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Making the EU's Common Agricultural Policy coherent with development goals

The new global context requires a fresh look at the CAP

Key points

- The CAP 2014-2020 must be compatible with development goals
- The CAP is designed to help EU farmers, but some of its instruments distort markets and damage developing countries
- The CAP's €50 billion a year budget must be used effectively to reconcile EU policy needs and concerns about food security in developing countries

The EU Common Agricultural Policy (CAP) aims to promote agriculture throughout the EU by increasing farmers' incomes and supporting the provision of public goods such as the environment. It is funded from the European Commission (EC) budget and accounts for roughly 40% of total EC expenditure. It is divided into two pillars. Pillar 1 includes both direct payments to farmers and market management measures. Pillar 2 focuses on improving the structural and environmental performance of agriculture and on promoting local/rural development. Pillar 2 requires Member State co-financing.

The EU has recognised that making development policy in isolation is not sufficient. Its commitment to Policy Coherence for Development seeks to ensure that all policies, not only development assistance, promote growth in developing countries. Any decision on CAP reform options must, therefore, be analysed against development goals.

A new debate on the EU's Common Agricultural Policy is needed urgently.

Past CAP reforms

The 1992 MacSharry reforms reduced the level of market price support and introduced direct aid to farmers together with a set of other relevant measures such as early retirement, agri-environmental schemes and forestation. Reforms in 2000 and 2003 decoupled most of the remaining payments from production to give clearer market signals to farmers and further strengthened rural development policy, transferring 5% of direct payments to rural development. The 2008 Health Check reform, within a wide set of interventions, phased out milk quotas, decoupled some, but not all, of the remaining support, and gave investment aid to young farmers. Coupled payments decreased from 77% of total CAP payments in 2004 to 15% in 2008; decoupled payments grew from 3% to 68% and Pillar 2 payments from 15% to 18%.

EU member states agreed in 2002 that expenditure on agriculture (though not rural development) should be held steady in real terms between 2006 and 2013, despite the admission of 10 new members in 2004. While the CAP budget has remained at around €50 billion over the past 15 years, it has fallen as a percentage of the budget from 70% in 1985 to around 40% in 2009. CAP domestic support is still twice the value of African exports of agricultural goods.

CAP reform options

The EC Communication 'The CAP towards 2020' (EC, 2010) discusses three CAP reform options. In broad terms, these are:

1) Some redistribution of CAP support from old to new members, possibly including restrictions on payments to large farms.
2) Redistribution, plus changes to direct payments to make them more conditional on environmental or rural development criteria.
3) Phasing out direct payments and increasing support for environmental purposes.

Translating these three options into detailed proposals requires decisions on:

- The overall level of CAP payments: major change is unlikely, but this depends on the multi-annual financial framework for 2014-20.

- The extent to which direct payments (Pillar 1) are redistributed among Member States. As they have very different patterns of agricultural production, a shift of funding to the new Member States could redistribute funds to different agricultural products.
- The extent of any stronger focus on environmental and climate change objectives, whether achieved by increases in Pillar 2 support at the expense of Pillar 1 or by greater targeting of the Pillar 1 payments at environmental objectives.
- The extent to which the menu of Pillar 2 measures is broadened to include, for example, climate change mitigation and risk management instruments.

The impact of any CAP policy reform will vary across developing countries depending on, among other factors, their composition of production, dependence on food imports, trading costs and national policies.

The CAP, other EU agricultural policy instruments and developing countries

It is important to analyse policy instruments in detail when looking at the impact of the CAP and any possible reforms on developing countries. These instruments have different effects on different types of countries and products.

