THE COMMON AGRICULTURAL POLICY: PAST, PRESENT AND FUTURE

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Abstract:

When the EC countries decided to tackle in common the agricultural problem by setting up a Common Agricultural Policy (CAP) they embarked on a task of immense economic and social implications. Despite the difficulties which this has caused from the start, many observers agree that on the whole the EC has succeeded in establishing its most comprehensive common policy.

The main purpose of this short analysis is to present an overview of the main developments of the CAP and to outline its prospects beyond the turn of the century taking into account the enlargement of the European Union and the negotiations with the World Trade Organisation (WTO). The EU's negotiating position in future WTO negotiations will be formulated along the lines of the Berlin agreement, which fall far short of the US objectives regarding the liberalization of the international trade in agricultural commodities. Moreover, a delay is expected in EU's eastward enlargement. Nevertheless, over the next seven years, it will be the first time in the EU's history that spending on agriculture will not have shown constant growth in real terms. The agreement also recognizes that agriculture contributes to the preservation of natural resources and the European heritage and maintains the visual amenity of the countryside. Finally, it seeks to respond to consumer concerns on food safety, quality and animal welfare issues.

1. Introduction

When the EC countries decided to tackle in common the agricultural problem by setting up a Common Agricultural Policy (CAP) they embarked on a task of immense economic and social implications. Despite the difficulties which this has caused from the start, many observers agree that on the whole the EC has succeeded in establishing its most comprehensive common policy. The CAP, in a way, still reflects the balance of interests and the compromises reached between the six original Community members, which continue to have vested social and economic interests in their agricultural sectors.

The main purpose of this short analysis is to present an overview of the main developments of the CAP and to outline its prospects beyond the turn of the century taking into account the enlargement of the European Union and the negotiations with the World Trade Organisation (WTO).

2. Objectives and Principles of the CAP

The main objectives of the CAP are clearly defined in Article 39 of the Treaty of Rome as follows:

- to increase agricultural productivity by promoting technical progress;
- thus to ensure a fair standard of living for the agricultural community;
- to stabilise markets;
- to assure the availability of supplies;
- to ensure that supplies reach consumers at reasonable prices.

The CAP was set up on three principles which guide every policy: the single market, community preference and financial solidarity.

3. An Evaluation of the Common Agricultural Policy

The CAP was created at a time when Europe was in deficit for most food products. Its mechanisms were devised to meet this situation. In essence, they support internal prices and incomes, either through intervention or border protection or, where no frontier protection exists, by variable aids in the form of deficiency payments.

The main policy instrument before the 1992 reform of the CAP was price support. This was adopted not because it was considered to be the most efficient means of achieving the set objectives but because it is generally regarded as less interventionist than other policies, such as direct subsidies, and therefore politically more acceptable to the taxpayer.

The original CAP system revealed a number of advantages but also some serious deficiencies:

- Community prices of agricultural products are more stable than world prices, though at significantly higher levels.
- The CAP ensured security of supply of agricultural products in the Community through increased self-sufficiency.
- Intra-Community trade of agricultural products multiplied manyfold.

- Labour productivity in agriculture grew by more than 6 per cent a year, while the corresponding percentage for average labour productivity in the Community was about 4 per cent.
- High prices and guarantees stimulated output increases which went beyond the market's absorptive capacity. Between 1973 and 1991, the volume of agricultural production in the EC increased by 2 per cent per annum whereas internal consumption grew by only 0.5 per cent per annum. This resulted in surpluses for some commodities. In the 1991 budget, these stocks were worth 3.7 billion ECU.
- The impressive rise in agricultural output has led to a spectacular increase in Community expenditure[1] on price support. The budget of the Guarantee Section rose from 4.5 billion ECU in 1975 to 11.5 billion ECU in 1991 at constant 1975 prices. Although European Agricultural Guidance and Guarantee Fund (EAGGF) expenditure increased over this twenty-year period approximately twice as fast as the rate of growth of Community GDP, real farm incomes remained almost unchanged. Three explanations of this paradox were offered: it was argued that, first, most incomes in the economy experienced stagnation or decline and that without the support of the CAP a fall in farm incomes would have been inevitable; second, the price support policy was not an efficient method for raising incomes; and third, half of the Guarantee Section expenditure is accounted for by the cost of stocking surpluses and by export restitutions.
- The public cost of protection of the agricultural markets seemed to increase inexorably, limiting the funds available for other purposes.
- Since the system linked agricultural support with quantities produced, it inevitably stimulated production growth and thus encouraged intensification of production techniques and use of more farm inputs.
- A consequence of the price support policy was that the largest and the most intensive farms absorbed the greater part of EAGGF funds. It was calculated that 80 per cent of the support provided by EAGGF was directed to just 20 per cent of farms.
- EAGGF expenditure was traditionally dominated by the support provided to the "northern commodities" (i.e. milk, sugar, beef and veal) which received above-average protection. The "southern commodities" (i.e. fruit, vegetables, olive oil, cotton, wine, sheep and goat meat and tobacco) have traditionally played a minor role in the history, and certainly in the cost, of the CAP.
- World market prices for most agricultural products were well below those of the EC. Hence, the European consumer lost from having to pay very high prices. Moreover, as the poor in the population spend a relatively higher proportion of their disposable income on food and the CAP's price support mechanism keeps food prices high, the CAP causes massive transfers of income from consumers in one member country to producers in another.
- Under the CAP, the European Community has changed from net importer to net exporter of food and agricultural products. This turnaround has been the outcome of support policies rather than of any market-created shift in comparative advantage. In its trading capacity, the EC has been accused of using protectionism as an instrument for social policy in support of farmers and of adding to the instability of world markets by buying agricultural products abroad only when domestic supplies are short and by selling its surpluses on world markets at subsidised prices. This has not only caused serious financial problems to the Community but

