The Effects of the Reform of the
Common Agricultural Policy on EU Agriculture

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The author assumes full responsibility for the accuracy of this paper as well as for the opinions expressed therein.

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Abstract

CAP reform was necessary on two grounds. First, from 2006 a ceiling has been imposed on CAP payments during the period 2007-2013, also taking into consideration EU enlargement. Second, support of EU agriculture will have to reflect clearly the international constraints imposed on the EU following the WTO negotiations. To this end, a set of proposals for the adjustment of the CAP had been put forward by the European Commission and was adopted by the Council of Ministers of Agriculture on 26 June 2003. The completion of this major process of the CAP reform was reached on 22 April 2004 with Mediterranean products

The purpose of this paper is to evaluate the medium-term economic consequences of the reform. To this end, we have utilized the findings of a series of studies analyzing the impact of the Mid-Term Review proposals on the agricultural markets and incomes in the EU, while taking into account the final decisions reached by the Council of Ministers of Agriculture regarding CAP reform. Four of these studies were carried out by external organizations at the request of the EU Commission and two others by Commission services Directorate General for Agriculture) on the basis of two in-house models.

The impact of the reform on total cereal and oilseed production will tend to leave the situation unchanged. The effects will be significant on rye, durum wheat and rice given the considerable reduction of their support. EU-15 beef and butter production will fall over the medium-term, triggering a rise in domestic producer prices and reducing exports considerably for the years 2009 with reference to a status quo policy situation which corresponds to the continuation of the Agenda 2000 agricultural policy over the medium term. The impact of the reform on agricultural income in the EU-15 will be marginally smaller than would have been the case under Agenda 2000 until 2009.

Decoupling in the enlarged EU should produce similar trends to those in the EU-15, as producers' decisions will be driven by market considerations rather than by the maximization of direct payments. The CAP reform will generally reduce most of the downside risks of agricultural markets in the EU-25, notably in the area of structural surpluses. In the new Member States market income should increase in real terms as compared to the pre-enlargement situation in 2002.

1. Introduction[*]

The reform of the Common Agricultural Policy (CAP) was necessary on two grounds. First, CAP payments[1] during the period 2007-2013 will be capped at their 2006 level, also taking into consideration EU enlargement. Second, support of EU agriculture will have to reflect clearly the international constraints[2] imposed on the EU following the WTO negotiations (Baltas 2001, pp.105-107).

In its Communication on the Mid-Term Review (MTR): Towards Sustainable Farming adopted in July 2002, the Commission proposed a set of substantial adjustments to the CAP with a view to enhancing the competitiveness of EU agriculture, promoting a market oriented, sustainable agriculture and strengthening rural development.

The main elements of the proposed review were: to decouple direct support to farmers from production in order to render the current blue box [3] direct payments to be less production and trade distorting; to make direct payments conditional on compliance with environmental, food safety, animal welfare and occupational safety standards; to increase support for rural development by modulating direct payments for all except small farmers; to introduce a new farm audit system and new rural development measures; and to improve production quality, food safety and animal welfare.

In bringing forward its legislative proposals in January 2003, the Commission took into account the conclusions of the Brussels European Council in October 2002, notably the new budgetary constraints, as well as the outcome of the debate that followed the publication of the Communication.
The legislative proposals for the reform of the CAP presented in January 2003, differ from the July 2002 MTR proposals in the introduction of the reform of the dairy sector, the modification in the quality premium for durum wheat production and changes in the modulation mechanisms.

On 26 June, 2003, EU farm ministers adopted a fundamental reform of the CAP. Due to pressure from France, supported by Germany, the Presidence Compromise as endorsed by the Commission watered down the original proposals to fully abolish the direct link between subsidies to farmers and their production levels (*decoupling*). To avoid abandonment of production, Member States may choose to maintain a limited link between subsidy and production under well defined conditions and within clear limits. The single farm payment will enter into force in 2005. If a Member State needs a transitional period due to its specific agricultural conditions, it may apply the single farm payment from 2007 at the latest. The Council furthermore decided to revise the market arrangements in the cereals, durum wheat, rice, dried fodder, nut and milk sector. In order to respect the tight budgetary ceiling for the EU-25 until 2013, ministers agreed to introduce a financial discipline mechanism. The reform will also strengthen the EU's negotiating hand at the ongoing WTO trade talks. The different elements of the reform will enter into force in 2004 and 2005 (Council of the European Union, 2003).

