Economics of European Integration

Lecture # 7

Common Agricultural Policy

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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;

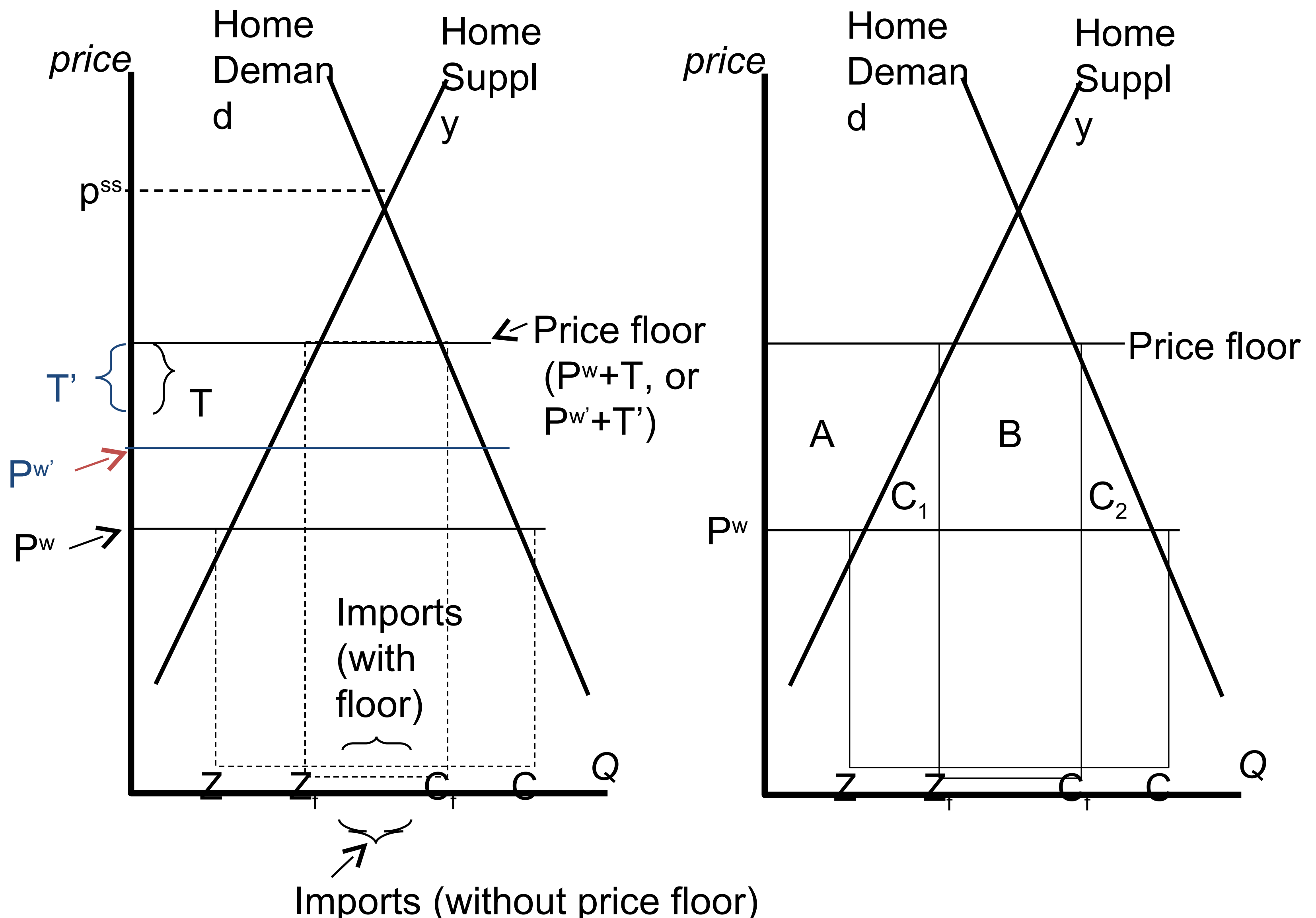
(e) to ensure that supplies reach consumers at reasonable prices.

