

# **Economics of European Integration**

## **Lecture # 7**

### **Common Agricultural Policy**

Fall Semester 2008

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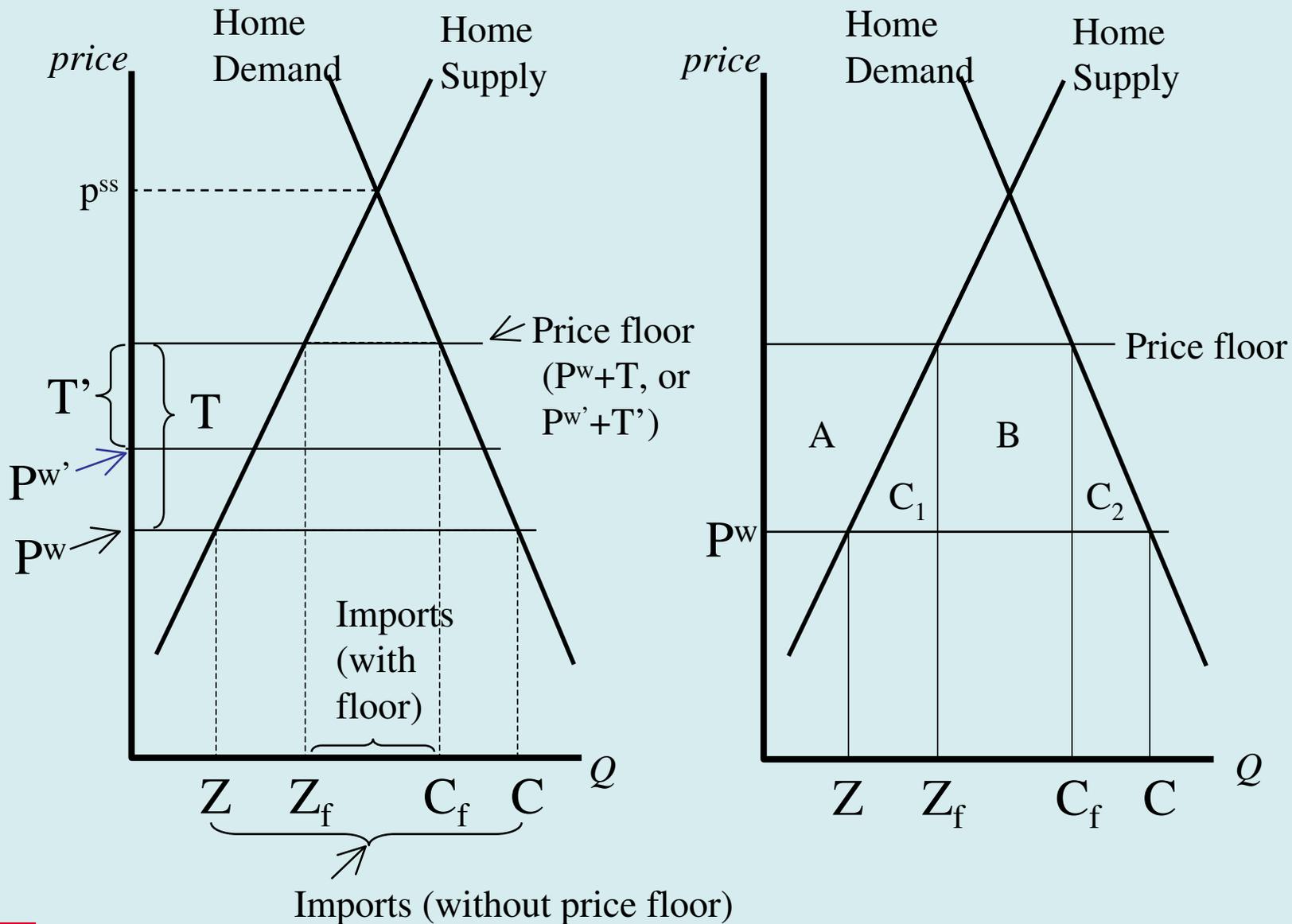
**Article 39. 1.** The objectives of the common agricultural policy shall be:

- (a) to increase agricultural productivity by promoting technical progress and by ensuring the rational development of agricultural production and the optimum utilisation of the factors of production, in particular labour;
- (b) thus to ensure a fair standard of living for the agricultural community, in particular by increasing the individual earnings of persons engaged in agriculture;
- (c) to stabilise markets;
- (d) to assure the availability of supplies;
- (e) to ensure that supplies reach consumers at reasonable prices.