[1] The Commission noted in 1981 that agriculture spending was growing faster than the growth of the Community's budgetary resources. Having reached 68 per cent of total spending in 1985, the burden of the CAP has since declined below 50 per cent of the budget. This happened as the Commission managed to control spending of the CAP especially as to reflect the diminishing share of the agricultural sector of the overall economy. Since 1988 the annual rate of increase of the "agricultural budget guideline" has been limited to 74 per cent of the growth (nominal increase) of the EU GDP. The decline in agriculture's relative budgetary importance has been accompanied by a market increase in the proportion of the budget dedicated to the Structural Funds.

also to its major trading partners and to the less developed countries and has complicated EU international relations.[2]

4. Reform of the CAP and its Consequences on the EU

On 21 May 1992, the Council of Ministers reached political agreement on far-reaching changes to the CAP. Although the reform makes fairly wide-ranging changes to the rules in force until then, it does not invalidate the objectives laid down in Article 39 of the EEC Treaty or the three principles on which the CAP was founded. The basic policy instruments, i.e. intervention buying to support market prices and variable levies and export refunds to close the gap between Community and world market prices, have been kept in place, albeit at much lower levels. In addition, they have been supplemented by new instruments (Swinbank, 1993), namely:

- a substantial reduction in the prices of agricultural products to make them more competitive both within the Community and on world markets;
- compensation for the price cuts in the form of hectare or headage payments;
- implementation of measures to limit the use of factors of production (set-aside of arable land and stocking rate criteria) alongside the retention of earlier supply management measures such as the milk production quotas;
- introduction of accompanying measures such as environmentally friendly farming, afforestation and early retirement of farmers.

The reform regarding farm incomes support implies a major shift in emphasis from price support to the use of a mixed system of lower prices supplemented by compensation payments. It covers 75 per cent of agricultural production falling under common market organisations.

For cereals, the support price was lowered by about 30 per cent, bringing it close to world market levels. Producers was compensated for the price cut in the form of hectare payments. To be eligible for these compensatory payments, the larger producers (with a production capacity of 92 tonnes of cereals or more) had to set aside 15 per cent of their arable land, while small farmers were exempted. The same policy was adopted for oil-seeds.

In the milk sector, the butter intervention price was reduced by 5 per cent over two years. The quota system was maintained, although the reference quantity could be cut by a further 2 per cent spread over two years. Greece and Spain received a quota increase of 100,000 and 500,000 tonnes respectively in order to make up part of their serious deficit in fresh milk output.

In the beef sector, the intervention price was reduced by 15 per cent and a headage payment was introduced to make up for the drop. In the sheep sector, a limit per producer of a 1000 head in the less favoured areas and of 500 elsewhere was introduced for the number of ewes eligible for the premium.

For tobacco, the varieties produced in the Community were regrouped into 5 categories plus 3 special varieties of Greek tobacco. The global maximum quantity eligible for a premium was reduced from 370,000 tonnes in 1993 to 350,000 tonnes in the 1994-95 period and intervention and export refunds were discontinued.

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[2] It should be emphasized that the EU is not just the world's second-largest exporter of agricultural goods, it is also the biggest importer.

The agri-environmental measures were directed at promoting environmentally friendly production methods for which farmers would receive extra aids in recognition of their role in the protection of the rural environment and management of the countryside. Against a background of Community deficits in wood and wood products and in recognition of the environmental importance of woodland, the afforestation programme was meant to provide additional finance for planting trees on agricultural land no longer needed for productive purposes. Finally, the early retirement scheme was intended to increase the aids available to older farmers wishing to step out, on condition that the land released be used to improve the production structure and economic viability of the remaining farm holdings.

After the 1992 reform, there has been considerable improvement in market imbalances and a decrease of public stocks in most of the reformed sectors. The general evolution of agricultural per capita incomes has been positive since the reform, growing on average by 4.5 per cent yearly between 1992 and 1996, with a diversity of situations according to member states and farm orientations. Favourable market conditions, the strong adaptative capacity of farmers, the agri-monetary context and, last but not least, the continuing decline in agricultural employment have contributed to this result (Baltas, 1997).

Total cereal production dropped by about 3.5 per cent in the three years following the reform. One of the major contributory causes to this cut-back in production was, undoubtedly, the success of the set-aside programme, introduced as an integral part of the whole reform process.[3] Under the reformed CAP, the intervention price for all cereals was reduced, reaching 119.1 ECU per tonne in the final year of the reform. These reductions were not fully offset by compensatory payments, which reached 54.34 ECU per tonne per ha. However, the drop in production resulted in a balanced internal cereals market in which the prices that prevailed were higher than the intervention prices and thus farmers from all countries benefited in the early years of reform, especially those in the peripheral countries who were also able to take advantage of devaluing currencies to raise nominal support prices during this period. It is expected that the areas devoted to the cultivation of these crops and to set-aside will stabilize at a level of about 53.5 million hectares. Under the present policy framework, cereal production is expected to rise from 201 million tonnes in 1996 to 214 by 2005. Cereal consumption is also forecast to increase further, though at a lower rate, in response to the development of wheat production. It would be possible to react to the new cereals surpluses by increasing the compulsory set-aside rate but since EU prices remain above world prices the Union could well fail to benefit from the positive development expected on the world market.