Chapter 12 Common Agricultural Policy

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 and subsidy 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

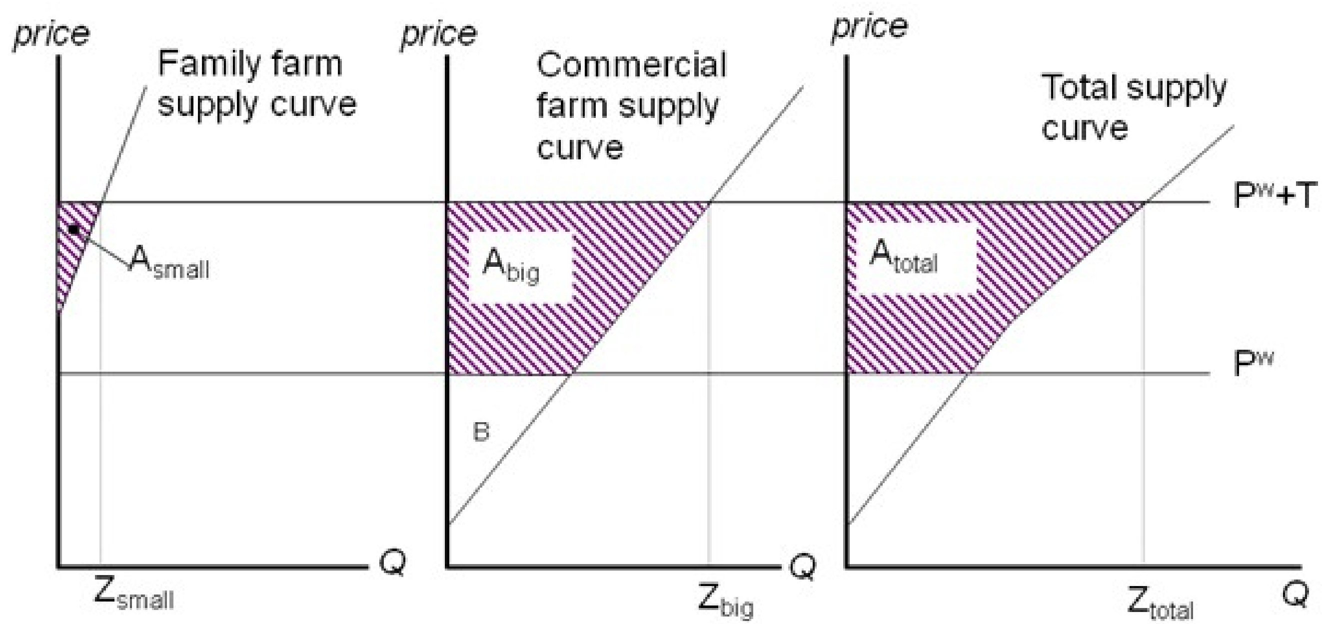
- Price, quantity, revenue and welfare effects are identical.

Food tax and subsidy interpretation (continued)

- 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 is wasted (areas C_1 and C_2).

NOTE: benefit of price support goes particularly to large farms

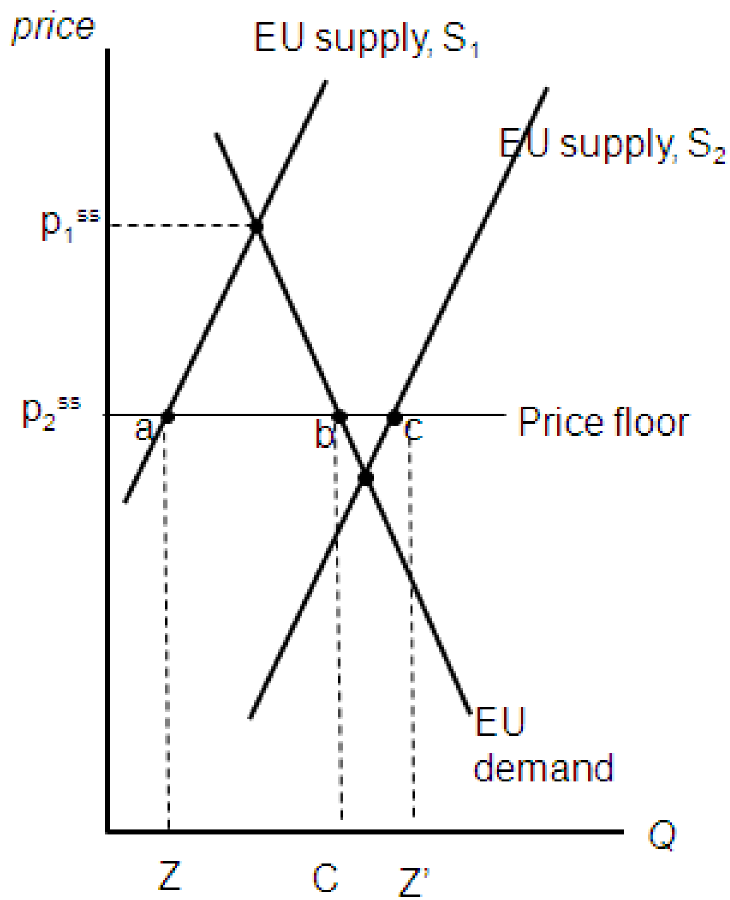
Uneven distribution of benefit



Changed circumstances and CAP problems

- The supply problem.

