CAP REFORM AGREEMENT AND IMPLICATIONS FOR DEVELOPING COUNTRIES

A preliminary analysis by Tim Rice, ACTIONAID, 1st July 2003

Because of the complexity of the final agreement, please treat this as a draft for comment but feel free to circulate
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SUMMARY

The CAP 2003 reform process (also known as the mid-term review – MTR - of Agenda 2000) only tackled one aspect of agriculture in the European Union – that of domestic subsidies. The reform proposal and final agreement was not an attempt to tackle issues of fundamental concern to developing countries such as market access and export subsidies (although the latter will be indirectly affected due to very limited cuts in market price support).

It was also a limited exercise in that sugar was never going to be included in the reform process (although proposals are likely to be tabled in the autumn of 2003). Only very limited dairy reforms were included. The central plank of the EU package is that the majority (but not all) of the current direct payments to farmers will be 'decoupled' from production. This will enable the EU to reclassify these decoupled payments into WTO compliant subsidies, moving them out of the blue box into the green box. One estimate is that, as a result of the agreement, the EU will be able to reduce its blue box subsidies by about 75%, more than meeting the call in the Harbinson text to reduce them by 50%.[1] According to Pascal Lamy, the final agreement will give the EU "*negotiating capital in the WTO round…and I have plenty of ideas how I can use this negotiating capital*".[2] Trade-offs are almost inevitable and these piecemeal reforms offer little, if any benefit to the world's poor.

Following the Brussels summit of October 2002, the CAP budget was fixed but will rise to about 49 billion euros by 2013 (current expenditure is about 43 billion euros). This new expenditure covers the 10 new member states.

Implications for developing countries: Since the dairy and sugar sectors remain relatively untouched, large quantities of export subsides will still be required (see below) and dumping will continue. Serious questions remain whether decoupled subsidies will be de-linked from production (and whether this will be sufficient to reduce or stop dumping in other key sectors such as cereals). Evidence from the US on decoupled (green box) payments is that they are not strictly decoupled and have increased the total planted acreage thus distorting production. Assessments conducted for the European Commission in February found that, when compared to 2002 production, the decoupled proposals (along with the rest of the reform proposal) would increase EU production to 2009 for most cereals (soft wheat, barley, maize and rice).

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1 AgraEurope, 2003. A CAP reform agreement that – just about - delivers. 27th June.
2 AgraEurope, 2003. EU Staggering towards hybrid CAP reform. 20th June.

DAIRY

This was one of only three crops or products where intervention prices were <u>cut</u> (rice and rye being the others). However, intervention price support is still an important element of the EU sugar regime and to some extent cereals (see below). For dairy products, the original proposal was always weak and the final agreement – to cut the butter intervention price by 25% by 2007/8 and skimmed milk powder (SMP) by 15% by 2006 – is extremely disappointing. In fact, the changes to the milk powder regime are no different to those agreed as part of Agenda 2000 in 1999. The final agreement will still leave the EU butter intervention price in 2007 at about 2,450 euro/tonne compared to the current world price of about 1,150 euro/tonne.[3]

Direct payments will go to dairy farmers as compensation for cuts in the intervention prices. In the first instance, they will still be coupled. Decoupled payments will not come into effect until the reforms are fully implemented (ie 2008) unless member states decide to introduce it earlier. To some effect, decoupled payments will still be partially linked to production "*as farms have to be in possession of* [a production] *quota in order to receive the dairy premium.. the more quota the greater the premium.*"[4] The way the UK government tries to defend this position is by arguing that dairy farmers do not have to produce milk to get the payment but keep all land in 'good agricultural condition', so in effect it is decoupled (more information is awaited on this proposal and how it would be implemented).

According to the UK government, following the final agreement, there will not be a substantial review of the EU dairy regime until 2014! There will be a market review of these changes in 2007 but these are likely to be no more than technical discussions regarding the implementation of the final agreement. However, more substantive changes to the dairy regime may occur before 2014 if export subsidies are eliminated as part of the renegotiation of the AoA.