The purpose of this paper is to evaluate the medium-term economic consequences of the reform. To this end, the findings of a series of studies analysing the impact of the MTR proposals on the agricultural markets and incomes on the EU are utilized while taking into account the final decisions reached by the Ministers of Agriculture regarding the CAP reform. Four of these studies were carried out by external organizations at the request of the EU Commission and two others by Commission services (Directorate General for Agriculture) on the basis of two in-house models. Our analysis also takes into consideration the paper prepared by Defra, which summarises the estimated economic costs and benefits of the Commission's reform proposals of 22 January 2003 for the EU-15 and UK (Agricultural Policy and Food Chain Economics, 2003).

The paper consists of six sections. The introduction is followed by a second section setting out the key elements of the reformed CAP. The third section presents the methodological framework of the models used to estimate the consequences of CAP reform. The results of impact analysis of the CAP reforms on the commodity arrangements in EU-15 agriculture and in EU-25 agriculture are discussed in the fourth and fifth sections respectively. Finally, the sixth section contains some concluding remarks drawn from the above-mentioned analysis.

2. The reformed CAP

The key elements of the new, reformed CAP are:

A single farm payment system, which will no longer be linked to the volume of production and which will be an average of the subsidies received by the individual farm during the period 2000-2002. Limited coupled elements may be maintained to avoid abandonment of production.[4]

This payment will be linked to the respect of environmental, food safety, animal and plant health and animal welfare standards, as well as the requirement to keep all farmland in good agricultural and environmental condition (*cross-compliance*).

A strengthened rural development policy with more EU money and new measures to promote the environment, food quality and animal welfare and to help farmers to meet EU production standards will start in 2005. All direct payments for bigger farms will be reduced by 3 per cent in 2005 with the proceeds going to finance the new rural development policy (*modulation*). This rate will be increased to 4 per cent in 2006 and to 5 percent from 2007. A franchise of 5,000 Euro will apply.

The modulation rate of 5 per cent will result in additional rural development funds of 1.2 Euro billion a year. As regards the distribution of the funds generated through modulation, one percentage point will be re-distributed to the country where it has been generated, with the remaining percentage distributed according to the rules proposed by the Commission. However, each Member State shall receive back at least 80 per cent of its

modulation funds. Modulation will not apply to direct payments to producers "in outermost regions" and the Aegean islands.

A mechanism for financial discipline will be created from 2007 to ensure that the amounts for the financing of the CAP respect the annual ceilings set in the financial perspectives until 2013.

Finally, the reform includes modifications to the market arrangements for a number of products, which are summarized below.

Cereals: The current intervention prices will be maintained.[5] The basic amount for arable crops remains at 63 Euro per tonne, but the monthly increments will be reduced by half.

Durum wheat: The specific intervention price for durum wheat[6] will be fixed at 313 Euro per hectare in 2004, at 291 Euro per hectare in 2005 and at 285 Euro per hectare, included in the single farm payment, from 2006 onwards. A new premium will be introduced to improve the quality of durum wheat used for semolina and pasta production. The premium will be paid in traditional production zones to farmers who are using a certain quantity of certified seeds of selected varieties. The premium amounts to 40 Euro per hectare and is paid within the limits of Maximum Guarantee Area (MGA). In traditional zones decoupling will start from 2005.

Rye: In view of the structural adjustment pressures resulting from the abolition of rye intervention, some transitional measures will apply.

Drying aid: The supplementary payment for cereals, oilseeds, linseed and flax and hemp-grown fibre is increased from 19 to 24 Euro per tonne.