In the case of oilseeds, too, for most of the time actual market prices have been significantly higher that the reference price, so that producers have benefited from the change in four years out of five. The Commission's intention is to remove the area restriction imposed by the Uruguay Round Agreement. Oilseed production is expected to decline between 1996 and 2006. Trade deficits in oilseeds and oilseed meals would remain at very substantial levels.

The current EU situation in the market for milk and dairy products seems fairly balanced after the CAP reform. It should, however, be underlined that market stability is still fragile and cloaks a structural surplus which consistently requires large-scale intervention in the form of

[3] The area devoted to cereals stood at around 36 million ha following the decision taken by the Council of Ministers to reduce set-aside by 3 percentage points in the 1995/96 marketing year. Equally significant was the fact that the first two years have not seen the increase in yield which would offset any reduction in the area under cereals. However, in the third year, the fall in yields in Spain and Portugal, due to bad weather conditions, was partially compensated for by a rise in yields in other member States, particularly in Northern Europe.

subsidised end-uses.[4] Global milk demand is expected to decline by 3.1 per cent (112.2 million tonnes to 108.7) between 1995 and 2005. This is the result of decreasing consumption of some dairy products, notably butter, and increasing demand for other products, such as cheese and fresh products. Further export growth in the cheese sector would appear to be constrained by WTO limitations on subsidised exports. Intervention stocks of skimmed milk powder tend to increase from 1998 onwards and will reach some 200,000 by about 2005, as the WTO export commitments become binding. For butter, WTO export commitments provide a sufficient margin for subsidised exports, so that no accumulation of intervention stocks would normally be expected.

The effects of the reform on the beef sector are similar to those on the milk sector. Here, too, intervention prices[5] for beef and veal were repeatedly reduced. These institutional price reductions were passed on to market prices, which were around 80 per cent of the prevailing intervention prices. However, the reduction in the beef intervention price was outweighed by the reduction in feeding cost and the premia on bovine animals. The favourable market situation regarding intervention stocks, which were diminishing rapidly, remained until the outbreak of the BSE crisis in March 1996. Beef production will be influenced on the one hand by the short term measures adopted in 1996 and on the other hand by the elimination of adult cattle over 30 months from the food and feed chain in the UK. Beef consumption is expected to gradually recover from the 1996 shock and return to its long-term declining trend. After 2001, if the market policy remains unchanged, production should return to its full potential with consumption continuing its long-term decline. Intervention stocks will tend to accumulate again and could reach some 1.5 million tonnes by 2005. In this case, it is not acceptable to solve the problem of over-production in the sector by the slaughtering or young calves a few days after birth. Nor can the surplus problem be solved efficiently by pure management (quotas on animal numbers or on production), as this would present major administrative complications.

In the sheep-goat sector, the Union is only 82 per cent self-sufficient. About 43 per cent of production is located in the southern countries of the EU and 5 per cent in Ireland. The basic support mechanism involves a sheep-goat premium. With the reform, the Union tried to stabilize the existing level of production in the sector which has in fact registered successive drops in the early 1990s and remained stable in 1995. In any case, no significant changes have taken place in the level of output and farm incomes.

In the case of tobacco, where more than 90 per cent of EU production is located in the four Mediterranean countries (including Italy), the 17 per cent drop of 1993 raw tobacco output in relation to 1992 is the direct result of the first-time application of the reform adopted in mid - 1992. Obviously, this measure negatively affected farm incomes. Greek farmers especially suffered significant losses because of the country's relatively large tobacco production (a little less than half of total EU output). This reduction is significant for certain varieties such as flue-cured tobacco produced in Greece.[6] Moreover, since tobacco production is localised and is one of the most labour intensive crops, net per cent farm income losses in some regions were much larger than average (Baltas, 1998).

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[4] The intervention price for butter was further reduced by 3 per cent as from July 1994 in order to improve its competitiveness following earlier price cuts in 1993. As a result, the target price for milk fell by 1.5 per cent. These moves have been accompanied by a drop in butter production and a sharp fall in the intervention stocks of butter and skimmed-milk powder which now stand at historically low levels. Total milk production is forecast to decline from 121.6 million tonnes 1996 to 118.1 in 2005, if the milk quotas remain unchanged over the coming years.

[5] In fact, they were reduced by 6.2 per cent at the beginning of July 1993 and by a further 5.3 per cent at the beginning of July 1994. Two further reductions by 5 per cent each have also taken place since then, as provided for in the 1992 reform.

[6] This fell from 71,526 tonnes in 1992 to 37,921 tonnes in 1993 (i.e., a reduction of 47 per cent).

The reform effects on the environment[7] are mixed. Some positive elements can be identified: the more rational use of fertilizer and pesticides resulting from reference price decreases, the possible environmental benefits of set-aside (if well managed), incentives for a long-term improvement in the territorial distribution of livestock rearing. In this context, it is not without interest to note that the agro-chemical industry reports reduced purchases of fertilisers and pesticides by farmers. But there are also negative elements, mainly the encouragement given to irrigated crops through the regionalization of direct payments to cereals, oilseeds and protein crops, as well as the relative advantage given to intensive livestock farming through lower feed prices and subsidized silage.