Implications for developing countries. Little or no change. Massive amounts of export subsidies will still be required to sell (and dump) surplus EU dairy products on world markets. Currently, the dairy sector spends about 1 billion euros on export subsidies. Under the final agreement, according to the European Commission, export subsidies for dairy products in 2013 will be at least 620 million euros.[5]

SUGAR

Sugar was not included in the current reforms but proposals are likely to be tabled in Autumn 2003. Until such time that an agreement is reached, the EU internal price will continue to be some 2-3 times the world price. However, more substantive changes to the sugar regime may occur rather sooner if export subsidies are eliminated as part of the renegotiation of the AoA.

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[3] AgraEurope, 2003. CAP reform – a detailed overview of the new deal. 27th June.
[4] Hird, V. and T. Lobstein, 2003. *Land of Milk and Money?* A Briefing on the dairy system and reform of dairy policies. Sustain.
[5] European Commission, 2003b. *CAP Reform – A long-Term Perspective for sustainable Agriculture.* http://europa.eu.int/comm/agriculture/mtr/index_en.htm. The legislative proposals can be found at: http://europa.eu.int/comm/agriculture/mtr/memo_en.pdf

Implications for developing countries. No change. Massive amounts of export subsidies will still be required to sell surplus (and dump) EU sugar products on world markets. Currently, the EU sugar sector spends some 1.5 billion euros on export subsidies per annum (some of which is funded by the industry itself).

CEREALS (excl rice)

With the exception of rice and rye, proposals for further cuts in intervention prices for cereals were dropped. It is in this sector - as well as livestock (not covered here) – that the proposals for decoupling will have most effect. According to the European Commission, subsidies will be decoupled because, in WTO language, they are not linked to current production but to historical production reference years (2000-2002). A further element is that farmers will not have to keep the land in production (ie growing cereals) but in 'good agricultural condition'. Member states also have the option to retain up to 25% of payments as 'coupled' but the remainder must be decoupled. This will start in 2005 "*but with a grace period until 2007 for those states, led by France, who wish to delay.*"[6]

Whilst estimates are difficult given the data available, evidence from the US on decoupled (green box) direct payments reveal that some have increased the total planted acreage.[7] In addition, many believe that they are not totally decoupled and distort production for the following reasons (these payments are referred to as production flexibility contracts – PFCs – which ran from 1996 to 2002 and have been replaced by a similar programme in the 2002 Farm Bill): [8,9]

- Wealth effects; guaranteed payments are an annual flow of income that the farmer may invest in the farm operation, potentially increasing production.
- Any income that reduces income variability – and thus risk – will tend to increase output.
- The PFC programme ran from 1996 to 2002. The farmer may well have felt compelled to keep production and acreage high in case the base reference years changed. This is exactly what happened in 2002 when the programme changed under the US Farm Bill.
- The payments are not totally decoupled because a farmer is not allowed to grow certain other crops – such as fruit and vegetables – on the land. The farmer thus has an incentive to keep growing the crops that are eligible for the programme.

The EU proposals for decoupling are similar to these US payments but are more flexible in that the land does not have to be under production (but similar to the US programme in that fruit, vegetables and potatoes are not allowed to be grown on land that was previously under cereals). One would have expected therefore that, once the decoupled programme comes into the effect in 2005, farmers would stop growing unprofitable crops and just keep the land in good agricultural condition (but still get the decoupled payment). This does not appear to be the case. Assessments conducted for the European Commission in February 2003 found that, when compared to 2002 production, the decoupled proposals (along with the rest of the reform proposal) would increase EU-15 production to 2009 for most cereals (soft wheat, barley, maize and rice)[10] and this production increase will more than meet any increase in

