The EU Commission's Proposals for Reform of the CAP

Reform of the Common Agricultural Policy continues to be one of the major challenges facing the EU. In its mid-term review of the Agenda 2000 the European Commission has presented a number of proposals which are discussed by the contributors to this Forum.

Franz Fischler*

The Mid-Term Review: What It Means for Europe's Agricultural Sector

Three years after it presented its Agenda 2000 reforms, the European Commission set down its proposals for a review of the European Union's (EU) Common Agricultural Policy (CAP). Addressing rural development, the re-allocation of current support, environmental aspects of agriculture, food quality and safety, we are looking to justify the CAP to the taxpayer and make it more sustainable for the future. We also plan to target our support to farmers more effectively and appropriately, give agriculture the flexibility to respond to society's changing concerns and take further measures to guarantee food safety and quality. Some call the proposals radical. True, if adopted they will mean changes, but these are the changes needed to put European agriculture on the right road for the future. The reason being? Agriculture is a fragile industry dependent on natural resources, responsible for the environment and rural development, and intricately linked to economic and social issues in our rural areas as well.

Over the course of its forty-year existence the CAP has undergone many changes, but it is since 1992, when we began the reform process that we are continuing today, that we have taken really large strides towards moving the CAP forward. In addressing the problem areas we have progressively moved away from production oriented support to make the CAP more compatible with our budgetary restraints and international commitments. We have also introduced and subsequently reinforced the concept of rural development, now the "second pillar" of our policy and a focal point for the mid-term review.

Beyond the sustainable use of resources, the future of the EU's agricultural sector also relies on ongoing and renewed public support for the wealth of services that it provides. This means we need a competitive farming sector that continues to guarantee farmers a fair income, but puts the environment at the centre of its policy, and provides consumers with the safe, high quality food products they want. As it stands however, there is a broad consensus that the CAP can do more to successfully achieve these goals. The mid-term review serves two purposes. Firstly, it gives us the opportunity to reflect on and assess our current policy and initiatives, and secondly it provides the chance to make some improvements where we see our shortfalls to be.

Shift towards Quality

One aspect of the CAP that has been subject to continued debate is the question of how best to support agriculture and its related roles. While substantial adjustments have already taken place under the 1992 and Agenda 2000 reforms, the Commission believes that still more can be done in this vein to shift the focus away from the quantity of production and towards the quality that the agricultural industry should provide as a whole. Both the previous reforms saw a progressive shift away from the old price support mechanisms that rewarded farmers exclusively for production towards partially decoupled direct payments that were tied to hectares of land or head of stock on a particular holding. Environmentally, the benefits of these reforms were clear, but still more must be done to ensure that support for farmers does not encourage environmentally harmful behaviour.

What is needed to achieve this, as our proposals suggest, is an expansion of our rural development policy and a complete separation of direct payments from production incentives. Broadly speaking, such a move means that farmers will have to produce in response to market demand and will be more able to carry out the wider role of services that the public sees

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agriculture as responsible for. So, in line with this, the mid-term review is looking to take the final step in totally decoupling direct payments from production. In future, it proposes, financial support to agriculture should constitute a single payment to farmers, based on a historic reference period and be subject to their fulfilling mandatory environmental, animal welfare and food safety standards ("cross-compliance"). Not only would the scheme allow farmers greater flexibility to respond to market demand but it will also ensure that these other issues are addressed as well. By combining all the payments into one single one, the support process will also be greatly simplified reducing the bureaucratic burden for the farmers and making the procedure more transparent and acceptable for the taxpayer.

Strengthening the Second Pillar

In itself though, this move alone is not enough. It needs to be accompanied by further adjustments to redress the balance in support for market policy and rural development, and it requires more efforts to be made in boosting instruments under the "second pillar", the rural development policy. One way of doing this is to introduce a system of compulsory dynamic modulation for all Member States as proposed in Agenda 2000. In practice this would involve progressively reducing direct payments by 3% each year, up to a maximum of 20%, and redirecting this money from the first pillar to the second.

The money saved in this way, which according to our initial estimates would generate an additional €500-600 million for rural development in its first year of application alone (2005), will be distributed to the Member States according to agricultural area, agricultural employment and prosperity. It will be up to the individual governments then to target the specific rural needs of their countries. They will be entitled to allocate modulation money to any rural development measure that is eligible for rural development financing under the EAGGF (European Agricultural Guarantee and Guidance Fund) Guarantee section.

It is not, however, just about righting the balance of funds between the two pillars; it is also intended to improve the balance in distribution of funds to individual farms. So, where smaller farms are often more labour intensive, but receive less support and are less prosperous, a franchise is proposed dependent on the employment situation on each farm. This means that the first €5000 granted will not be subject to modulation, a limit that will rise by a further optional €3000 for each additional annual work unit (AWU – full time employee) over the first two. After the application of modulation, which after franchise would actually only be applicable to less than a third of the EU's farms, an upper limit of funding will be set so that the maximum an individual holding can receive will be €300 000.

Beyond this, there is also a clear need to consolidate and strengthen the second pillar by reinforcing the existing measures and supplementing them with additional schemes to address food safety and quality, to promote animal welfare, and to support farmers in the application of the new auditing system. A food quality chapter will be incorporated into the rural development regulation to encourage farmers and producer groups to participate in quality assurance, certification and promotion schemes for certain products. Within the agri-environment chapter there will also be a possibility to offer additional animal welfare payments to farmers who go beyond our mandatory levels.