- **Import tariffs:** The tariffs paid by countries without special arrangements with the EU, the Most-favoured Nation (MFN) tariffs, are still high. They average 54% for milk products, 34% for grains and 32% for meat. This key form of protection is not affected by CAP reform. Lower tariffs would help developing country exporters who face MFN tariffs but would hurt those who already have tariff-free access. Lower import tariffs would increase EU, and therefore world, demand for specific commodities and this would damage developing country consumers dependent on imports of food.
- **Coupled payments:** These are an addition to the price received for EU products and therefore encourage EU production. Reducing them would lead to increased exports, and therefore income, in many developing countries.
- **Direct decoupled payments:** These are described as non-distorting, but in practice there is growing evidence that by supporting non-competitive farmers they may induce farmers who would otherwise leave the industry to keep on producing. As payments are conditional on ensuring that the land to which they relate remains usable for farming, these payments help to retain more land in use for farming. Because direct payments increase EU supply, any reduction in such payments would allow an increase in developing country exports and higher world prices, although it would raise costs for developing country importers of CAP-affected products.
- **Pillar 2 payments for rural development:** The economic effects on developing countries depend on the extent to which the payments provide additional income based on measures the farmers would have taken in any case (with the same effect as direct payments) rather than compensating for extra spending on rural development or environmental measures. If they reduce greenhouse gas emissions, this would benefit developing countries.
- **Export subsidies:** The EU paid farmers €1 billion in export subsidies in 2008 and €650 million in 2009. Most recently, these have subsidised dairy products. Because export subsidies boost EU supply, some developing country consumers would lose from a reduction in export subsidies via a rise in the price, but producers and exporters whose products have been displaced by EU exports would gain.
- **Intervention price:** Public intervention at fixed prices remains available in principle for cereals, beef and veal, and butter and skimmed milk powder, but only for quantities fixed in advance or at very low prices. Since 2009-10, no cereals apart from soft wheat have been eligible for intervention. There are unlikely to be major effects in the future on the rest of the world.

Of all the instruments for which changes are proposed, direct payments and rural development support have the largest impact on developing countries. We will now provide a quick overview of their impact as background to an analysis of the extent to which the CAP and the proposed reforms meet the EU's objective of Policy Coherence for Development.

Measuring the effects of CAP

Analysis of trade statistics

The developing countries most likely to be affected by CAP reforms are those for which exports of any of the CAP-affected products are (or could be) important (they could see increases in their real income because of price and/or volume effects) or those for which imports of such products are important (they could lose out as a result of price rises).

Table 1 identifies the developing countries that are significant suppliers to the EU and, in particular, small countries where a specific product accounts for more than 2% of total exports. Table 2 identifies countries where CAP-affected products constitute a large part of total imports.

The tables show that African and Latin American countries are particularly affected by CAP policy instruments.

CGE studies of the effects of CAP direct payments

To put numbers on the effects of the CAP, researchers have used Computational General Equilibrium (CGE) models and partial equilibrium studies of how

Table 1: Countries with significant agricultural exports to the EU in 2009 (ranked from highest to lowest)

Significant agricultural exporters to EU[a]			Small countries for which a product is a significant % of total exports[b]		
Dairy	Meat	Grain	Dairy	Meat	Grain
Morocco, China, South Africa	Argentina, Brazil, Uruguay, Chile, Namibia, Botswana	Ukraine, Thailand, India, Argentina, Chile, Pakistan, Mexico, Uruguay, Brazil	Nicaragua, Djibouti, Uruguay	Uruguay, Paraguay, Nicaragua	Belize, Paraguay, Uruguay, Guyana, Pakistan, Ukraine, St Vincent

Notes: a) countries whose exports of a specific product category represent more than 2% of EU27 imports; (b) countries for which a product category represents more than 2% of total exports.

Table 2: Countries where a product category represents more than 2% of total imports in 2009 (ranked from highest to lowest)

Dairy	Meat	Grain	Vegetables	Fruits and nuts
Somalia, Cape Verde, São Tomé & Príncipe, Senegal, Tonga, Samoa	Tonga, Samoa	Yemen, Côte d'Ivoire, Guinea-Bissau, Haiti, Gambia, Senegal	Somalia, Bangladesh	Niue, Djibouti

Table 3: Impact of the removal of CAP instruments (variations as % of baseline output)

	Crops	Livestock	Food processing	Forestry and fishing	Manufacturing	Services
Africa	0.81	2.93	-0.18	6.13	-1.02	-0.02

Source: Boulanger et al. (2010).

prices are transmitted. Both types of studies face uncertainties. In addition, modelling the effects of both direct payments and rural development spending is complex and depends on assumptions about farmers' behaviour.

Conforti (2005) examines the effects of a removal of direct payments and the consequent increase in production in non-OECD countries. The impact is largest for cereals, but there are also increases for oilseeds, fruits and vegetables, rice and plant-based fibre. Output would increase, especially in Latin America and, to a smaller extent, in Asian countries. He also points out that modelling coupled and decoupled payments together can result in a high overall impact, despite the fact that the separate effects of the two types of subsidies may be small.