Rice: The intervention price is halved (from 298.35 Euro per tonne to 150 Euro per tonne) and intervention limited to 75,000 tonnes a year. Compensation payments will increase from 52.65 Euro per tonne to 177 Euro per tonne. From this amount, 75 Euro per tonne is granted as a special aid and the rest as a single payment per farm. Furthermore, the super-penalty in case of an overshoot of the MGA will be replaced by a proportional penalty.

Starch potatoes: Maintenance of the minimum price at a level reduced in parallel with the maize intervention price. 40 per cent of the direct payment to producers of starch potatoes will be integrated in the single farm payment.

Nuts: A Community aid will be granted for a MGA of 800,000 hectares divided into fixed National Guaranteed Area (NGA). The amount of the aid will be 120.75 Euro per hectare per year calculated as an average at national level. A national aid of up to 120.75 Euro per hectare per year may be granted by Member States.

Meat: There are major implications from decoupling. The basic price for beef at 2,224 Euro per tonne with private storage possible at 103 per cent of this price, as well as the safety net intervention level of 1,560 Euro per tonne are abolished.[7] A maximum of 50 per cent of the sheep and goat premia, including the supplementary premium in less favoured areas, can remain linked to production.

Dairy: The general quota increases decided under Agenda 2000 will only take place from 2006 onwards. There will no longer be an additional general quota increase in 2007 and 2008. However, given the deficit situation in fresh milk supply in Greece, the national reference quantity is increased by 120,000 tonnes. Also, from 2005/2006 onwards

an additional reference quantity of 50,000 tonnes will be granted to the Azores. Asymmetric price cuts will occur in the milk sector[8]: the intervention price for butter will be reduced by 25 per cent over four years (2004-2007), which is an additional 10 per cent price cut compared to Agenda 2000. A 15 per cent reduction for skimmed milk powder over three years (5 per cent annually from 2004 to 2006), as agreed in Agenda 2000, is retained. The compensation per tonne, including the additional payments, is fixed as follows: 11.81 Euro per tonne in 2004; 23.65 Euro per tonne in 2005 and 35.5 Euro per tonne form 2006 onwards. Butter intervention will be gradually limited from 70,000 tonnes per year in 2004/2005 to 30,000 tonnes in 2008/2009.

CAP reform for the Mediterranean products

The EU Council of Farm Minister has agreed widely-ranging reforms of the olive oil, cotton and tobacco sectors within the CAP on the 22 April 2004 (Council of the European Union, April 2004). The three sectors are known collectively as the Mediterranean products since they are of key importance to Spain, Italy and Greece, which dominate EU production. The main element of the reforms is the shift from the current production linked payments to the decoupled single farm payment which was the cornerstone of the main CAP reform in June 2003, in which the Mediterranean products were excluded. The reforms will start in 2006 and have a neutral effect on the CAP budget, which amounts to half of the EU's annual budget of some 100 billion Euros. Subsidies for the three regimes cost just ever four billion Euros a year, less than 10 per cent of CAP spending. The main details of the reforms of each sector are the following :

Olive Oil

Production- linked payments will be transformed into income support. The reform will apply from November 2005, so payments can be decoupled from January 2006. For producers with holdings larger than 0.5 hectare, 60 per cent of subsidies will be decoupled, while 40 per cent of payments will be redistributed on an area or "per tree" basis. Smaller holdings will have completely decoupled payments. Member states may decide by 1 August 2005 to increase decoupling rate beyond 60 per cent and may hold back 10 per cent of payments for spending to promote quality production. Areas planted after 1 May 1998, except those in approved new planting schemes, will be excluded from these payments. Private storage aid will be kept, with no subsidies for export.

A system of calculating subsidy levels will apply based on a 2000-02 reference period for overall amount of aid per country. Each farmer's payments then depend on his average planted area and individual subsidy between 1999 and 2003.