An EU wide farm auditing system, to be introduced as part of our cross-compliance requirements and also supported by our new rural development measures, will apply to all producers receiving above €5000 per year in direct payments. Their focus will be material flows, on-farm processes, and equipment relating to environment, food safety and animal welfare standards. Apart from increasing the awareness of farmers, the scheme will also mean greater transparency for the consumer and taxpayer.

Market Organisations and Set-aside

The mid-term review is not, however, just about how to redirect our support and boost rural development. The Commission's proposals also foresee some changes in market organisations to address existing imbalances in certain sectors. Where cereals are concerned, given that the EU is a major world exporter in this sector, it is important that we continue to align our prices on the internal market with those on the world market. This means establishing intervention as a real safety net mechanism and completing the cereal reform process through a final 5% reduction (of the 20% proposed in Agenda 2000) in intervention price.

For rice, a one step 50% reduction of the intervention price in 2004/2005 should reduce possible surpluses in this sector in the long term, and for rye, where surpluses already pose considerable problems, abolition of the intervention price is proposed. To promote quality in the durum wheat industry a specific premium should be paid per tonne of durum wheat that meets certain quality criteria and is sold to the processing industry. This will be accompanied by a reduction in the intervention price. Finally, a simplification of the support arrangements in the nuts sector is also proposed. Where livestock is concerned, the replacement of the per-head payments for production with a single income payment per farm, based on historical references, will reduce pressures towards intensive production and create a more balanced market situation.

My final point concerns set-aside. In order to maintain the supply benefits of set-aside, whilst reinforcing its environmental benefits under the new decoupled system of support, we would like to see compulsory, long-term set-aside of ten years on arable land. Under this scheme farmers would be obliged to put an amount of arable land equivalent to the current set-aside arrangements on their holding into long-term non-rotational set-aside as an element of the cross-compliance requirements they have to fulfil to receive direct payments.

Where these new arrangements would no longer lend themselves to the production of energy crops, currently the dominant non-food use of set-aside land, we propose replacing the existing scheme for non-food crops with a carbon credit. This would take the form of a non-crop specific aid for energy crops with the objective of achieving carbon dioxide substitution as a bio-fuel. Applicable to a maximum guaranteed area of 1.5 million hectares, the aid level will be €45/hectare for those producers who have entered into a contract with a processor.

An Opportunity for Improvement

Taken altogether, the proposed adjustments to CAP instruments will significantly improve the capacity of our agricultural and rural development policies to achieve the objectives established in Agenda 2000. They should provide the bridging point between the differing expectations of consumers, farmers, taxpayers and public administrations. For consumers they represent a major step forward in integrating food safety, food quality and animal welfare concerns into the CAP. For taxpayers, they ensure a more efficient and transparent use of public resources. For farmers they provide the flexibility to respond to market demand, reduce the administrative burden, and reinforce the opportunity to promote quality and speciality produce. For the public administrations, they also signify a vastly simplified application of legislative and control requirements.

In the broader picture, the mid-term review also gives us the chance to assess our international commitments. From an enlargement perspective they will facilitate the integration of new members into the CAP and for the WTO, the proposals are fully compatible with our commitments to improve market access for developing countries and reduce trade-distorting support. The mid-term review is an opportunity for improvement. It is not, as some suggest, about delivering a premature reform, but rather is an assessment of what we already have in place and how to make this better. The CAP has been subject to continued criticism, aggravated by a series of animal health and food quality scares, and as a common policy we cannot, and should not, ignore what the public is saying. As its name suggests, a "common" agricultural policy should be just that – a policy that benefits all its stakeholders. Given that it receives a large but falling proportion of the annual EU budget, consumers and taxpayers have a right to expect this. What's more, we have a duty to ensure that future generations can benefit from the wealth of services that Europe's rural landscape provides, be that in the production of food, from one of the many livelihoods it offers, from the rich aesthetic variety it provides, or from its environmental importance.

What we want to achieve from the mid-term review is a CAP that employs not only sound economics, shows social awareness and demonstrates environmental responsibility, but one in which the public as a whole can believe. We still have some way to go in convincing our consumers and taxpayers that the CAP is a valuable policy, worth investing in, and one that can be relied upon. I believe that our proposals are the way to achieve this, to ensure the EU is able to fulfil its obligations to support our farmers, and ensure we fulfil our obligations to provide a range of public services. Our ideas are on the table and we look forward to continuing the discussion on how best to proceed over the coming months.

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The Ghost of "Old Policies" Still Lingers On

The European Commission has issued new proposals to reform the Common Agricultural Policy (CAP) in its Agenda 2000 mid-term review. In a changing climate shaped by the EU's enlargement, WTO trade negotiations and a much more aware general public, decision-makers are now called upon to act swiftly to determine the future form of the CAP, and to find the right partners to implement an ambitious reform project. The key standards by which the CAP ought to

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be measured in future are the interests of consumers, the environment, animal welfare and fair international trading relations. Inevitably, when funds are redirected and assistance programmes redesigned, this will generate criticism and resistance, primarily from past and present beneficiaries. Yet sticking to the old policies would do untold damage to the Community as a whole. However strong Commissioner Franz Fischler's drive to reform the CAP may be, the ghost of these "old policies" still lingers in parts of the Commission's proposals. In these areas, it will be up to the European Parliament and all others who want to see real change to give their backing to the reform process.

Premiums and Production Levels De-coupled

The Commission is proposing to intensify moves to loosen the links between CAP assistance payments and levels of production. The plan is that direct EU payments to farms should no longer be calculated per hectare under cultivation (as in the case of cereals, maize, rape etc.) or per head of stock, but should be based on the total acreage covered by the farm. This is intended to ease the present policy's distorting impact on the market and on production levels.