# CAP

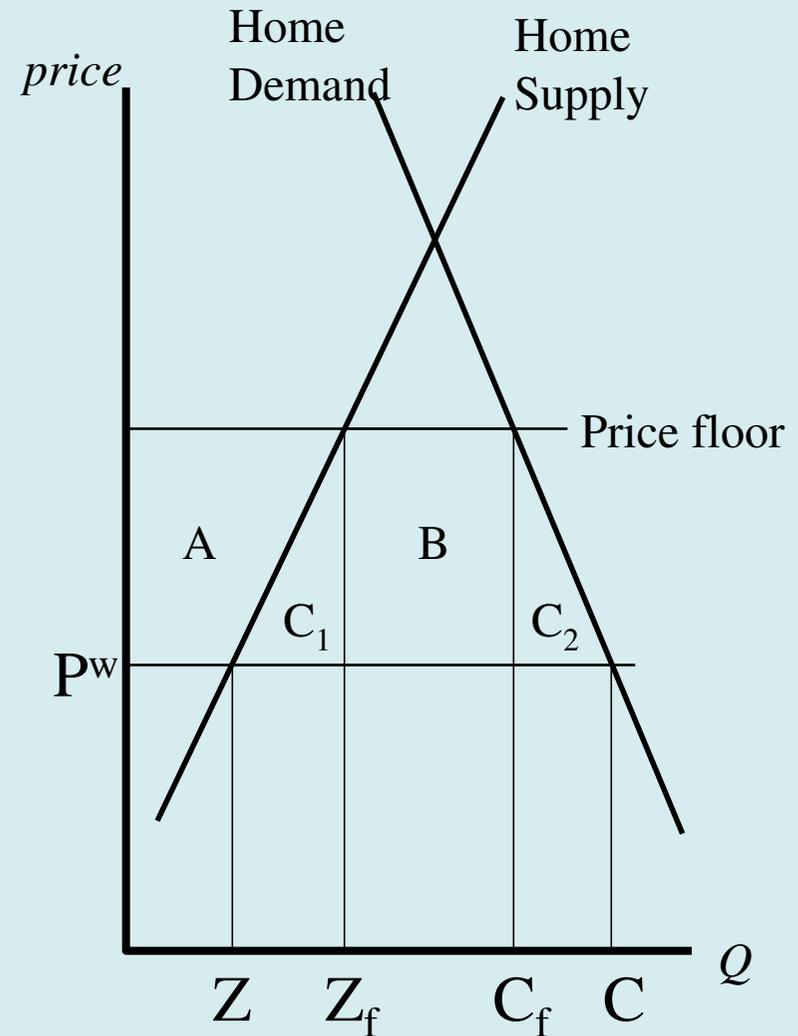
- Massively complex, massively expensive policy.
- Hard to understand without seeing how it developed.
- CAP started as simple price support policy in 1962.
- EU was net importer of most food, so could support price via tariff.
  - Technically known as a ‘variable levy.’

# Simple price support with tariff



# Food tax interpretation

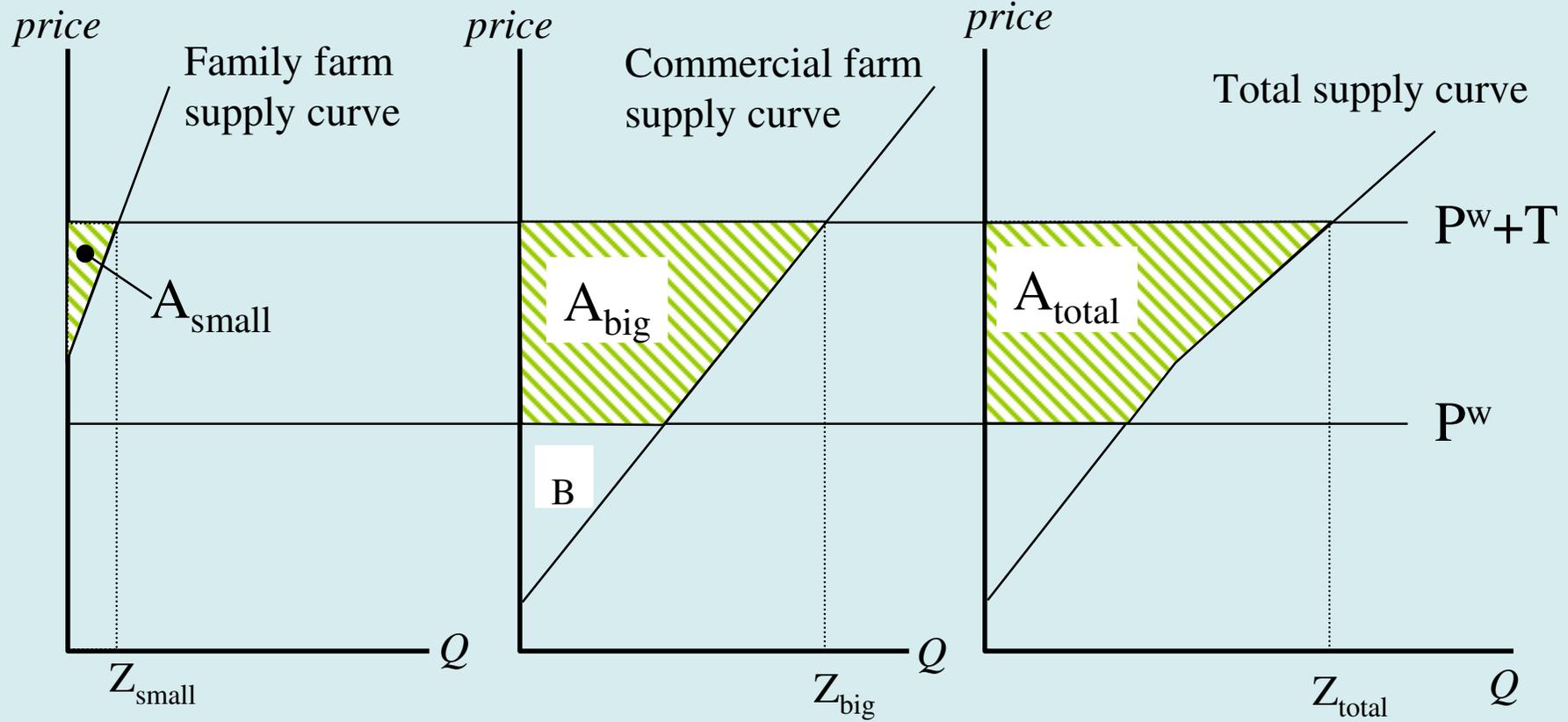
- Price floor supported by tariff is like all-in-one package made up of simpler policy measures.
  - (i) free trade in the presence of
  - (ii) a consumption tax equal to  $T$  and
  - (iii) a production subsidy equal to  $T$ .
- Price, quantity, revenue and welfare effects are identical.
- This is insightful:
  - makes plain that consumers are the ones who pay for a price floor enforced with a variable levy.
  - Part of what they pay goes to domestic farmers (area A),
  - part of it goes to the EU budget (area B),
  - part of it wasted (areas  $C_1$  and  $C_2$ ).