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[6] AgraEurope, 2003. Deal reached on CAP reform. 26th June. News alert.
[7] Gardner, B., 2002. *North American Agricultural Policies and Effects on Western Hemisphere Markets since 1995, with a Focus on Grains and Oilseeds*. Department of Agricultural and Resource Economics. University of Maryland, page 18. http://www.arec.umd.edu/Publications/papers/Working-Papers-PDF-files/02-12.pdf
[8] Gardner, 2002. Op cit.
[9] Andrews, N., R. Nelson, S Hagi Hirad and I. Shaw, 2002a *Grains Policies in a Global Market.* Abare Research Project, Report 02.8.
[10] European Commission, 2003. *CAP Reform: Impact Analyses of the Mid-term Review Proposals.* http://europa.eu.int/comm/agriculture/publi/reports/mtrimpact/index_en.htm. The Commission plus some member states

EU-15 consumption. In an analysis for the UK government, consultants concluded that: "*In the short run, decoupling is predicted to have limited impact on cereal production*".[11] ActionAid believes that the final agreement in fact may increase production even more than forecast because:

- Some important cereal producing countries may not implement the decoupled payments until 2007;
- 25% of payments could still be coupled (member states discretion);
- The 5% cut in the intervention price was not implemented.

Given the above (particularly the experience from the US) ActionAid questions the UK government's assertion that a "*producers' decision will* [now] *be based on the costs of production and the market price of the output*".[12] ActionAid still remains concerned that any subsidy (whether coupled or decoupled) will be used to bridge the gap between the sale price and cost and thus decoupled payments will still influence production decisions and thus distort trade.

Implications for developing countries. No meaningful change. ActionAid believes that decoupled payments would still be partially linked to production and may even increase production putting further pressure on world prices. Because significant amounts of cereal production in the EU is sold at less than the cost of production, unless prices improve, any subsidy (whether coupled or decoupled) will be used to bridge the gap between the sale price and cost. Dumping is likely to continue.

RICE

The intervention price was cut to bring the EU market into line with the world market, due notably to the impact of the everything-but-arms initiative.

Implications for developing countries: As a result of the intervention price cut, "*The Council also invited the Commission to open negotiations in the framework of the WTO for the modification of the bound duties for rice with the EU's trading partners.*"[13]

KEY CONCLUSIONS FOR DEVELOPING COUNTRIES

- Massive amounts of domestic subsidies are still available (in different coloured boxes);
- Export subsidies and market access are largely untouched;
- Sugar is not included and dairy reforms were very limited – dumping will continue;
- Further substantial dairy reforms may not be forthcoming until 2014 (but will depend on the decision on export subsides at Cancun);

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have concluded that production will go down as a result of the reform process. This is because their analyses contrast the level of production in 2009 following the implementation of the MTR against the level of production in 2009 if current policies continue to be adopted (essentially Agenda 2000). The EU analysis does not contrast the level of projected MTR production against current production.

[11] CRER, 2003. *CAP Reform: Decoupling Arable Payments.* A Discussion Document for DEFRA. Centre for Rural Economics Research, University of Cambridge. http://statistics.defra.gov.uk/esg/reports/decoupling/Cambridge.PDF

[12] DEFRA, 2003. Assessment of the Economic Impact of the Commission's Long Term Perspective for sustainable Agriculture. Department of Environment, Food and Rural Affairs. http://statistics.defra.gov.uk/esg/reports/capreform.pdf

[13] European Commission, 2003. EU fundamentally reforms its farm policy to accomplish sustainable farming in Europe. Press Release, 26th June.
http://europa.eu.int/rapid/start/cgi/guesten.ksh?p_action.gettxt=gt&doc=IP/03/898|0|RAPID&lg=EN&display=

- In all sectors, members are still able to retain a percentage of subsidies as ‘coupled’ (ie blue box);
- Decoupling (and other elements of the reform package) may still increase production and thus potentially distort trade. Dumping will probably continue;
- Decoupled subsidies are still tied to recent production (historical base years of 2000-2002);
- For some states – ie France – decoupling could be delayed to 2007;
- Market access for rice is possibly to be renegotiated.