A problem here is that the basis on which each farm's entitlement to this generalised area payment (or "premium") is calculated would be the previous level of direct payments, thus perpetuating the in-built disadvantage suffered by certain types of farms such as those in grassland areas.

In the past, the artificial increases in the profitability of, for example, silage maize relative to green fodder or putting stock out to pasture have acted as a substantial incentive to intensify methods of husbandry, with all the negative impact this has had on the environment, animal welfare and employment. It is important that these distortions now be counteracted, by transferring each country's combined beef premium payments to a new form of grassland-based support. However, if the Commission persists in its approach of using past payments as a reference level, any switch from the current beef premiums to new payments based on total farm area should be made conditional on documentary evidence of the supporting grassland acreage. In parallel to this, as part of the agri-environmental programme in the "second pillar", an income-support grassland premium payment based on minimum environmental standards should be introduced, and individual member states obliged to offer this. Over and above this, an additional pasturage premium incorporated into the second pillar would help support the work of farmers in less favoured areas, especially hill farmers, in maintaining extensive cattle husbandry in keeping with both animal welfare and environmental concerns.

Dynamic Modulation

The Commission proposes that the farm support provided by the "first pillar" of the CAP – via direct payments – be reduced step by step, and that the retained funds be used for overall rural development purposes in a "second pillar". An allowance (known as a "franchise") would be excluded from this rededication of funds and would continue to be paid directly to each farm. In the third component of the proposed "modulation", Commissioner Fischler proposes a ceiling of €300 000 on the total amount that any one farm should receive.

The redirection of funds from the first to the second pillar of European agricultural policy is a vital move to ensure its future. This is all the more true because international pressure calling for a reduction in production-dependent payments lacking any component of service to society at large will continue to increase, especially from the Doha round of WTO trade negotiations.

The European Parliament must press for current imbalances in the way support is provided to be reduced, by applying suitable detail to the modulation criteria. Rather than the proposed linear cuts, a graduated approach is needed, also involving basic exclusions governed by labour costs; this would help compensate for the impact of rationalising farms' economic structures. The proposed overall ceiling ought to be made more flexible by a provision allowing recipients to offset half of their real labour costs, thus ensuring appropriate support is provided to labour-intensive forms of husbandry. That would switch the polarity in the debate from the present "big versus small farms" to "farms employing more versus farms employing fewer people", and would enhance the CAP's impact in a social and employment dimension. A basic "franchise" of €30 000 per farm also ought to be excluded from the modulation process, thus effectively exempting farms that receive only a small volume of payments.

Cross-compliance with Social and Environmental Standards

Direct farm payments via the first pillar will, in the Commission's proposal, be made conditional upon compliance with environmental, animal welfare, food safety and work safety standards. They will not be credited in full unless a "certain number of statutory … standards" are fulfilled.

In addition, the Commission proposes that all full-time farms receiving more than €5000 per annum in direct payments from the EU should be subject to a mandatory system of auditing.

Thus direct payments will no longer be independent of how a farm produces its income. The proposal will effectively provide a bonus to farmers who, out of their own good sense as to how a sustainable business ought to be run, already endeavour to treat both the environment and their animals with care and take proper responsibility for the safety of their produce.

The proposed farm audits will raise the transparency of how agricultural output is obtained, giving evidence of what a farm does and how, and thus will enhance consumer confidence. However, care must be taken to see that audits and indicators are appropriate to farming conditions and do not impose an additional bureaucratic burden.

Set-aside as a Measure to Aid Soil Recovery

In place of the current set-aside arrangements, the EU Commission has proposed that farmers should undertake to set aside a land area equivalent to their current obligatory set-aside for a ten-year period, as a precondition for any entitlement to receive direct payments.

This approach places at a disadvantage farms (including organic farms) which already leave land fallow for a time as part of their normal crop rotation.

The set-aside policy, originally introduced partly to ensure compliance with international obligations, ought to be transformed into an instrument to promote soil health. To make the best of this measure's positive environmental impact, it ought to be permissible to integrate a set-aside period into the crop rotation. Similarly, because of their effect on the soil, growing forage legumes ought to be permitted for all farm types and not for organic farms alone.

Sectoral Reforms

Cereals: The European Commission proposes a further 5% cut in the cereals intervention price to take effect in the 2004/05 financial year. On the assumption that this cut will also lead to a reduction in market prices, it also proposes that 50% of the impact of the intervention price cut be compensated for in the form of increased direct payments.

In proposing to reduce the intervention price for cereals, the European Commission creates two false impressions; namely that today's prices are too high and that it is possible to produce cereals more cheaply in Europe. In fact, without the output-oriented acreage premiums it would not even be possible to cover costs at or below €10 per decatonne (100 kilograms), let alone to produce on a sustained basis.

The European Commission ought to say goodbye to the use of world market cereal prices as its benchmark, since these are in any case subsidised. At the same time, it ought to take a more courageous stance and openly declare its desire to end the cereals intervention system once and for all.

For the sake, among other things, of honest pricing in the cereals market which properly reflects the real costs of production, it is necessary to move away from the direct payments in their present, market-distorting form (€100 000 – 150 000 per employee in rationalised cereals units) in favour of a socially just premium-payment system.

Beef: The proposal is to de-couple beef premiums which are currently made on a per-head-of-cattle basis from production levels, and to replace this element by a farm-related payment derived from the historic premium entitlement.