# Farm size distribution in 1987

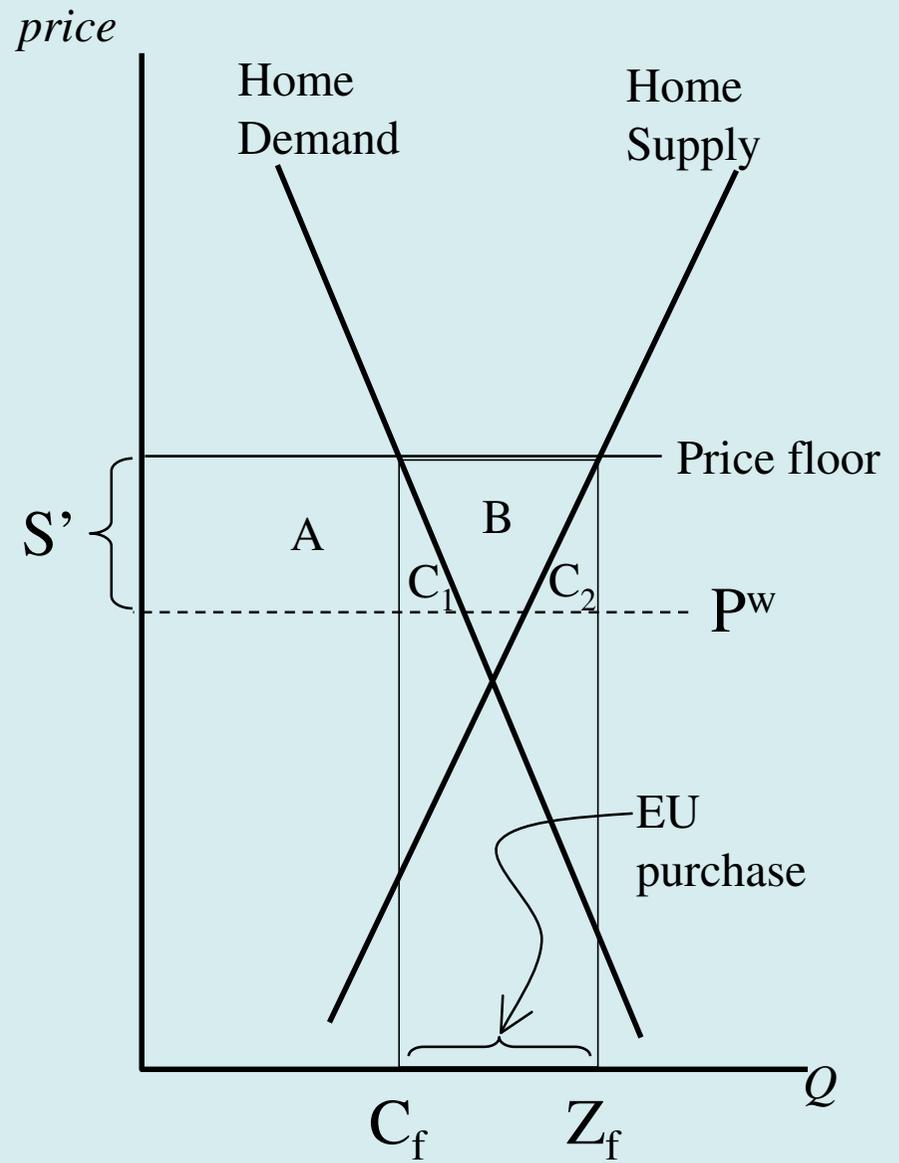
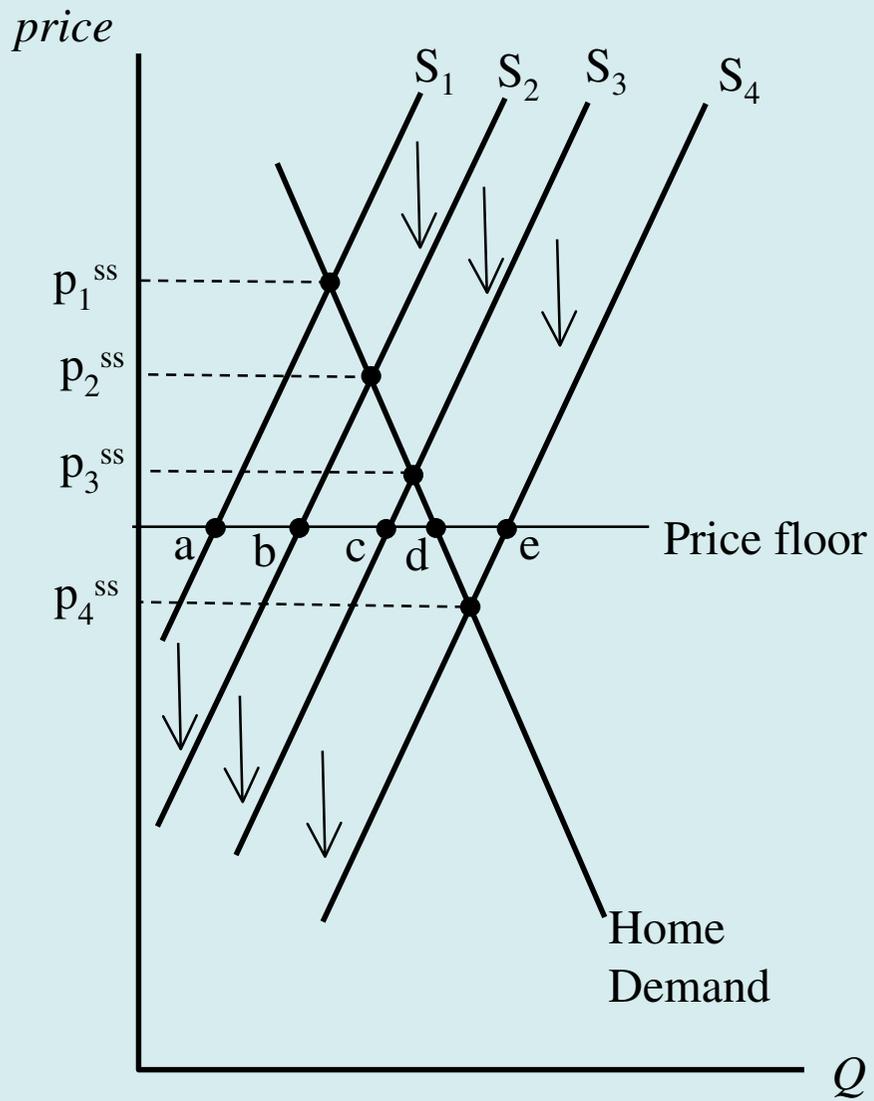
- Very skewed ownership:
  - Biggest 7% of farmers owned ½ of the land.
  - Smallest 50% of farmers owned only 7% of the land.