The plans on afforestation influence mostly the northern farmers, as farm sizes in the south are typically too small to be suitable for afforestation. Regulation (EEC) No.2080/92 institutes a Community aid scheme for forestry measures in agriculture.

Conversely, the early retirement scheme instituted by Regulation (EEC) No. 2079/92 might be particularly beneficial in the periphery of the EU, since in the South nearly three fifths of the farmers are over the age of 55 while in Ireland less than half are above this age. The resulting restructuring of farm holdings will create the necessary conditions for maintaining the maximum number of viable farm households in the wider rural economy. Moreover, this scheme, which is co-financed by the EU, is characterized by higher levels of aid and greater flexibility in comparison to previous schemes. Although it is not compulsory, it could potentially prove very important from the social equity and macroeconomic perspectives, given the inadequate pension systems of these countries and their mounting budgetary expenditure on social security and pensions.

By 1995, nine member States (with the exception of the United Kingdom, the Netherlands and Luxembourg) had presented draft schemes for early retirement from farming. Taken together, the programmes' objective was the retirement of 184,200 farmers and 7,500 farm workers over the next six years. The area released should amount to almost 3 million ha. It is estimated that around 5 per cent of this land will be used for non-agricultural purposes, such as forestry and the creation of ecological reserves. The remainder of the area released will be taken over by other farmers, who will use it either to expand their holdings or to set up as full-time farmers.

The reduction of price support coupled with direct compensatory payments have shifted the burden of agricultural support from the consumer to the general tax-payer. Increases in the CAP budget come basically from the compensatory payments to cereal, milk and beef producers (Baltas, 1997). The overall budgetary cost in the tobacco, wine, olive oil and sheep-meat sectors will decline. The benefits to consumers resulting from the reformed CAP are rather small but have marked distributional effects for the relatively poorer countries of the EU given that their consumers spend a considerably larger proportion of their disposable income on food than those in the richer ones.

[7] Most of the 158 programmes submitted by the member States under Regulation (EEC) No. 2078/92 have been approved by the Commission. The measures under this Regulation are co-financed from the EU total budget, which provides 50 per cent of the payments for all areas and 75 per cent of the payments in Objective 1 areas (i.e. currently most of the Mediterranean countries, Ireland, the eastern Lander of Germany, and the Highlands of Scotland). This Regulation continues and extends the measures provided for in Article 19 of Regulation (EEC) No. 2328/91, which came into force before the reform of the CAP. The programmes submitted by the member States set out a variety of approaches to solving environmental problems in agriculture.

5. The GATT Uruguay Round Agreement and the WTO Negotiations

The 1992 reform both anticipated and facilitated the changes brought about by the GATT Uruguay Round agreement which was concluded in 1994, came into effect July 1995 and will last until June 30, 2001. The Uruguay Round is the first-ever global trade agreement to encompass agricultural products and should bring a significant degree of liberalisation to world agricultural markets. The GATT agreement[8] on agriculture imposes disciplines on member countries in three separate areas; domestic support, market access, and export subsidies below the reference figures for 1986-88.

- ***Domestic support***

Domestic subsidies to the agricultural sector were to be reduced by 20 per cent over six years (13.3 per cent in developing countries). For the European Union, this part of the agreement has never been an issue because the various reforms of the CAP are already reducing subsidies by more than 20 per cent. The Aggregate Measure of Support (AMS) for the EU, already below the commitment for the year 2000, was further reduced by the Berlin Agreement.

- ***Market access***

All import restrictions were converted to customs tariffs (by "tariffication"). These tariffs are reduced by 36 per cent over a period of 6 years with a minimum reduction of 15 per cent for each agricultural product. For developing countries, the reduction will be by 24 per cent over 10 years, using the 1986-1988 period as base for the calculations. However, it would be wrong to think of the Uruguay Round as opening up markets and moving far toward free trade. The degree of discretion allowed to each country in their conversion procedure for non-tariff barriers led countries to set their bound tariffs somewhat higher than necessary. This was exacerbated by the fact that for many commodities the base protection rates (internal price less world price expressed as a percentage of world prices) were historically high. As a result, some of the tariffs that emerged from the Round are so high[9] as to preclude trade under normal circumstances.

- ***Export subsidies***

The volume of subsidised exports was to be reduced by 21 per cent (14 per cent for developing countries) over six years (base period 1986-90). Budgetary expenditure on export subsidies will simultaneously have to be reduced by 36 per cent - 24 per cent for developing countries over six years. Taking into account these commitments on export subsidies[10], non-exportable surpluses are likely to emerge after 2000 causing problems to the Union.

New multilateral trade negotiations formally started in December 1999 as a follow-up to the Uruguay Round, but in the end failed even to agree a negotiating agenda. Cutting border

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[8] For more details see e.g. Delmore and Clerc, 1994; Josling, 1994; OECD, 1995; Swinbank and Ritson, 1995.

[9] For the EU, these bound tariff rates were set at 250 per cent for sugar, 237 per cent for beef, 341 per cent for butter, and between 150 per cent and 170 per cent for grains (Harvey, 1997). CAP reform had reduced cereal prices and hence costs, whereas border protection was still reflecting the pre-reform situation. For a few commodities, those where the tariff was based on the base period grain levies (pigs, poultry and eggs), the level of protection actually rose as a result of the Uruguay Round.