Yet if the de-coupling is carried out in this way it will not bring any fundamental change in the distortion of competition, and extensive, grassland-based beef farming will continue to be placed at a disadvantage relative to intensive fattening units feeding silage maize.

The European Parliament should do what it can to push for a modulation process with a consistent linkage between payment levels and labour input, and for moves to strengthen the position of farmers using extensive, grassland-based husbandry by way of a true de-coupling worthy of the term, or by paying a grassland/pasturage premium.

For the sake of animal welfare, exports of live animals should not only be subject to stricter conditions and restrictions, but all state support for the export of live animals for slaughter should also be abolished.

Milk: The Commission does not propose any specific changes to the Berlin Council's Agenda 2000 decisions regarding the milk market.

The various options set out in the Commission proposal ignore one important alternative: quotas could be lowered. The European Parliament must use its influence to try and prevent the 1.5% increase in the EU reference quantity resolved in Agenda 2000 so that EU milk production can approach the domestic demand level. Both intervention and export subsidies must be brought to an end within a specified period. This would spare an additional burden not only for the EU's budget (and thus particularly for net-contributor nations) but also for milk producers themselves.

The milk premium now proposed should be altered. Here too, a more rigorous approach to the de-coupling of payment and production levels is needed to remove each farmer's incentive to maximise production, which encourages the concentration of milk production in most favoured areas. The level of the milk premium should be tied not to a farm's current milk quota but to the grassland acreage available.

The Second Pillar: Boosting Rural Economies

The key to placing European agriculture on the path to a sustainable future lies in integrated, autonomous development in rural areas, with agriculture and its wide range of functions playing a pivotal role. As seen by the Commission's proposal, whatever budgeted funds are released by the reforms in the first pillar of agricultural policy should be transferred for use in the second, focusing on overall rural development.

Both the increase in co-financing (or "part-financing") rates and the facility for using modulation funds to boost the EU co-financing of existing projects to the maximum rate are likely to improve the support provision in countries with weak budgets, which have previously been unable to make full use of EU funds because their financial resources were too scarce to provide their own part of the co-financing input.

However, the Commission deserves criticism for not having used the opportunity presented by the mid-term review to develop the mixed bag of support measures in the policy's second pillar into a true programme of integrated, autonomous development for rural regions.

Similarly, support still geared purely to agriculture falls short of the mark for an integrated development approach. This applies all the more because farms no longer only look after primary production but may also engage in a broader range of commercial activities. The support provided therefore ought to include various associated craft trades and services, but these ought nevertheless to have some direct connection with farms and/or farming.

The second pillar should be further developed into an effective form of support for integrated, autonomous regional development. This urgently requires the integration of specific support measures to form consistent programmes. However, bringing new dynamism to rural economies also involves drawing up a new "typology" of rural regions, to allow a more tailored response to particular circumstances. This will make the process of tapping and developing local potential more effective. Key features in the implementation of the European model should be the strengthening of local and regional initiative and decision-making structures, subsidiarity and a bottom-up approach, as developed in the LEADER programmes.

International Trading Relations

Regrettably, the European Commission's report has nothing to say on the issue of external protection, including export refunds. At present, a convincing concept for the EU's international trading relations in agriculture is still lacking.

Not only the policies of official intervention in agricultural markets should be abolished, but also the export subsidies which have allowed exporting and transport firms to profit while causing disruption to markets in other parts of the world.

Instead, the spotlight should be turned on the quality of produce. In the WTO's new negotiating round, the EU ought to advocate "qualified" external protection, in which shared quality requirements are laid down for producers and those engaging in world trade. Rather than free trade in an unqualified sense, the order of the day ought to be *fair* trade, which is properly qualified through compliance with both social and environmental standards. Already today, the European Union is the world's largest importer of foods, and it will remain so after its enlargement. This alone is reason enough why external protection should not simply be seen as a matter of protecting the "home" market of EU producers. Rather, the policy should aim to influence the quality of imports, to ensure that the standards democratically agreed by the EU's peoples are applied equally to imported produce.

Setting Reform in Motion

Those engaged in and affected by European agricultural policy should seize the opportunity for reform presented by the mid-term review on Agenda 2000, just as European Commissioner Franz Fischler has made the most of the framework he operates in. Support and active involvement is now needed from other levels in the policy-making dialogue to push through the reform measures. The Commission needs to be rather bolder in thinking specific proposals through to their logical conclusion. Member states must devote more attention to common European interests and stop concentrating solely on those of their own governments. The European Parliament must make optimum use of its powers, and secure a full right of co-decision with regard to the CAP. Europe's farmers and farming unions or federations must meet the challenges of the times, making an active contribution to change. The Common Agricultural Policy is located in a "force field" involving a variety of tensions and opportunities. What we all need to do is make constructive use of these forces to benefit the common future of Europe's agriculture and its rural regions.

P. Michael Schmitz*

Possibilities and Risks Arising from Fischler's Path of Reform

The mid-term review of Agenda 2000 as recently submitted by the EU Commission is more than a mere evaluation of the Berlin Agreements on EU agricultural policy valid up to 2006. It is an attempt – already at this stage – to initiate a discussion on reform and to establish the initial aspects of this in the current agricultural programme and not in 2007. This is, on the one hand, a welcome move, as in the course of EU enlargement and the WTO negotiations the EU will be faced with new challenges which will inevitably require further adjustments and demand rapid answers. On the other hand, policy is also responsible for planning security and the continuity and the reliability of the political and legal framework. It is therefore understandable when agricultural entrepreneurs complain of the high policy risk that results from the constant discussions on reform and the new regulations on both the European and the national level. Uncertainties, the holding back of investments and concerns about an overkill of regulations are the consequence. It is precisely German farmers and their partners in the upstream and downstream industries who have had their sense of security undermined as a result of the discussions on the turnaround in agricultural policy. More than ever they desire reliable conditions and a clear path in agricultural policy. To what extent this clarity and reliability are recognisable in the path for reform as expounded in Fischler's mid-term review, and whether he takes the new challenges brought about by the EU enlargement and the WTO negotiations sufficiently into account, or whether there are new risks and dangers for a free market orientation, shall be examined here using the most important propositions and statements from the mid-term review.