Farm size class (hectares)	Number of farms (millions)	Number of farms as share of total	Share of EU12 farm land in size class	Average farm size (hectares)
1 to 5	3.411	49.2%	7.1%	2.4
5 to 10	1.163	16.8%	7.1%	7.0
10 to 20	0.936	13.5%	11.5%	14.1
20 to 50	0.946	13.7%	25.7%	31.2
over 50	0.473	6.8%	48.6%	117.6
total	6.929	100%	115 (mill.ha)	16.5



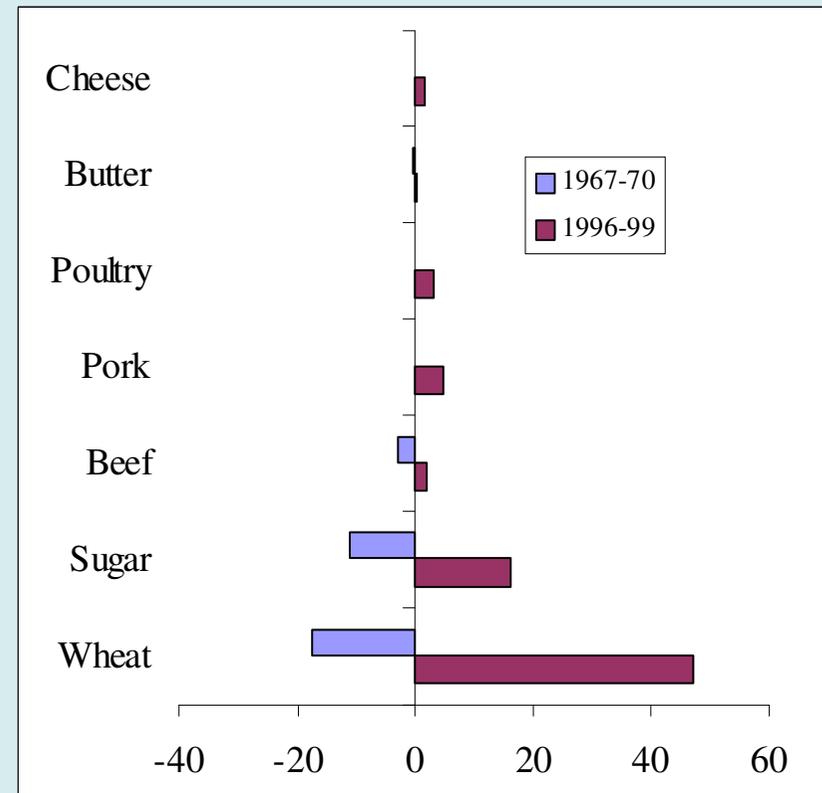
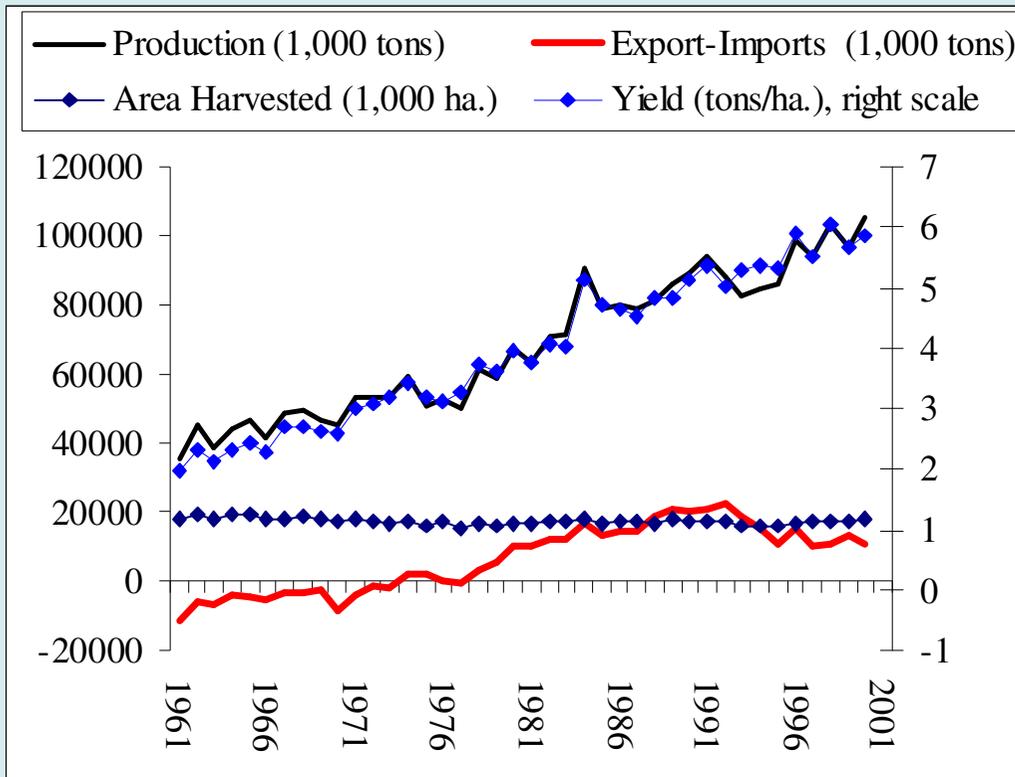
# CAP problems