[10] In the markets for coarse grains, dairy products, olive oil, beef, poultry and fresh and processed fruit and vegetables, export subsidies nave been limited as a result of the WTO constraints (Tangermann, 1999). In the case of export subsidies for wheat have been unnecessary because the EU ran down surplus from 1993 to 1996 and then in 1995 and 1996 sold wheat without subsidies onto a high-price world market.

protection, reducing export subsidies and reshaping internal support towards more "decoupled" instruments will enhance the Union's regotiating stance in the new Round. On September 27 1999, the Agriculture Council unanimously adopted an aggressive approach to defend the European model of agriculture on the basis of Agenda 2000 decisions. As we will see in part 7, the Berlin Summit CAP reform outlines the EU's intentions[11] in respect of the WTO negotiations. These are rather limited compared to the ambitious U.S. objectives. In particular, the U.S. aims at the elimination of export subsidies, substantial cuts and, where possible, elimination of tariffs on farm products, reduced domestic subsidies, reform of State trading enterprises, whose monopolistic position in domestic markets distorts trade, and tightened rules on technical barriers that unjustifiably restrict trade.

On market access, the EU is going to be unreceptive toward any sweeping cuts in tariffs. A modest across-the-board reduction in tariffs is likely to be the preferred outcome, because the EU cannot move too far from its traditional protection of the domestic market. Moreover, the EU will be vulnerable on the issues of the widespread use of specific tariffs, the use of reference prices on fruit and vegetables and the high degree of excess protection for cereals as afforded by the bound tariff relative to the "maximum duty-paid import price" for cereals which was agreed in the Uruguay Round (Josling and Babinard, 1999).

On export subsidies, the EU is likely to agree that these are essential to the clearing of markets, at least for the next few years. The Commission would rather not have to use them as instruments of policy, but it would be unacceptable to lose market share too rapidly in the cereals and dairy markets as a result of not being able to offer lower prices.

One of the most contentious issues will be the "size" and "composition" of the green box representing a possible solution to the dilemma of how one satisfies political imperatives for the maintenance of farm incomes and at the same time how one lives within the constraints of the WTO. Payments aimed at compensating farmers for the "multifunctionality" of European agriculture would be allowed even if not totally consistent with current definitions of trade-neutral instruments (Josling and Babinard, 1999).

On the blue box, the EU is likely to defend it in the early stages but could change its own compensation policies without too much inconvenience to make them compatible with the green box. If the compensation payments are not made "green", then the EU will want to maintain the "blue box" because reforms will result in increased payments for beef and cereals and the introduction of "semi-decoupled" direct payments in the dairy sector (Josling and Babinared, 1999).

Last, since CAP reform was decided before the next round of WTO negotiations, the changes adopted will clearly reflect the international constraints on the EU and will strengthen the EU in the WTO round (Coleman and Tangermann, 1999).

[11] As stated in the conclusions to the European Council in Berlin on Agenda 2000: "the decisions adopted regarding the reform of the CAP within the framework of Agenda 2000 will constitute essential elements in defining the Commision's negotiating mandate for the future multilateral trade negotiations at the WTO".

6. The EU's Enlargement and the CAP

This part of the paper considers the economic dimension of the forthcoming enlargement of the EU with regard to agriculture. Ten countries with economies in transition (Bulgaria, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia and Slovenia), and two market economies (Cyprus and Malta) negotiate full membership with the EU. Turkey became a candidate country and will have to carry out political reforms before proceeding further in the accession process. While there is no question about Cyprus and Malta being market economies (one of the conditions for the EU membership), there are still certain concerns about the acceding countries whose economies are in the long transition process. Chief among them are the increasingly demanding standards that come from the ever-growing *acquis communautaire* which are costly to introduce, implement and enforce (Jovanovic, 2000).

The entry of the thirteen countries (including Turkey) would increase the EU population by 45 per cent but its GDP by only by 6.7 per cent at current 1999 prices and by 15.8 per cent in terms of purchasing power standard (PPS) (Eurostat, 2000). As for the level of development measured by GDP per capita in PPS, the acceding countries are at a significantly lower level of development than the EU average.

The beginning of the millennium will see the eastern enlargement of the EU to include countries that until recently were command economies. Political changes in the late 1980s and early 1990s mark the beginning of important economic reforms in these countries. Initially, the main objective was to return to a market economy but soon EU accession was added to the agenda. Most countries have applied for membership and have, as a first step, become associated with the EU by agreements involving trade concessions as well as assistance to harmonize legislation, develop democratic institutions and put a market economy in place.

The reforms of 1990-1992, designed to transform the Central and Eastern European Countries (CEECs) from centrally planned to market economies, have undoubtedly obscured the true agricultural potential of the region. The liberalization of prices, production, and trade that resulted from abandoning central planning caused a sharp contraction in income and led to a fall in consumption of most foods, especially meat. Falling demand, combined with input prices rising much faster than output prices (input prices have tended to move to world market levels while agricultural output prices have tended to stagnate or rise much less in the face of falling demand) resulted in lower output. While there have been some signs of recovery since 1993-1994, particularly in the crop sector, agricultural output in most candidate countries is still well below pre-transition levels. The slow recovery is mainly due to major initial structural handicaps such as unsettled property rights, capital constraints and inefficient downstream sectors (Josling and Babinard, 1999). An important consequence of the CEECs market reforms has been a deterioration of the balance of trade between the CEECs and the EU. The significant drop in agricultural output has reduced exports to the EU, which for many candidate countries is the most important agri-food trading partner. At the same time, their agricultural imports from the EU have grown significantly after the reforms. The CEECs' growing imports from the EU are partly due to shifting consumer preferences in the region towards products such as tropical commodities and western-style processed foods (Buckwell and Tangermann, 1997). The growing trade imbalance is also caused by the pronounced differences in protection rates that exist between the CEECs and the EU.