- ‘Green’ revolution technology boom, supply rise
  - High guaranteed prices encourage investment & adoption.
  - Output rises much faster than consumption
  - The EU becomes a net exporter of agricultural goods


price
EU supply, S1
EU supply, S2
p1ss
p2ss
a
b
c
Price floor
EU
demand
Q
Z
C
Z'

Follow-on problems

- CAP cost from 8% of EU budget in 1965 to 80% of EU budget in 1969

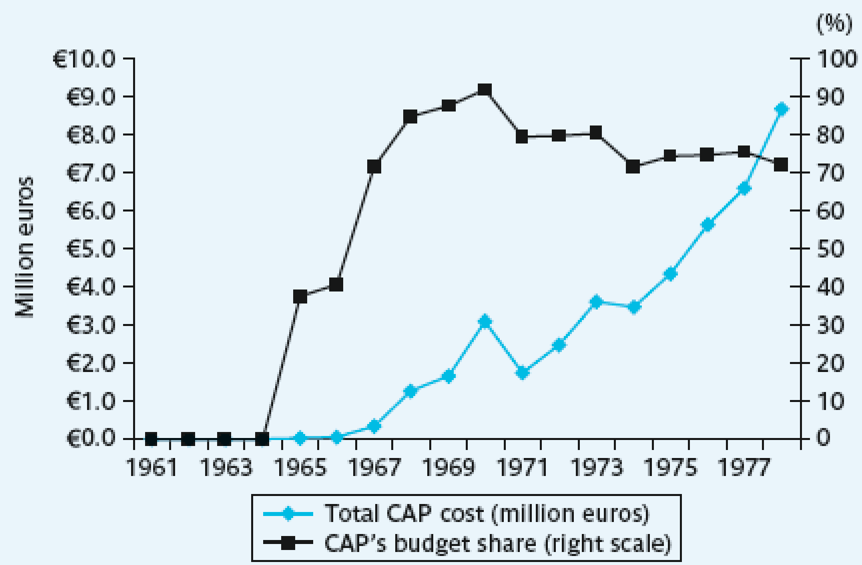
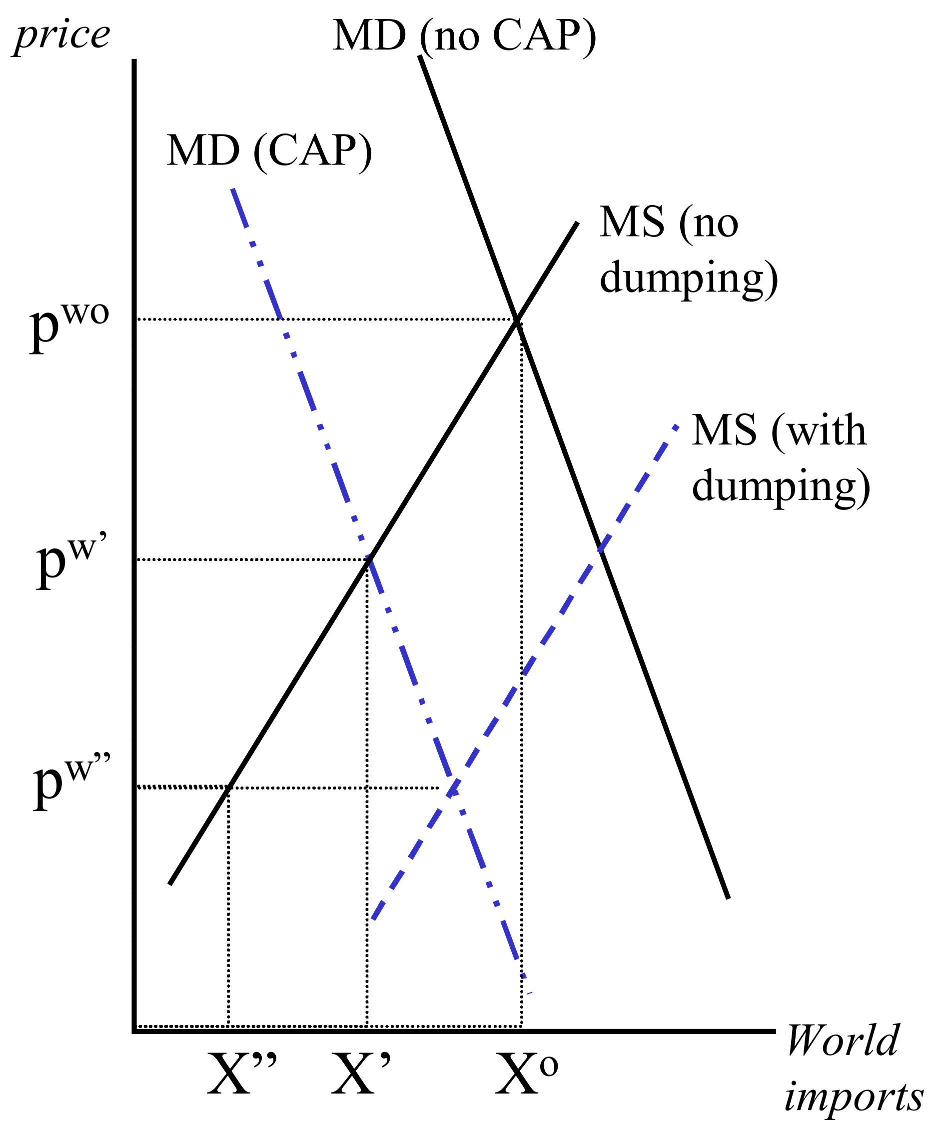