Cotton

Sixty-five per cent of cotton subsides will be decoupled and 35 per cent converted into area-based payments. Greece will have a maximum area for 370,000 hectares with a higher rate of subsidy paid for the first 300,000 hectares. Spain will have an area of 85,000 hectares and Portugal 360 hectares. The reference period will be based on 2000-02 output.

Tobacco

Gradual decoupling of all subsidies to tobacco farmers, with a restructuring fund to be created to help them to improve yields or switch to other crops from 2006. A historical reference period of 2000-02 will apply as the basis for calculating subsidies. As a social safety net to cushion the impact of the reform, member states may keep up to 60 per cent of payments linked to production, but only for farmers in poor areas or in schemes to promote quality varieties, for four years from 2006. As from 2010, for tobacco producers 50 per cent of the reference amount shall be included in the single payment and 50 per cent shall be transferred to the restructing envelope.

3. Methodological approach

An evaluation of the economic consequences of the MTR proposals for the agricultural sector of the EU has been carried out by the Commission services (Directorate General for Agriculture-DG AGRI) on the basis of two in-house models. The four other studies have been carried out by external organizations at the request of the Commission.[9]

The first DG AGRI analysis has been undertaken on the basis of a set of partial equilibrium, dynamic models covering the most important arable crops, animal and dairy products in the EU. These models are used annually to develop the outlook for agricultural markets and to form the baseline for policy simulation.

The second DG AGRI study has been conducted with the European Simulation Model (ESIM), which is a price driven, world, multi-country non-linear, agricultural sector model, with an extended policy representation. Although originally designed to analyze the impact of EU enlargement to Eastern Europe, it has been further developed and updated to assess the impact of the MTR proposals.

The first external impact assessment study has been conducted by a unit in the Food and Agricultural Policy Research Institute (FAPRI) at the University of Missouri (USA). The FAPRI models used in this exercise consist of a set of non-spatial partial equilibrium models for major agricultural markets used every year to develop projections of world agricultural markets which form the baseline for policy analysis on behalf of the US Congress. These models estimate production, consumption, stocks, trade and prices of major trading countries and agricultural commodities. This specific FAPRI-Missouri study used a detailed EU module which is of a similar general structure to the standard FAPRI models and which covers the most important EU policy instruments.

The second external study, carried out by the University of Bonn, has been undertaken at regional level based on the CAPRI modelling system. It is designed as a projection and simulation tool for the agricultural sector based on a physical consistency framework, economic account principles and a detailed policy representation. The model consists of separate supply and market modules which are interactively coupled and

operates at NUTS II level. It allows the impact of policy changes on agricultural markets, producers' income, the EAGGF budget, consumer welfare and some environmental indicators to be evaluated.

The Centre for World Food Studies of the University of Amsterdam (CWFS) and the Netherlands Bureau for Economic Policy Analysis (CPB) in the Hague jointly realized the third analysis using the CAP Modeling and Accounting Tool (CAPMAT) of the EU agricultural sector. It performs dynamic policy simulations on the basis of an analytical model of the applied general equilibrium type that generates developments in supply, demand and cross-commodity substitution. It incorporates the CAP instruments and farmers' behavioural responses to policy changes through agricultural supply models at national and EU level.

Finally, a further impact assessment has been provided by the University of Bonn based on the CAPSIM model for Eurostat (The Statistical Office of the European Communities). This partial equilibrium model allows forecasting and simulating policy changes on area allocation, production, consumption and income variables of the agricultural sector at national level. It consists of a supply component and a demand component dynamically linked in an overall system that determines price formation.

In all models, the impact of the MTR proposals is analysed for the year 2009 with reference to a status quo policy situation, which corresponds to the continuation of the Agenda 2000 agricultural policy over the medium-term. However, these status quo scenarios vary substantially across studies with regard not only to key underlying assumptions concerning the trade policy framework, the macro-economic environment (notably GDP growth, inflation and the EUR/$ exchange rate) and medium term developments on world agricultural markets, but also to the overall market developments projected for some specific sectors. Therefore, for comparative purposes, the simulation results are presented in the form of deviations from the status quo scenario. Furthermore, results should not be interpreted as changes relative to the current situation in 2003.