. The EU's eastward enlargement will add over 100 million consumers. Their average purchasing power, however, will be only about one third of that of consumers in the Union. On average, over 22 per cent of the workforce in the CEECs is employed in agriculture for a total of

9.5 million workers compared to 5 per cent or 8.2 million in the EU. Thus, enlargement will at least double the EU's agricultural labour force. The Union's agricultural area will increase by 60 million hectares (ha) to close to 200 million ha. Of the 60 million ha, two thirds will be arable land, adding 55 per cent to the EU's existing arable area of 77 million ha. In the CEECs, the share of agriculture in GDP ranges from 4.5 to 21 per cent compared to 2.4 per cent for the EU (EC, 1998). The CEECs have a serious need for structural improvement in their agricultural and up- and downstream sectors (Mergos, 1998). Restructuring can be expected to reduce agriculture's labour absorption capacity, implying a need for diversification of their rural economies.

Concerning the budgetary implications of the enlargement, various estimates have been made, ranging from 5 to 50 billion ECU depending on the assumptions used to develop alternative scenarios. According to EU estimates (EC, 1995), the cost of enlargement will require a 25 per cent increase of the CAP budget, which stands at 36 billion ECU. Despite these initial high estimates, the Berlin Summit agreed to set aside a budget for this future enlargement rising from Euro 6.45 billion in 2002 to Euro 16.78 billion in 2006 (Table 1). This assumes (very optimistically) that enlargement may begin from 2002. Agricultural spending will play a limited role, rising from Euro 1.6 billion in 2002 to Euro 3.4 billion in 2006.

Eastward enlargement of the EU will require extending CAP price support to new members.[12] It is generally assumed that this will involve a significant increase in producer prices in the new member states, taking into consideration that farm gate prices in the CEECs were 40 to 80 per cent of the EU level. These gaps[13] were considerably reduced but not eliminated after the Agreement on Agenda 2000. In any case is not possible at this stage, for the applicant countries to be immediately integrated in the CAP for the following reasons: First, it will trigger large supply responses in the new EU member states, in particular for sugar, milk and meat; Second, it will reduce competitiveness in the food industries of the acceding countries; and third, it will occasion sudden and undesirable changes to consumer prices resulting in a substantial reduction of consumers' real incomes, taking into consideration that households in the CEECs spend on average a relatively high proportion -30 to 60 per cent- of their disposable income on farm products.

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[12] Whether CEECs farmers need compensation even though they are not supposed to suffer a loss of income in acceding to the CAP is a topic of much debate. Since CEECs farmers will enjoy a price rise on accession, and not a fall it has been argued that compensation is unjustified (Brittan, 1999). On the other hand, excluding new members from compensations that benefit the rest of the EU members might be inconsistent with the principle of *acquis communutaire*. Most likely, given that the CEECs are strong candidates to receive such payment, their integration will rekindle the debate on compensation schemes and increase pressure for their review. Net contributing members will likely argue on the basis of subsidiary that it is logical that nationally determined rates be financed nationally. Poorer countries will likely argue that richer countries will distort markets by proving more generous support to their farmers. The outcome of such debates will make a big difference to the impact of the CAP in the CEECs as well as the access of the CEECs to the CAP (Buckwell and Targermann, 1997).

[13] For example, for cereals, oilseeds and protein crops they are around 10 per cent, for sugar beet somewhere between 40-50 per cent, for dairy products in the order of 15-25 per cent, for beef in the region of 15-25 per cent, while for certain fruit and vegetables those price differences can be even up to 80 per cent (which is the case for tomatoes).

Table 1: EU budget resource available for accession (appropriations for payments) (in million Euros, 1999 prices)

	2002	2003	2004	2005	2006
Payment appropriations	**6450**	**9030**	**11610**	**14200**	**16780**
Agriculture	1600	2030	2450	2930	3400
Other expenditure	4850	7000	9160	11270	13380

Source: Chairmanship's Conclusions, 24 and March 1999, Berlin.

7. Long -term Outlook and the New CAP.

According to the major international budgetary expenditure forecasting institutes, the long-term outlook for the main agricultural markets is favourable for exporting countries. Prospects for increased food consumption, mainly in developing countries, combined with the limited possibility of a proportionate growth in domestic production,[14] are expected to boost world trade and sustain world prices over the next decade.

Two key factors influence food demand: population growth and rising incomes. The world population is expected to increase by more than 85 million a year between 1995 and 2005. Moreover, growing urbanization will influence the pattern of food consumption. The second factor determining food demand is the favourable prospects for world incomes and economic growth, particularly in developing countries.