A range of proposals for the stabilisation of markets and improvement of common market organisations are a priority of Agenda 2000 and undoubtedly serve for a stronger market orientation. These include:

- reduction of intervention prices for cereals by 5% in the 2004/2005 financial year and partial compensation through an increase in arable area payments;
- abolition of the monthly premiums (reports) in cereal intervention prices;
- abandonment of intervention for rye;
- decrease in the specific premium supplements for durum wheat and the abolition of special subsidies in the customary growing areas over a period of three years;
- reduction of the intervention price for rice by 50% in the 2004/2005 financial year and the introduction of a private inventory regulation.

The reasoning behind these measures is, firstly, a stronger relating of EU agricultural prices to the world market with the aim of improving the price competitiveness of EU agricultural and food products. Secondly, as long as in this manner exports are able to be reimbursement-free, then the very restrictive export restraints of the GATT Treaty should be avoided and greater participation in the dynamics of the world market made possible. Thirdly, all intervention measures should be reduced to the function of a low level security net, from which no production-stimulating effects and no chronological price distortions can result. This should more than ever be oriented to private sector inventory planning. Fourthly, and finally, it is intended to reduce the special status of some products in order to no longer give false production incentives and to avoid the misallocation of factors of production. As well as this stronger market orientation, the EU Commission expects above all from these proposals to economise on market regulation expenses in the agricultural budget. However, while giving complete consent to this general path, several very critical questions arise in connection with the proposals regarding the stabilisation of markets and the improvement of market organisations.

Critical Issues

Participation in the world market will not automatically be achieved through an administrative lowering of the market organisation price, nor through a corresponding adaptation of levies or reimbursements. Under the current system it is not only possible that increasing or decreasing world market prices are not – or only partly – passed on to the European farmer. Rather, it can also happen for example that the EU price lies below the world market level for an extended period of time. This cannot be in the interests of the European agricultural industry. A remedy could be devised here through the introduction of specific quantity tariffs or quantity subsidies or of ad valorem tariffs or ad valorem subsidies which would then have to be gradually abolished. The

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question must also be asked as to why the reduction of price control is not carried out synchronically and uniformly across all products in order to avoid intrasectoral production distortions and a misallocation of resources. According to the proposals, EU cereal prices, for example, are quite close to the world market level, whereas the prices for beef, dairy products and sugar lie far above it. From a welfare economics point of view, a reduction in support which began with products with high rates of protection and which were harmonised in the course of liberalisation would therefore be advantageous. In this context it is also incomprehensible that the Commission does not take a definite stand on the issue of the reform of the milk market regulation, which had already been given a special status by the Berlin Agreements, being allowed a later starting date for reform, in 2005/2006. All the same, it is probably undisputed that quota regulations of any kind are incompatible with any market economy. In the long run this cannot be justified. Therefore it is not a question of whether the quota regulations should be abolished, but rather in which period, with regard to protection of trust, and with which transitional regulations.

What is also not understandable is why, despite the abolishment of some product-based special regulations, new and special situations come into play and complicated compensation regulations are to be introduced. The quality premiums for durum wheat, and the farm-related and simultaneously culture-specific subsidies for rice, serve as examples of this. In the end, it is imperative that there be great vigilance if the Commission wants to negotiate on an alteration and simplification of the EU border protection for cereals and rice. Evidently what is intended is the introduction of tariff quotas, which are an extremely problematic foreign trade instrument from an economic point of view. Experience shows that the allocation of import rights within the duty free or preferential tariff quota does not take place according to economic principles and that the level of protection outside the quota is often set prohibitively high. The foreign trade regime would consequently become more selective and more protectionist. This is not only directed against cereal imports from eastern Europe and the CIS states, but is also diametrically opposed to the desire for integration in world markets and the opening up of economies.

Reform of Direct Payments

Along with the proposals for the stabilisation of markets and the improvement of the common market organisation, in its report the Commission devotes greater attention and more detailed explanations to the reform of direct payments. In principle the Commission is striving for a decoupling and simplification of payments as well as their connection to environmental, quality and animal welfare standards. The proposals in detail are:

- the introduction of farm-related income payments per farm, which are decoupled from production, in analogy with the previous direct payments under various regulations, taking the complete implementation of Agenda 2000 into account;
- calculation of payment claims per subsidy-qualifying hectare of a farm and the possibility of a transfer of the claim to other farms under certain conditions, and with leeway to put this into practice with regard to the spread of hectare-related payments;
- linking direct payments to standards in the areas of the environment, food safety, animal welfare and occupational safety (cross-compliance) with a regional connection but on the basis of EU standardised fundamental implementing regulations, as well as the introduction of obligatory audits for all full-time farms which receive at least €5000 in direct payments;
- continuation of the currently valid, obligatory set-aside system of arable farm land over a period of ten years as a prerequisite for a claim to direct payments and thus as part of the cross-compliance requirements;
- new establishment of a subsidy which is not culturally specific for the cultivation of renewable energy crops as a substitute for CO_2;
- reduction of all direct payments in arithmetical steps of 3% per year to up to 20% as of 2004, with an allowance of €5000 for the first two full-time employees and (optional for Member States) €3000 for each further full-time employee (dynamic modulation);
- capping of direct payments per farm to €300 000 after applying the modulation and the allowance, and the transfer of funds made available in the second pillar in the Member State concerned.