The impact studies on the agricultural sector focus on the sectors mostly concerned by the MTR proposals, namely arable crops, meat production and the dairy sectors, with specific reference to area allocation, the main market variables (production, consumption, external trade, stocks and prices) and income changes.

It is difficult to directly model the impact of decoupling. The decoupling impact is extremely complex and at the level of the individual farm will depend on the extent to which farms are willing and able to shift production to more profitable sectors and to bring about further efficiency gains through further restructuring. Although decoupled payments to be modelled is a major subject in its own right, and thus could not be treated in a paper which was concerned with policy results not policy analysis per se.

4. Impact Analysis on the Agricultural Sector of EU-15

Arable crop sector

A negligible reduction in the total area and cereal production will be due solely to the halving of the monthly increments, since the current intervention prices will be maintained and the introduction of decoupling will have only a minor effect. Total cereal consumption and exports will remain at the same levels or will decline slightly thus maintaining the imbalances in the EU cereal markets. Cereal prices are also likely to remain more or less unchanged. Rye and durum wheat will exhibit the strongest falls (around 10 per cent or 0.1 and 0.4 million hectares respectively) in line with the overall reduction of support in these two sectors. Rye and durum wheat production will be in line with area developments (European Commission, 2003, March, pp.6-7). According to Defra's estimates in the case of rye producers returns are estimated to fall by 140 billion Euro and consumers' savings will be of a similar amount, while budget savings will be 150 million Euro. In case of durum wheat the overall effect on EU producers is estimated to be a reduction in receipts of some 150 million Euro. This will be coupled with a small rise in consumer costs, arising from the price increase associated with the reduction in production, and a saving to the EU budget of 190 million Euro (Agricultural Policy and Food Chain Economics, 2003, p. 7).

CAP reform in the oilseed sector will result in a very similar impact to as cereals, given the same small modifications.

Rice sector

The drastic cut in rice support towards the market price level, partially compensated by the granting of direct payments, will entail a decline in EU rice production[10] of 14 per cent by 2009 (with a 10 per cent fall in planted area and a 4 per cent fall in average yield). Lower domestic prices[11] will in turn boost domestic consumption and lower the attractiveness of the EU as an import market, resulting in a swift and significant improvement in the overall balance of the EU rice market (European Commission, 2003, March, pp.8-9).

Meat sector

The introduction of the decoupled single farm payment is projected to have a significant impact on the livestock sector by reducing the incentives towards intensive beef production systems and generating a fall in EU beef production. The abolition of institutional prices will bring about a progressive decline in beef output[12] to some 2.7 per cent below Agenda 2000 levels by 2009 (i.e. a fall of approximately 200,000 tonnes). Supported by lower domestic availability, beef producer prices will rise strongly and reach some 7.1 per cent above Agenda 2000 levels by 2009. This will in turn generate a fall in domestic consumption of some 1.8 per cent. Lower supply and higher domestic prices

would also reduce EU beef net exports, which would fall by some 26 per cent (or 30,000 tonnes) by 2009.

The impact of the CAP reform proposals on the pig and poultry sector is projected to be dominated by demand-side effects from the beef sector. The pork and poultry meat sectors should display a modest expansion in production and consumption of slightly less then 1 per cent over the medium term. These developments would result from the significant rise in beef prices, which is expected to bring about a swift improvement in the relative competitiveness of pork and poultry meat against beef (European Commission, 2003, March, pp.8-9).