- #1 Problem: The supply problem.
- ‘Green’ revolution technology boom, supply ↑
  - High guaranteed prices encourage investment & adoption.
  - Output rises much faster than consumption.



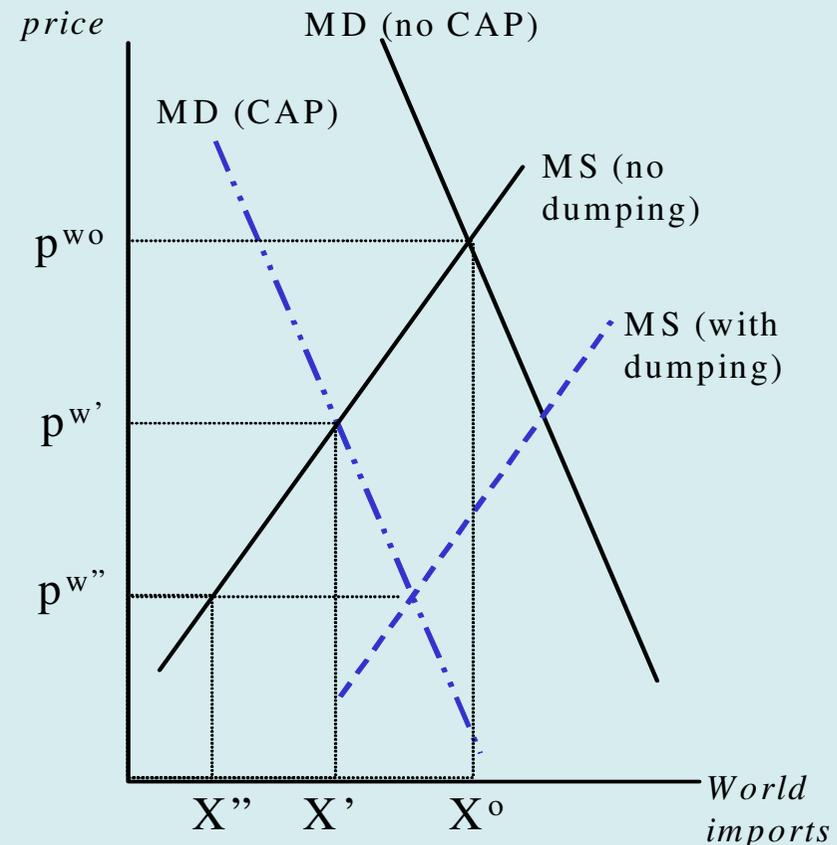
# Follow-on problems of oversupply

- EU switches from net food import to exporter in most products.