The positive aspect of these proposals is that the switch-over to farm-related subsidies in fact constitutes a far-reaching decoupling. This is especially true of livestock premiums. However, the production effectiveness for area premiums also decreases as a whole, although standard field premiums are to a large extent already being paid. These premiums are however still linked to the utilised agricultural area. Production distortions and factor misallocation consequently decrease, entrepreneurial freedom and the market orientation of farmers increase and direct payments probably reach green box ability in WTO negotiations. And not the least of these, the payment system will also become simpler, because no new payment claims per farm must be calculated, as previous amounts are maintained and will merely be apportioned in their totality on a hectare basis.

These positive aspects however raise a series of critical points, which will be addressed in the following.

The change-over to farm-related direct payments corresponding to the level of the present payments has admittedly the distributional policy charm that for the moment it does not necessitate an encroachment on acquired rights. On the other hand, the change-over establishes exactly this on a medium-term basis and leads to very different payment claims per hectare which are substantiated neither on a social nor on an environmental policy basis. On top of this, some products (e.g. milk and sugar) are to be included in the regulation much later and certain exceptions are to remain, e.g. for durum wheat, protein plants and nuts. One can therefore hardly speak of a drastic simplification. Moreover, further production distortions and misallocations of resources cannot be ruled out when different product-related control principles are applied. This would be especially true if the national leeway for a possible levelling of payment claims per hectare through leasing or the selling-off of farm elements or areas of farms from the Member States were to be used very differently. Depending on what each individual nation had in mind, the premium would then be oriented to income or to employment or to the environment. In any case, the premium would be without a clear objective and without a standard guiding principle.

The attempt by the EU Commission to define good professional practice by EU centralised implementing regulations, and to set them as minimum standards in the areas of environment, food safety, animal welfare and occupational safety, is a sensible one. However, it clearly goes beyond the current degree of knowledge within the aforementioned areas, when claims to direct payments are dependent on this, when it is stipulated that cost-intensive audits must be carried out for all full-time farms and when payment claims are tied to a long-term ecological set-aside system of farm land. With the planned amendment of the EU's uniform minimum standards by regional standards, it is easy to see that one result of this will be the amount of bureaucracy with which public authorities and farms will have to deal. An "overkill" of regulations will occur and it is to be feared that there will be a considerable distortion of competitive positions, burdening countries with excessive standards.

Problematic Role of Modulation

Although in principle it seems sensible to have a chronological degression of direct payments through the simultaneous construction of a system for rewarding ecological achievements, the EU Commission's proposal on dynamic modulation is decidedly problematic. This concerns on the one hand the upper limit of farm payments. As long as direct payments are used as compensation instruments for the loss of revenue as a consequence of price decreases, all farms are entitled to these for each hectare farmed. The capping of these direct payments then becomes unjustifiable. If, on the other hand, income policy objectives are pursued, as seems to be intended with reference to the cost degression of large farms, then it must be asked whether direct payments and their modulation are in general a suitable means for the intervention of income control in a sector. The answer is unambiguously no. Income redistribution is carried out efficiently only through tax policy, and not through farm policy instruments of market organisations. On the other hand, the orientation of modulation towards the employment situation of a farm is extremely problematic. In spite of all the assertions about a supposed double dividend (more work and a better environment) it can be inferred that the incentive for a greater amount of work – which stems from the modulation system – actually creates fewer work opportunities in the mid to long term. This arises from the cost disadvantages compared to competitors who do not have such an incentive scheme. The end result will be a decrease in competitiveness and employment opportunities. Finally, the extensive decoupling achieved through the change in the premium system will again be destroyed through modulation. As labour intensity will be favoured, a clear distortion of factor inputs with subsequent production distortions will take place, of which capital-intensive farms must bear the burden. The concern about these erroneous trends in development is augmented even further when one reads in the EU report that the funds made available from the dynamic modulation are to be allocated additionally to rural development according, amongst other things, to employment criteria. It is clear, however: agricultural policy is taking on more than it can handle if it is intended to be used as a vehicle for employment policy for rural areas.

With that point, the second pillar of agricultural policy is addressed, which the EU Commission would like to boost. The present accompanying measures, such as agricultural environment programmes, the promotion of disadvantaged regions, reafforestation measures and an early retirement scheme, are to be improved and new ones to be added on. These include, above all, support measures which would allow one to act on the expectations arising from food safety and quality, to assist farmers when higher standards are introduced, and to promote measures for animal welfare. What all of these proposals have in common is that they are not very concrete and permit considerable leeway for individual nations. It stands to question whether the second pillar of agricultural policy can achieve the coherence, effectiveness and efficiency which so many expect. Doubts also arise given experiences with the present accompanying measures. Besides, Fischler's reflections and those of numerous environmentalists start with the false assumption that in order to ease the pressure on the environment a reduction in production intensity is stringently necessary. On the contrary, more recent findings have already proven that more extensive production methods are not inevitably more environmentally friendly and that the same environmental benefits can be achieved through more intensive methods which are more cost-effective, more time-saving and more goal-directed. Modern production facilities and innovative production processes contribute to this effort. This fact has till now hardly been taken into account by environmental programmes. As always, the act (extensification) – and not the result – is rewarded.