Dairy sector

The cut of 10 per cent in the support price of butter which is further to the agreement in Agenda 2000 will lead to a moderate fall in milk prices, which will bring them nearer to the world price levels. Producers' returns will be reduced as a result of the price fall, which will not be fully compensated by the increase in direct payments. With a lower price incentive, butter production is projected to fall slightly over the medium term due to its low price responsiveness. Lower butter prices will lead to an increase in EU domestic consumption. The estimates show that there are expected to be substantial gains to consumers. Lower availability and rising internal use will entail a decline in EU exports. The lesser attractiveness of the butter market will on the other hand favour the production of cheese and fresh dairy products, which will benefit from lower milk prices to satisfy steadily growing demand. Higher price competitiveness might in turn lead a small increase in cheese exports (European Commission, 2003, March, pp 9-10).

The situation as regards skimmed milk powder will remain unaltered compared to Agenda 2000, given that support prices will remain as set out therein. As a result, the EU market price for skimmed milk powder will continue to diverge from the projected world market price level.

Mediterranean Products

Decisions on the reformed CAP regime for olive oil, cotton and tobacco were reached by the Council of the EU in April 2004. These products are known collectively as the Mediterranean products since they are of key importance to Spain, Italy and Greece, which dominate EU production. The main element of the reforms is the shift from the current production-linked payments to the decoupled single farm payment. The reform will start in 2006 and have a neutral effect on the CAP budget, which amounts to nearly half of the EU's annual budget of some 100 billion Euros. Subsidies for the three regimes cost over four billion Euros a year, less than 10 per cent of CAP spending.

Agricultural income

Compared to the continuation of the Agenda 2000 policy measures, the CAP reform is projected to have a very moderate impact on the income situation of the agricultural sector, which is likely to decline only slightly as against Agenda 2000. The impact of CAP reform will differ across regions and the various commodity sectors. Total receipts (i.e. market revenues and direct payments) compared to the projected Agenda 2000 levels are foreseen to decline for durum wheat, rye, rice and milk. In contrast, total receipts in the cereals and oilseed sectors would remain broadly stable.

5. Impact Analysis on the Agricultural Sector of EU-25

The baseline scenario for the EU-25 takes into account the entry of the new Member States in May 2004 as well as the specific conditions of entry agreed at the Copenhagen Summit. These conditions concern in particular the phasing in of direct payments, the top-up possibility, and the agreed production quotas in the new Member States. As for the EU-15, the baseline simulates the EU-25 under Agenda 2000 policies from 2004 until 2009. The agricultural prospects of the new Member States will develop more positively after accession than without accession. Agricultural production after accession will expand slightly as a response to high and stable prices and the beneficial effects of the single market and rural development measures. The current Member States will benefit from a relatively rapid increase in consumer incomes in the new Member States. Accession, therefore, will change some of the dynamics of agricultural markets in the EU, which will alter some of the market outlooks, in particular for some cereals and for dairy products, compared to the situation in the EU-15.

Arable crop sector

The new Member States add about 38 million hectares of utilized agricultural area to the 130 million hectares of the old Member States, representing an increase of 30 per cent. Agricultural production in the EU-25 will be only moderately larger than in the EU-15 because of lower production intensities in the new Member States. The EU-25 will produce in 2006 about 30 per cent more cereals with 42 per cent cereal area and 25 per cent more oilseeds with 37 per cent more oilseed area (without non-food production). The CAP reform will leave the cereal and oilseed area more or less unchanged compared to Agenda 2000 policies. Decoupling of the area payments will lead to only a limited extension of voluntary set aside, mainly from former rye and durum wheat area. A sharp decline in rye, durum wheat and rice production will lead to a reduction of marketable surpluses.

Meat sector

The beef market will be the sector most affected by the CAP reform. The decoupling of direct aids will lead to a reduction of beef production by 6.6 per cent compared to Agenda 2000 conditions. Beef production will decline in the current Member

States and will not build up in the new Member States to the same extent as would have been the case with coupled direct payments. EU-25 production will reach 8 million tonnes in 2009, showing a small increase of 50,000 tonnes between 2004 and 2009. Due to less supply pressure on the market, producer prices would increase by 7.9 per cent compared to Agenda 2000 conditions. The price increase therefore offsets the quantity decrease caused by the decoupling of direct aids. Beef market surpluses will in turn decline significantly. In 2009 net beef exports will stand at about 70 thousands tonnes, i.e. 250 thousands tonnes below the level under Agenda 2000 policies.