The wish to help European agriculture to take advantage of the expected positive world market developments, and to enable the prospect of enlargement of the EU to incorporate up to ten countries of Central and Eastern Europe (along with Cyprus) stimulated the Commission to come up with a blueprint for those aspects of the EU policy that are most affected. The blueprint was launched in 1997 as Agenda 2000. The main thrust of the document was that the budgetary implications of extending the regional and agricultural policies would be insupportable from current resources. Policy changes would be needed prior to enlargement to enable the EU to withstand the budgetary shock. Regarding the changes in agriculture policy, the Commission proposes in its Agenda 2000 the deepening and widening of the 1992 reform through further shifts from price support to direct payments and the development of a coherent rural policy to accompany this process. Lower prices will improve the competitiveness of EU agriculture on both domestic and external markets, benefit consumers and leave more room for price differentiation in favour of high quality speciality products. In addition, it will offer the EU increased flexibility in the next WTO Round negotiations. Environmental considerations[15]have become a major concern of the CAP which is adopting agricultural practices necessary to safeguard the environment and preserve the countryside.

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[14] These will be due to, firstly, the limited availability of land, because of urbanization and environmental constraints and, secondly, to a slowdown in the growth of yields.

[15] Since ratification of the Maastricht Treaty, there has been a legal obligation on the Union to take account of environmental protection requirements when drawing up and implementing Community policies. An obligation which was reinforced by the entry into force of the Treaty of Amsterdam on May 1, 1999.

At the Berlin Summit in March 1999, EU heads of government reached a global agreement on the reform of the CAP[16], which was less ambitious than the proposals of the Commission and the one that emerged form the March 11 Agricultural Council.

The reformed CAP represents a step towards supporting the broader rural economy rather than agricultural production and ensures that farmers are rewarded not only for what they produce but also for their general contribution to society. This means that the policy is targeted not just at agricultural producers but also at the wider rural population, consumers and society as a whole. The political agreement resulted in the adoption of new regulations which came into force (with the exception of milk) from the year 2000 onwards. These concern the arable crops, beef, milk and wine sectors, the new rural development framework, the horizontal rules for direct schemes and the financing of the CAP. The amended regulations[17]for the olive oil and tobacco sectors have to be added to this list, even though they were not adopted in the context of the Agenda 2000 reform package. A transitional regime for olive oil was introduced in November 1998 with a view to undertaking wider-ranging reforms in 2001, and a fundamental reform of the tobacco sector has been implemented, aimed at encouraging production of higher quality tobacco varities in the EU and strengthening environmental protection.

EU leaders have agreed that the CAP budget[18] should remain "stable" over the next seven years. The budget target agreed for the CAP is Euro 40.5 billion a year on average plus 2 per cent inflation, plus Euro 14 billion of expenditure on rural development (Table 2). In effect, EU governments have handed greater fiscal control to the Commission in return for guarantees that spending will not exceed the Euro 40.5 billion target. In order to do so, the Commission will now be forced to watch its expenditure and make early savings in areas such as export refunds and intervention buying, if there is danger of exceeding its remit before the end of any given financial year. To evaluate this, the Council added a demand for a report in 2002 from the Commission "on the development of agricultural expenditure, accompanied, if necessary, by appropriate proposals".

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[16] See e.g. E.C. ***Agenda 2000*** and **Agra Europe** (1999).
[17] *Official Journal of the European Communities*, L 160, 26.06.99/ L 179, 14.07.99.
[18] Current budgetary discussions are of particular importance due to the implications the eastern enlargement will have on budgetary balances. During the period 2000-2006, the Commission is not expecting any changes in the relative budgetary position of the current member States. However, a recent discussion of budgetary imbalances in relation to the relative prosperity of member States has drawn attention to the possibility of granting budgetary corrections. In this respect, the performance of the compensation mechanism for the U.K. with the 1984 the Fontainebleau Agreement is questioned and the legitimacy of the decision is being reviewed. As the Commission reports, the British rebate distorts the whole system of contribution. The UK has 16.1 per cent of the EU GNP and pays 11.9 per cent of the budget. In contrast, Germany has 26 per cent of the EU GNP and pays 28.2 per cent of the budget costs, Greece 1.5 per cent and 1.65, respectively, France 17.2 per cent and 17.5 per cent. The only other country with a disproportional share of the budget is Italy with 14.2 per cent and 11.5 per cent (Josling and Babinard, 1999). Germany, as the biggest contributor, wishes to substantially reduce its net contribution to the EU budget form the present 22 billion DM a year. However, the Germans decided eventually to abandon "co-financing", a scheme under which national governments would have shared the costs of subsidizing the agriculture sector in their respective countries.

Table 2: Planned CAP expenditure 2000-06
(in million Euros, 1999 prices)

	2000	2001	2002	2003	2004	2005	2006
Heading1 (Agriculture)	**40920**	**42800**	**43900**	**43770**	**42760**	**41930**	**41660**
CAP expenditure (excluding rural development and accompanying measures)	36620	38480	39570	39430	38410	37570	37290
Rural development and accompanying measures	4300	4320	4330	4340	4350	4360	4370

Source: *Chairmanship's Conclusions,* 24 and 25 March 1999, Berlin.