Considerable Risks

In conclusion, the following summary can be made of the mid-term review of the EU Commission and Fischler's path of reform. On the one hand, basic elements of the proposals allow one to recognise a distinct market orientation. These include the abolishment of price support, the reduction of intervention to a safety-net, and a further decoupling of direct payments. Certainly, in raising doubts about the quota system it would have been desirable to see the EU Commission be more courageous by giving a more distinct statement. On the other hand, numerous new proposals hold considerable risks which lead to less efficiency and competitiveness and more bureaucracy. Two in particular can be cited: the proposals for cross-compliance and for modulation. Finally, the formulation of the second pillar is still to a large extent unclear and the question must really be asked whether such an instrument does not already exist in regional economic policy, with which rural development can be regulated. It is a matter of concern that funds from agriculture will be quickly drained away, without guaranteeing sufficient confidence in a transitional period of liberalisation and deregulation. The proposed path of reform consequently contains numerous risks, and offers leeway for counterproductive unilateral national implementations. This seems, given the EU's expansion, to be not without problems. Furthermore, the political risk is increased in the current agricultural programme through the introduction of dynamic modulation from 2004. It would certainly be more sensible to reflect intensively once more on the reform of the direct payment system and to let this then commence in 2006.

Secondo Tarditi*

CAP Pseudo-Reforms: a Penelopean Web

Since its institution the Common Agricultural Policy has been almost permanently criticised and its policy instruments under reform, from the "structural" reform in the early seventies to the "producer levies and super-levies", the "stabilisers", the "maximum guaranteed quantities", the "milk production quotas", the "land set-aside" and the 1992 MacSharry reform. The Commission document on the mid-term review (MTR) of Agenda 2000 is now proposing new policy measures to reform the CAP. Will this be, at last, the proposal reforming the CAP for good? Present international pressures for market liberalisation through the WTO, the risk of extending to Central and Eastern European countries inefficient, inequitable and unsustainable policies, the domestic financial cost of the CAP, absorbing half of the community budget to manage a sector producing less than 2% of EU gross domestic product, should favour a successful "real" reform in the framework of an economically sound European integration process.

Unfortunately, past experience suggests a pessimistic outlook. Previous CAP reforms usually promised large steps forward in the direction of serving the common interests of EU citizens, but in the implementation process, sector-oriented bureaucrats and policymakers systematically frustrated the more biting reform proposals, maintaining the status quo or even generating a larger waste of public resources and a further reduction in social well-being.

This recursive pattern of CAP reforms reminds one of Penelope's web, woven in daylight and unravelled at night. We shall only mention how some major reform attempts were frustrated, then focus on the mid-term review, highlighting the steps forward and how Agenda 2000 and its MTR could be thwarted into the umpteenth pseudo-reform of the CAP.

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Past Experience

The core economic issue in establishing the EEC customs union was setting the common external tariff for all commodities. According to Article 19 of the Treaty of Rome: "… duties in the Common Custom Tariff shall be at the level of the arithmetic average of the duties applied in the four customs territories comprised in the Community". Such an average of the duties previously enforced by the member countries would have avoided market imbalances as a consequence of the customs union and was consequently applied to all commodities. However, in order to avoid shocks in farm incomes and favour structural adjustment, time-limited decreasing compensatory payments were instituted for Italian and German farmers, whose domestic price levels should have decreased.

In the few years immediately following the institution of that fair common tariff and the time-limited waiver for farm commodities, the Council of Agricultural Ministers frustrated it. Common duties, and consequently domestic farm prices, were set at a level much nearer to the previous, high German and Italian farm prices, rather than to the lower French and Benelux prices, creating extra distortions in the domestic market and income transfers from EU consumers to farmers. Consumer and other organisations defending the general interests of EU citizens were not aware or not powerful enough to contrast this original unravelling of the fair integration web in the European agricultural sector.

The 1972 "structural reform", the consequence of the Mansholt Memorandum, failed mainly because in implementing it the Council of Agricultural Ministers did not substantially reduce the agricultural price support. Farmers, understandably, invested structural subsidies in the most profitable commodities, which happened to be the most price-supported. As a consequence farm interests diverged from the interest of society as a whole, increasing unsold surpluses and export subsidies, and generating a large waste of economic resources.

The 1992 MacSharry reform almost dismantled the price support for basic commodities such as cereals and oilseeds. In order to avoid shocks to farm income "compensatory payments" were envisaged. Notwithstanding the recurrent declarations of farm ministers and EU Commissioners for Agriculture that such payments would be reduced, as "there was no reason to compensate farmers in the year 2000 for price reductions implemented in the year 1993", in the following years such payments were maintained and implicitly considered permanent "production aids". The correct parameter for assessing distortions in EU agricultural production are "producer prices" (market prices plus direct production aids), not just market prices. It will not be possible to restructure EU agriculture if producer prices are not reduced.

The recurrent CAP reforms promised a substantial reduction in producer price support, but in practical policy implementation such a reduction was always frustrated. The prevalent strategy adopted in the last three decades was not to eliminate, but rather to disguise, the huge economic and financial costs generated by the CAP. Supply management policies (production quotas and land set-aside) constrained domestic supply in order to maintain high domestic price levels and limit surpluses which were highly visible to citizens in the form of food destruction or in the form of high budgetary expenditure for their disposal. Unfortunately such policies disguised but did not reduce the real economic cost to society as a whole. How can we justify the social or economic rationale of spending annually over €1.2 billion to subsidise farmers for not cultivating over 5 million ha of arable land in order to reduce domestic supply and maintain high food prices? Why should households pay first as taxpayers and then pay again, probably even more, as consumers for such wasteful policies?