The production of pork and poultry will be less affected compared to the beef market. Consumption will equally be higher by 2.4 per cent as prices will be about 1.6 per cent lower than under Agenda 2000 conditions. The EU-25 will export about 200 thousands tonnes more pork than foreseen in the baseline. Poultry production and consumption will also expand slightly in the EU-25 compared to Agenda 2000 (European Commission, 2003, March, pp.13-14).

Dairy sector

For the ten acceding countries total milk production will remain relatively stable under CAP reform conditions. Under Agenda 2000 conditions, however, butter and, to a lesser extent, skimmed milk powder production will expand in the new Member States owing to the increase in their prices after accession. At the moment the structure of production of dairy products in the new Member States lies more with the production of bulk dairy products than with high value added products such as cheese; where about 60 per cent of all bulk milk produced under quota is used in the production of bulk products (butter and skimmed milk powder), compared to 40 per cent in the current Member States. After enlargement production of butter and skimmed milk powder will decline in the current Member States and cheese production will expand (European Commission, 2003, March, pp 14-15).

Under the Agenda 2000 scenario, markets for butter and, to a lesser extent, skimmed milk powder would remain under pressure in the EU-25. Milk prices would therefore increase less in the EU-25 than in the EU-15. The reform will remove significant pressure from the butter market in the EU-25 and lead to significantly lower exports than under Agenda 2000 policies.

Agricultural income

CAP reform will lead to an overall decline of Gross Agricultural Output compared to Agenda 2000. The main reasons are the lower production of durum wheat, rye and rice in the crop sector and butter in the dairy sector. The reform, however, strengthens the efficiency of agricultural production by allowing farmers to move out of less competitive commodities without losing significant amounts of direct payments thanks mainly to introduction of decoupling with the single farm payment. In the new Member States, agricultural income will increase due to higher farm prices following the enlargement. The impact on agricultural income in the acceding countries will be higher when taking account of the phasing-in of

direct payments and rural development. The CAP reform would also reduce most of the downside risks of agricultural markets in the EU-25, in particular as regards structural surpluses.

6. Concluding Remarks

The CAP reform is in line with the objectives of Agenda 2000, completing the reform process in some areas and establishing "WTO - compatible rules". It also constitutes the limits for the Commission's negotiating brief in Cancun. Moreover the reform is in accordance with the overall CAP expenditure ceiling for the enlarged EU set until 2013.

A single farm payment will replace most of the premia under different Common Market Organisations. Consequently, the vast majority of EU direct payments will no longer be linked to production.

The studies show that decoupling will favour extensification of the production and improve producer incomes as producers no longer have to produce at a loss to receive subsidy. The impact of the CAP reform on total cereal and oilseed production will tend to leave the situation unchanged. The effects will be significant on rye, durum wheat and rice given the considerable reduction of their support. EU-15 beef and butter production will fall over the medium-term, triggering a higher rise in domestic producer prices and reducing exports considerably. The impact of the reform on agricultural income in the EU-15 will be marginally smaller than would have been the case under Agenda 2000 until 2009. The Commission's expenditure forecast for Pillar 1 will rise from 41.4 billion Euro in 2004 to nearly 43.7 billion Euro in 2009, which in line with estimates by Defra (Agricultural Policy and Food Chain Economics, 2003, p.4). Overall, the effects on the environment are expected to be positive. There will be potential benefits from decoupling and cross compliance, but there may be adverse effects in certain localized areas which will need consideration.