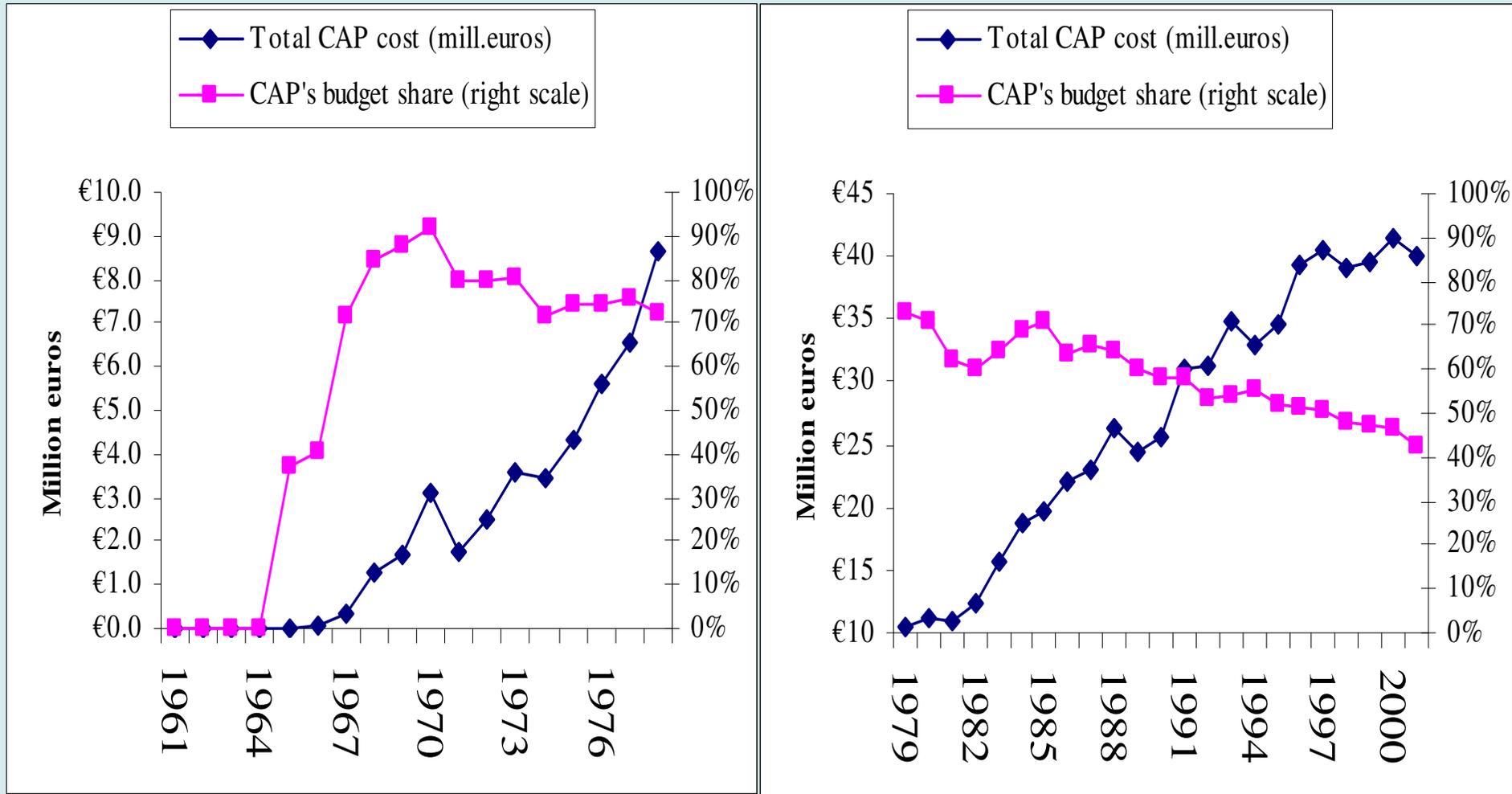
# Follow-on problems: World market impact

- Import protection insufficient for price support.
- CAP becomes major food buyer.
  - Some of this is dumped on world market.
- CAP protection and dumping depresses prices on world markets.
  - Harms non-EU food exporters.