Weaving Progress in the Mid-term Review

The MTR sets objectives shared by all citizens. The competitiveness of EU agriculture should be enhanced "by setting intervention as a real safety net measure, allowing EU producers to respond to market signals while protecting them from extreme price fluctuations"; market orientation should be attained "by completing the shift from product to producer support with the introduction of a decoupled system of payments per farm". The MTR "aims at enhancing the efficiency, sustainability and subsidiarity of the CAP, simplifying its administration".

A step forward is the unequivocal institution of some time-limited and degressive subsidies. In the new chapter "meeting standards" of the rural development policy, "aid would be payable in the form of a degressive annual compensatory payment for a period of maximum of 5 years, up to a maximum of EUR 200 per ha in the first year". A planned reduction of farm subsidies is envisaged also in the reform of the market policy: "All direct payments will be reduced progressively in arithmetic steps of 3 % per year to reach 20%".

Unfortunately such steps forward are very small and slow. In the second CAP pillar, rural development, the "degressive compensatory payments" will involve a very small share of the agricultural budget. In the first pillar, market policy, the annual reduction (modulation) of former "compensatory payments" by 3% is very slow, limited to 20% of total payments and further limited only to commercial farms. It is "proposed to introduce a franchise dependent on the employment situation on each farm. For up to 2 (full time) annual work units (AWU), the franchise will be EUR 5 000. This will ensure that the majority of farms will not be subject to modulation".

As the reduction of present farm subsidies is so partial and slow, it will have a very limited impact on structural adjustment. In practice the strongly criticised price support existing before the 1992 CAP reform was maintained in the nineties by transforming compensatory payments into permanent income payments, and will be maintained under the new name of a "farm income payment" probably for several further decades.

Unfortunately such huge farm aids will not only preserve the existing inefficient, inequitable and unsustainable agricultural policy in the EU15, but will expand it to the new EU members, lowering the competitiveness of their agriculture, increasing surpluses or wasting economic resources through land set-aside, generating a perverse income redistribution in favour of large farms and landowners and worsening the agricultural impact on the environment by intensifying the use of polluting inputs.

A credible real reform of present market policy would phase off price support while stabilising domestic market prices. Degressive compensatory payments would compensate farm income losses for a limited time period, say a decade, in order to allow a gradual but generalised structural adjustment oriented to the market and not to a system of producer prices which does not have economic, social or environmental justification in the EU15 and even less in the CEECs. The worst features of market policy – export subsidies, production quotas and land set-aside – would not be needed any more. The large amount of budgetary resources could be much better spent on rural development, on environmental and regional policies, on favouring inter-sectoral labour mobility and also on non-agricultural rural investments where this was more consistent with the common interests of local communities.

Main Strategies for Unravelling the Web

Price support of farm commodities benefits primarily particular farmers, still largely in proportion to their farm size, costs taxpayers' money, acts as a regressive tax on consumers and involves a large share of social deadweight losses.[1] Such extra benefits to farmers are not consistent with the interests of EU society as a whole, but they explain the recurrent strategies applied to unravel the web woven in the direction of the common good.

A first strategy for unravelling the web is to change the name and modalities but not the core of the market policy, i.e. maintain the existing huge income transfers from consumers and taxpayers to producers. According to OECD estimates, total agricultural support[2] amounts to over €100 billion per year, half via price support and half via direct payments. Notwithstanding the 1992 reform and the 1994 GATT-WTO agreement the support per farm work unit did not show a long-term reduction in the nineties.

Previous transfers from consumers to producers via price support were changed into "compensatory payments" by the 1992 reform, into "direct income payments" by Agenda 2000 and now will be changed into "farm income payments" by the MTR. An extremely large amount of money will continue to be transferred to the same people, preventing a "real" structural reform. The motivation has changed and farmers will receive those same transfers under an "environmental label" if they comply with "good farming practices".

If farmers who were not previously supported, such as fruit and vegetables producers, do not receive such aid, should they not comply with "good farming practices"? If the basic principle "polluter pays" becomes "government should pay for not polluting", should all citizens receive a subsidy for not dumping garbage into the streets? The MTR is also proposing a crop-specific subsidy for durum wheat for "quality" reasons, so should other farmers produce low quality products?

A second strategy is to present partial and distorted information. In official documents of the Commission, including Agenda 2000 and the MTR, only half of the CAP burden borne by households is mentioned: the budgetary expenditure. Market transfers consequent to the protection of the domestic market by import levies and export subsidies are not mentioned. National and regional expenditure in agriculture are not properly diffused. EU citizens receive partial and distorted information on the actual cost of the CAP and on its impact on resource allocation, on income redistribution and on the environment.

A third main strategy is to maintain the present institutional bias in the decision-making process. The share and the consequent bargaining power of sector-oriented components of institutions where agricultural policy measures are formulated is usually overwhelming. Representatives of consumers, of environmentalists, and of other social groups oriented to the common interest are usually a tiny minority, notwithstanding the fact that households – as consumers or as taxpayers – bear such a high burden as a consequence of the CAP.

Without correct information and a more balanced representation in the policy decision-making process, the reform of the CAP will probably remain an incomplete Penelopean web.

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[1] Secondo Tarditi: Consumer interests in the Common Agricultural Policy, CIPAS, University of Siena 2000.

[2] OECD: Agricultural Policies in OECD Countries – Monitoring and Outlook, Paris 2002.