-0.65	3.8	0.11	-0.94
Automobile	-2.51	-1.61	2.35	12.93	ns	6.77
Textile clothing	-0.01	-0.08	-0.92	1.49	0.12	1.23
Wood	-0.3	-0.05	8.25	23.41	22.25	32.85
Electronics	-0.29	-0.21	0.95	1	-0.03	-1.35
Chemicals	-0.05	-0.15	1.15	6.76	1.22	-4.64
Metal products	-0.8	-0.21	15.3	24.43	4.11	24.31
Transport	0.76	0.49	0.51	1.83	-2.67	-13
Other industry	0	-0.02	1.6	6.07	2.33	3.27
Other Services	-0.03	-0.03	24.97	24.7	22.49	23.09

% deviation from baseline

Baltic GDP: dynamic adjustment (% deviation from the baseline)



Other CEECs GDP: Dynamic adjustment (% deviation from the baseline)

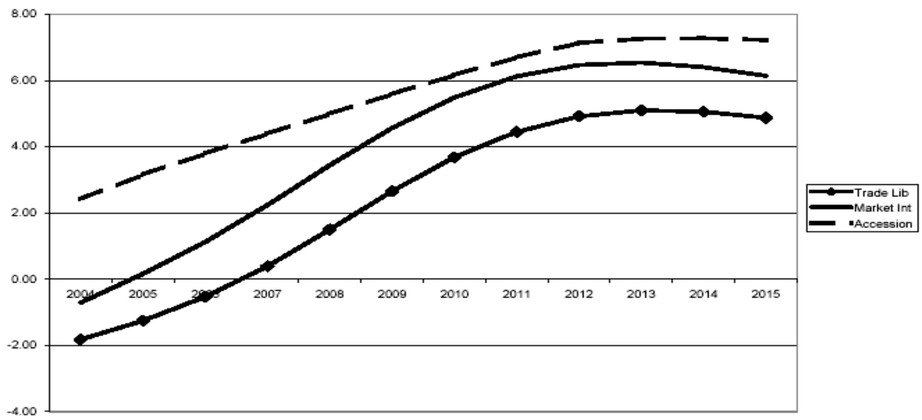


Table 17. The agriculture in accessing countries

	Agricutlural land		Agricultural production		Agricultural employment		Trade in agricultural and food products	
	millions ha	% total surface	millions euros	% GDP	millions	% total employment	% total exports	% total imports
Poland	18.4	59%	4.4	3%	4.0	25%	11%	11%
Hungary	6.2	66%	2.7	6%	0.3	7%	18%	5%
Czech Republic	4.3	54%	2.0	4%	0.2	5%	6%	8%
Slovenia	0.5	24%	0.7	4%	0.1	7%	4%	8%
Estonia	1.5	32%	0.3	6%	0.1	9%	16%	16%
PECO-1	31.0	56%	10.1	4%	4.6	18%		
in % EU-15	21%	-	8%	-	56%			
Romania	14.8	62%	5.1	16%	3.4	38%	9%	8%
Bulgaria	6.2	56%	1.7	15%	0.8	23%	19%	8%
Slovakia	2.4	50%	0.7	4%	0.2	8%	5%	9%
Lituania	3.2	49%	0.9	9%	0.4	24%	13%%	17%
Lettonia	2.5	39%	0.2	4%	0.2	15%	17%	13%
PECO-2	29.1	55%	8.7	11%	5.6	28%		
in % EU-15	20%	-	7%	-	68%			
PECO-10	60.1	56%	19	6%	10.2	22%		
in % EU-15	41.5%		15%		125%			
UE-15	144.9	45%	122.6	2%	8.2	6%	7%	10%

source : national, world bank, compiled by M.Girard-Vasseur and E.Vergniaud. Based on 1999 Figures.

Why should we be prepared?

- As a member of EU the agriculture sector would face an environment that is very different from now. Macedonia would be exposed to a very severe competition of producers from 25 or more member states at that time. The EU sanitary and phyto-sanitary regulation had to be followed and the institution foreseen in the *acquis communautaire*, chapter of agriculture, needed to b in place.
- Macedonia would have access to a market of 460 million consumers with a considerable purchasing power. Macedonia would benefit of the CAP, especially from the organised markets. They could use buying-in schemes to sell products for a guaranteed price and could use direct subsidies for farmers as stated in the relevant organised markets at that time.
- The idea to be exposed to such severe competition without having any possibility of national protection looks frightening, as some areas of agricultural production in nowadays Macedonia do not have a chance to sustain in such an environment. It is task of the agriculture policy and the agriculture industry and of all people who want to live on agriculture to identify the areas in which Macedonia can become competitive. These areas are to be developed during the next years. The funds have to be focused on the promising areas. Doing so Macedonia has a very good chance to sustain as the natural resources are very good and the people know how to work in agriculture. The strategy should support exactly that process.
- Stability and Association Agreement is a good opportunity for Macedonia to define the legal and economic environment for the development of the agriculture industry during the period of transition between signing the SAA

and the full membership in thee EU. It can buy time to develop its competitiveness in a more protected environment.

Conclusion

The beginning of the CAP was considered as a great success. However, after a decade high costs from overproduction and storage of surpluses arose. There have been four major attempts to reform the CAP, but the changes are very small. After 30 years, the policy still has the same problems.

The CAP is suffering from internal conflict of interest. There is a desire and even a commitment for sustainable development, but at the same time there is a promotion for increasing the. The original objectives need to be reviewed and updated to face with new challenges. The EU eastern enlargement is motivated by a range of economic and political factors. The enlargement facing the EU today is without precedent in terms of scope and diversity. In particular, the EU has never before faced the proposition of the new member states and their agricultural sector. For their part, these countries still have work to do in preparing for accession. Further, reform and modernization of the agricultural sector are necessary. In order to ease the burden of adjustment, changes of CAP have to occur. The experience of the EU and CEECs in reforming their agriculture suggests that this is a long and difficult process. Although liberalization of agricultural policies would lower the adjustment burden of the CEECs and increase the economic gains in the EU, this scenario is rather unlikely. Political forces are more likely to lead to a further adjustment of the CAP rather than a complete liberalizing.

References

1. Henrik Zobbe “The Economic and Historical Foundation of the Common Agricultural Policy in Europe”
2. Hellen Nilsson : “European Common Agricultural Policy”
3. Brian Gardner (1996) “European Agriculture, Policies, production and trade”
4. Marek Dabrowski and Jacek Rostowski(2001) “The eastern enlargement of the EU”
5. Hubert Gabrish, Ruediger Pohl(1998) “EU enlargement and its macroeconomic effects in eastern Europe, Currencies, Prices, Investment and Competitiveness”
6. Magazine, Informationen zur politischen Bildung. Europaeische Union. 279
7. Dick Leonard (2002) “Guide to the European Union, Agriculture”
8. EU Enlargement: Implications for New Member Countries, the United States, and World Trade. Nancy Cochrane and Ralph Seeley
9. Jean-Cristophe Bureu “Enlargement and reform of the EU Common agricultural policy”