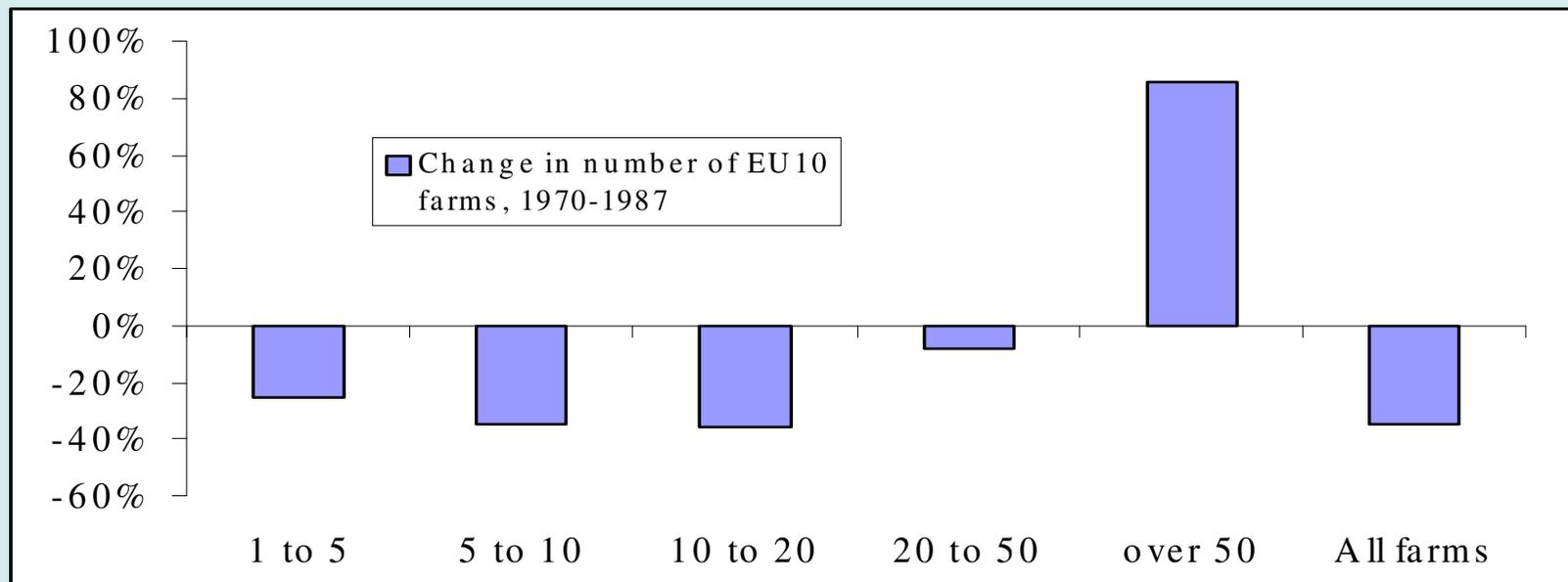
# Follow-on problems: Budget

- Buy and storing or dumping food becomes increasingly expensive.



# Other CAP problems

- #2 Problem: The farm income problem.
  - General problem, inelastic demand means farm sector's total income falls with prices, so either average farmer income must fall, or then number of farmers must fall.
- In EU: Average farm incomes fail to keep up despite huge protection and budget costs.
  - Most of money goes to big farms that don't need it:
    - CAP makes some farmers/landowners rich.
    - Keeps average (i.e. small) farmer on edge of bankruptcy.
  - Farmers continue to exit farming (about 2% per year for last 4 decades).



# Other CAP problems

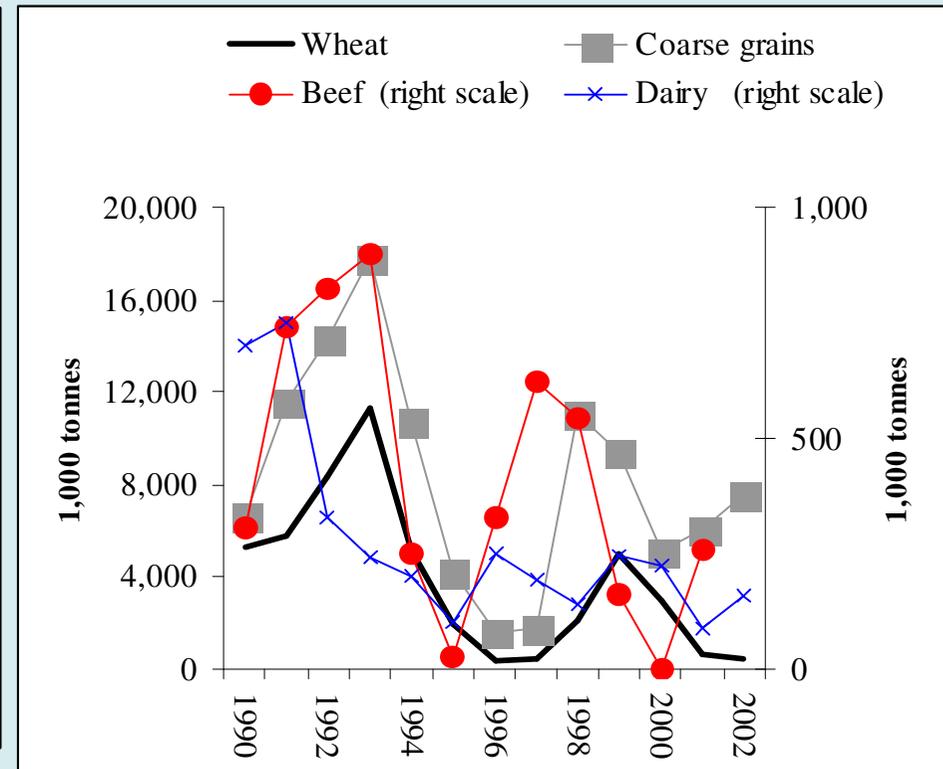
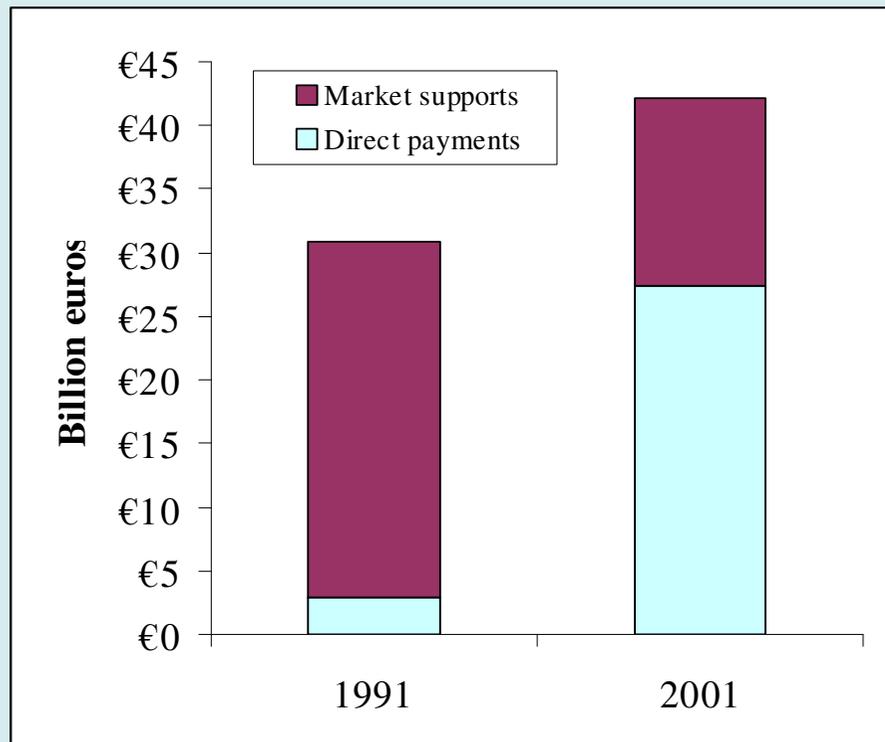
- Factory Farming:
  - Pollution,
  - Animal welfare,
  - Nostalgia.
- Bad for 'image' and thus public support for CAP.