In more detail, the reform comprises (E.C., 1999):

i. *Lower institutional prices to encourage competitiveness*
Reductions in market support prices ranging between 15 per cent for cereals and 20 per cent for beef will be introduced. A cut of 15 cent will apply to the milk sector from the year 2005/2006. The cuts will be introduced gradually with the objective of bringing Europe's farmers into closer touch with world market prices, thus helping improve the competitiveness of agricultural products on domestic and world markets with positive impacts on both internal demand and export levels. Equally important, the changes will contribute to the progressive integration of the new member States.

ii. *A fair standard of living for the farming community*
The institutional price reductions will be partially offset by an increase in direct aid payments, thus contributing to the aim of providing farmers with a fair standard of living. The move away from price support towards direct income support for farmers means a further decoupling of aid from production.

iii. *Strengthening the EU's international trade position*
Greater market orientation will help to reinforce the EU's position in the WTO negotiations.

iv. *Focus on quality*
The reform takes full account of increased consumer concerns over food quality and safety, environmental protection and animal welfare in farming. Both in market support and in the new rural development policy compliance with minimum standards in the fields of environment, hygiene and animal welfare is a requirement.

v. *An integration of environmental goals into the CAP*
Member States have to introduce undertake environmental measures they consider appropriate. In fulfilling this obligation, member States would have three options at their disposal. In the first place, implementation of appropriate agri-envrironmental measures applied under rural development programmes may be sufficient. Secondly, member States may also make direct payments under the market organisations conditional on the observance of generally applicable environmental requirements. Thirdly, they may attach specific environmental conditions to the granting of such payments. In the latter two

cases, a proportionate reduction or cancellation of payments would be applied in cases of non-compliance.

vi. *A new rural development framework*

The new policy for rural development seeks to establish a coherent and sustainable framework for the future of Europe's rural areas. It will complement the reforms introduced into the market sectors by promoting a competitive, multi-functional agricultural sector in the context of a comprehensive, integrated strategy for rural development.

The guiding principles of the new policy are those of decentralisation of responsibilities thus strengthening subsidiarity and partnership- and flexibility of programming based on a "menu" of actions to be targeted and implemented according to member States' specific needs. As a coherent package of measures it has three main objectives:

- To create a stronger agricultural and forestry sector, the latter recognised for the first time as an integral part of the rural development policy;
- To improve the competitiveness of rural areas;
- To maintain the environment and preserve Europe's rural heritage

The environmental measures are the only compulsory element of the new generation of rural development programmes. The agri-environmental aid scheme will encourage farmers to introduce or continue to use farming practices compatible with environmental protection and natural resource conservation.

vii. *Decentralising management*

Direct payments to producers have been organised in a different way compared with 1992. Part of the direct payments for the beef and dairy sectors will take the form of a national financial envelope from the EAGGF budget which member States can distribute, thus allowing them to target specific national or regional priorities. Each member State will be able to allocate resources freely, subject to certain Community criteria designed to prevent distortions of competition.

8. Concluding Remarks

Given the historical background of the six original member countries, their agricultural structures and the fact that the EC-6 was a net importer of agricultural products, the CAP objectives, essentially about productivity gains in order to bolster the living standards of European farmers and to secure food supplies following the traumas of the 1940s and early 1950s, were neither surprising nor inappropriate. The same holds with respect to the choice of policy instruments, mainly internal price support. However, given the massive technical progress and structural shake-out which took place in the European Community, the CAP soon was dominated by problems of chronic overproduction. It was not until mid-1992 that a significant reform took place under the intense pressure of the GATT Uruguay Round.

The reform resulted in a major shift from price support to forms of farm support not directly linked to production. After 1992, there have been considerable market improvements with significantly lower public stocks in most of the reformed sectors (except in the case of beef, which is due to extraordinary events rather than market policy). Moreover, farm incomes have markedly improved over the period.

However, the progress achieved was not sufficient to meet the challenges facing the EU in the light of the WTO negotiations (which would push EU agriculture to a freer trade regime) on the one hand and the EU's eastern enlargement on the other hand. Taking into consideration that the CEECs farm prices are 40 to 80 per cent those of the EU's, the adoption of the *acquis communautaire* would increase the surplus of principal agricultural products in the majority of the candidate countries. Thus, it would place great pressure on the finely balance arrangements of the WTO Agreement. The Commission, having reviewed these prospects and the expected positive world market developments, concluded that the best option was to continue the 1992 approach through further shifts from price support to direct payments and the development of a more integrated rural policy to accompany this process. However, the agreement reached at the recent Berlin Summit is less ambitious than the Commission's proposals included in Agenda 2000. As a result, a delay is expected in the EU's eastward enlargement. The EU's negotiating position in future WTO negotiations will be formulated along the lines of the Berlin Agreement, which falls far short of the US objectives regarding the liberalization of international trade in agricultural commodities. More specifically, the approach of the EU to the next round negotiations can be summarised as follows. On the question of access to the markets, the EU will declare itself against any drastic reduction in tariffs. On export subsidies, it will maintain that these are essential to the clearing of markets, at least for the next few years, while on other questions the EU has already expressed its intention to re-negotiate the Sanitary and Phytosanitary Standards Agreement to take into account situations where consumer concerns are being underpayed by market considerations. Last, since the CAP reform was decided before the next round of WTO negotiations, the changes adopted will reflect clearly the international constraints on the EU and will strengthen the EU negotiating position in the WTO round.

After the introduction of the compensatory payments in 1992, a considerable wave of dissent has been rising within the EU on the issue of subsidiarity and on the idea that some elements of the CAP should be financed by national governments. The budget issue is especially controversial due to the differences in the contributions by individual member States and to the impact of CAP on EU expenditure as a whole. Nevertheless, over the next seven years it will be the first time in the EU's history that spending on agriculture will not have shown constant growth in real terms.

Proposals for the further "greening" of the CAP included in Agenda 2000 have been adopted in the Berlin Agreement. These comprise support and remuneration to farmers for services to the environment as well as for their contribution to the maintenance of the rural heritage within the EU and have encouraged the transformation of the CAP from an essentially agricultural policy to one of environmental and rural development.

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