Decoupling in the enlarged EU should produce similar trends to those in the EU-15, as producers' decisions will be driven by market considerations rather than by the maximization of direct payments. The CAP reform will generally reduce most of the downside risks of agricultural markets in the EU-25, notably in the area of structural surpluses. In the new Member States market income should increase in real terms as compared to the pre-enlargement situation in 2002. According to estimates made by the Commission for the new Member States, expenditure will reach 6.3 billion Euro by 2013, above the forecast by Defra for that year which will be 5.3 Euro billion. The paper does not report the major issue of decoupling because this was not included in the analyses of 2002 and 2003. Apparently, this holds for CAP reform for the Mediterranean products, which was completed on 22 April 2004.

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Notes

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[1] In the light of the forthcoming enlargement, the European Council (24-25 October 2002) decided on the "adjustment" of future CAP payments. From 2006, total CAP subsides would have a ceiling. This would keep payments fixed at current levels during the 2007-2013 period with an allowance of 1 per cent per year for inflation. In real terms, these payments would almost certainly represent a steady decrease. Regarding subsidies to farmers in new Members States, the European Council in Brussels (October 2002) decided on a gradual introduction of direct subsidies over a ten year transitional period. In years 2004, 2005, 2006 and 2007 direct subsidies will be equal to 25, 30, 35 and 40 per cent respectively of the amount provided by the existing system. In the second stage, direct subsidies will be granted gradually reaching 100 per cent in 2013.

[2] The GATT Uruguay Round agreement on agriculture imposes disciplines on member countries in three separate areas: reduction of domestic subsidies by 20 per cent over six years ; market access, i.e. all import restrictions were converted to customs tariffs which were reduced by 36 per cent over a period of six years; and reduction of export subsidies by 21 per cent in volume and by 36 per cent in value over six years. Regarding domestic support the agricultural policy measures are classified into three boxes according to the degree of production and trade distortion. The “green” box includes measures which do not distort production and international trade and characterized as “neutral”, such as structural policy measures, i.e. incentives to young farmers, compensations for natural disasters, etc. The “blue” box includes aid per hectare or per animal, which concern arable crops, rice, beef and sheep-good meat. These aids decided in the framework of the 1992 CAP reform. Finally, the “yellow” box include production measures and direct subsidies granted according to the volume of output. These measures are not compatible with GATT/WTO.

[3] Since the compensation payments are not compatible with the green box the EU will maintain them with the introduction of single farm payments and partial decoupling in some products.

[4] Member States can keep up to 25 per cent of the current per hectare payments in the arable sector linked to production. Alternatively, 40 per cent of the supplementary durum wheat premia may be tied to production.

[5] The initial Commission proposals would have reduced the intervention prices by 5 per cent and abolished the monthly increments.

[6] The initial Commission proposals would have reduced the intervention price from 344.5 Euro per hectare to 250 Euro per hectare in “traditional areas”.

[7] Member States may decide to: (i) retain up to 100 per cent of the suckler cow premium and 40 per cent of the slaughter premium, to be included in the single farm payments, or (ii) retain up to 75 per cent of the special male premium, to be included in the single farm payment.

[8] The initial Commission proposals provided for an annual reduction for skimmed milk powder and butter of 3.5 per cent and 7 per cent per year respectively over the period 2004/05-2008/09, with a one per cent increase in quotas and a corresponding increase in payments in 2007 and 2008.

[9] For more details regarding the six models employed by the Commission services, refer to the European Commission (2003), February.

[10] Estimates of the drop in total EU rice production range between 1 per cent (FAPRI) and 29 per cent (CAPMAT) (European Commission, 2003, February, p.20).

[11] According to Defra estimates, rice market prices in the EU will fall by about 30 per cent (Agricultural Policy and Food Chain Economics, 2003, p. 8).

[12] Estimates for the fall of beef production range between 5.7 per cent and 7.6 per cent according to the ESIM and CAPSIM models respectively, whereas the range of the estimates from all the other models is the same as AGRI. Regarding beef exports, two studies (AGRI and FAPRI) show that the EU would remain a net beef exporter, hile the four other analyses indicate that the EU would become a net importer of beef. Finally, the estimates of beef prices in all the models with the exception of CAPMAT are at the same levels as AGRI (European Commission, 2003, p.21).

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