# CAP Reforms

- Supply control attempts:
  - 1980s, experimentation with *ad hoc* & complex set supply 'controls' to discourage production.
  - Generally failed; technological progress & high guaranteed prices overwhelmed supply controls.
- 1992: MacSharry Reforms:
  - Basic idea: CUT PRICES supports to near world-price level & COMPENSATE farmers with direct payments.
  - Was essential to complete the Uruguay Round.
  - Worked well.
- June 2003 Reforms; essential to Doha Round.
  - Implementation 2004-2007.
  - Similar to MacSharry reforms in spirit.
  - Still might not be enough to allow Doha Round to finish.

# Evaluation of the today's CAP

- Supply problems & food “mountains.”
  - Left figure: massive shift to direct payments.
  - Price cut reduced EU buying of food: right figure shows important drop in EU storage of food.
  - EU dumping of food on world market also dropped.



# Farm incomes & CAP support inequity

- Reformed CAP (post MacSharry) support still goes mostly to big, rich farmers.
  - payments intended to compensate, so inequity continued.
- Half the payments to 5% of farms (the largest).
- Half the farms (smallest) get only 4% of payments.
- Recent studies show that only about half of these payments go to farmers.
  - Rest to non-farming landowners and suppliers of agricultural inputs (seed, fertilisers, agri-chemicals, etc.)
  - See: “Who Finances the Queen’s CAP payments?”
  - [http://shop.ceps.be/BookDetail.php?item\\_id=1285](http://shop.ceps.be/BookDetail.php?item_id=1285)

# CAP support inequity

Size Class	Payment per farm	% of EU15 farms in size class	Number of farms in size class	% of EU15 payments to size class	Cumulative % of budget (from largest to smallest)	Cumulative % of farms (from largest to smallest)
0 to 1.25	€405	53.76%	2,397,630	4.3%	100.0%	99.97%
1.25 to 2	€1,593	8.54%	380,800	2.7%	95.7%	46.21%
2 to 5	€3,296	16.30%	726,730	10.7%	93.0%	37.67%
5 to 10	€7,128	9.17%	409,080	13.0%	82.2%	21.37%
10 to 20	€13,989	6.81%	303,500	19.0%	69.2%	12.20%
20 to 50	€30,098	4.13%	184,100	24.8%	50.2%	5.39%
50 to 100	€67,095	0.94%	41,700	12.5%	25.4%	1.27%
100 to 200	€133,689	0.24%	10,720	6.4%	12.9%	0.33%
200 to 300	€241,157	0.05%	2,130	2.3%	6.5%	0.09%
300 to 500	€376,534	0.03%	1,270	2.1%	4.2%	0.04%
over 500	€768,333	0.01%	610	2.1%	2.1%	0.01%
Average, All farms	€5,015					

# Future challenges

- Doha Round:
  - Completing these WTO talks may require deeper reform of CAP.
- Eastern Enlargement:
  - Number of farms will rise.
  - Farmland rise from 130 million hectares to 170 million.

# EU newcomers: Farm facts

Table 2. Basic agricultural facts for 2004 entrants

	Farmland (million hectares)	Number of farms (000s)	Average farm size (hectares)	Agricultural employment (000s)	Ag. share of employment (%)	Ag. share of GDP (%)
Czech Republic	3.7	54	67	212	4.5	1.1
Estonia	0.8	37	22	37	6.3	2.2
Cyprus	0.1	45	4	17	5.2	3.7
Latvia	1.6	141	10	146	14.6	2.1
Lithuania	2.5	279	9	276	18.7	2.6
Hungary	5.9	773	6	211	5.4	2.7
Malta	0.0	11	1	4	2.5	1.6
Poland	16.1	2,178	7	2485	18.2	2.3
Slovenia	0.5	77	6	75	8.4	1.6
Slovak Republic	2.2	72	30	130	6.0	1.2
NMS10	33.5	3,667	9	3,593		
EU15	130.0	6,766	18.7	6,487	4.0	1.6

Notes: Agricultural employment is employment in agriculture, forestry, hunting and fishing (column 5). Part-time farmers who also work off the farm may not be classified as farmers (e.g. there are more holdings in Slovenia than people employed in agriculture).

Source: Table 2.0.1.2 in "Agriculture in the EU – Statistics and economic information", 2004, European Commission. Note: Number of EU15 farms and average farm size for 2000 report due to missing data for 2004.