Costa et al. (2009) examine the impact of direct payments, border tariffs and export subsidies on Africa. Using the Global Trade Analysis Project (GTAP) model, they find that these three measures together reduce Africa's gross national expenditures (a welfare measure including consumption, investments, public expenditures and terms of trade effects) by 0.05% ($560 million).

A more recent study by Boulanger et al. (2010) analyses the impact of the removal of CAP instruments on African agricultural sectors (Table 3). On the one hand this reduces EU supply of crops, raising world prices and African exports. On the other hand it encourages a switch of resources in the EU from agriculture towards other now more attractive sectors such as manufacturing and services that compete with African production.

The main message from these models is that in many cases CAP instruments are distorting and can damage developing country economies. This problem must be resolved to ensure coherence between CAP policy reform and development goals.

Price transmission mechanisms

The CAP affects EU prices and this effect is transmitted to world prices and then to developing countries with varying effects. Boulanger et al. (2010) suggest that the abolition of CAP would lead to average changes in world prices of the order of 1-4%, but the size of the impact will vary across commodities and across countries. The expected changes seem small compared to recent fluctuations in commodity prices of 50-100% in one to two years, but these are around the trend, while reform would cause a permanent shift.

For any change in EU policy, the effects on the prices faced by individual developing country exporters or importers depend on the structure of markets (the response of EU importers and exporters) and the structure of international trade. Countries with high transportation costs or other market imperfections are likely to see lower than proportional pass-through. If developing country governments intervene in agricultural markets, the prices faced by countries may not be directly transmitted to domestic markets and different groups within them, distorting any response.

The net economic effects are sometimes small, e.g. when the producers gain and consumers lose from higher prices, but this may mean that rural poverty declines and urban poverty increases. The distribution of gains and losses may have major social or welfare effects. These effects mean that an analysis of coherence with development must move beyond the country averages of CGE models.

Policy and research questions for the CAP

When the details of the reforms are known, further research and analysis will be needed to understand better who may be the losers, and then to determine how the European Commission will need to adapt the proposals or adopt complementary changes in order to avoid damaging development. The CAP may also need to adjust to new concerns.

1. Most important for development: CAP reform takes place when the EU has become serious about the provisions on Policy Coherence for Development. If the CAP or CAP reform leads to losers in developing countries, how should European policy respond?
2. Price volatility matters. Agricultural prices are more volatile than those of manufactures as they are subject to natural variations. Any policy that attempts to separate the EU's share of total world consumption and production of agricultural products from world markets increases volatility in the rest of the world. For low-income countries, price rises for an essential part of their consumption are a serious problem. How should EU development policy deal with this?
3. Food security is important, but could it be supported more efficiently by providing aid to increase agricultural productivity in developing countries instead of funds to unproductive farmers in the EU?
4. Maintaining the CAP sends a signal about the EU's understanding of 'good governance' to the rest of the world. How does the CAP assumption that European consumption must depend on European production affect developing countries' policies for food security?
5. The EU's new financial framework for 2014-20 should be agreed during 2011. New data released by the European Commission estimate CAP and other payments to farmers at €387 billion over 2014-20, which is €55 billion a year, an increase of 4% over the previous seven years (although a drop in share of the EU budget). Is this increase likely to be acceptable to those Member States trying to limit the size of the overall budget and will it be agreed to be a priority at a time of financial constraint?
6. High food prices now provide high incomes for efficient farmers. What is the case for farm income support in current conditions?
7. Will the new role of the European Parliament in trade policy mean more attention to consumer concerns? And will these concerns be prices or food quality? Or will the Parliament be more responsive to the interests of well-organised pressure groups, such as farmers?
8. EU Member States have always had different positions on the CAP. How will changes in the influence of different Member States affect EU policies?
9. Increased concern for environmental objectives could lead to more careful analysis of using CAP support for environmental reasons. Is support for farmers the most efficient way of delivering support for environmental global public goods?

Conclusions

The Common Agricultural Policy has the potential to affect developing countries in a variety of ways. The magnitude of these effects and the countries most vulnerable to them depend on the specific policy, on market conditions and on country-specific characteristics. These findings imply that research is urgently needed to analyse the coherence between CAP reform and European development policy. Research areas, including the various effects of CAP reform on developing countries, the EU internal policy process, the new global environment of high price levels and volatility, and the links between economic and environmental sustainability, set an agenda for ODI and other researchers in the coming months.

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