Figure 12.5 **The CAP's early budget problem**

Follow-on problems (cont.)

- Storage issue: wheat, beef and butter mountains
- Dumping into international markets, and WTO rules
- Pollution and animal welfare
- Lagging income in farming and uneven benefit distribution meant a retreat from agriculture
  - E.g. about half of EU farmers get only 2.1% of payment

Follow-on problems: World market impact



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: distribution of CAP payments

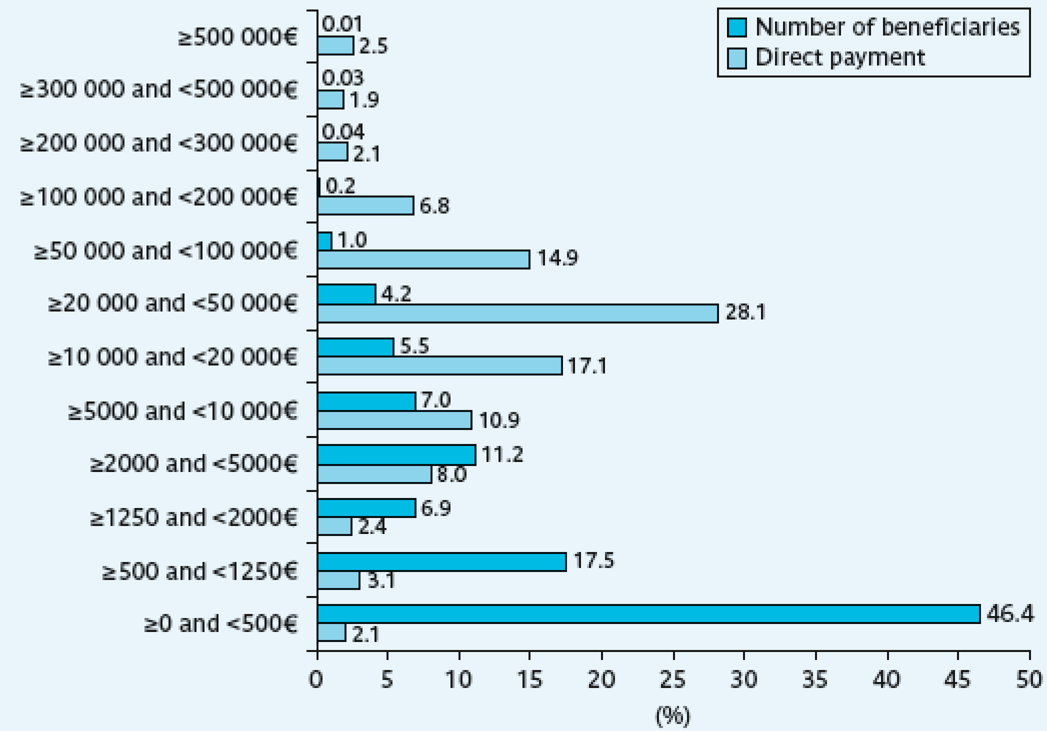


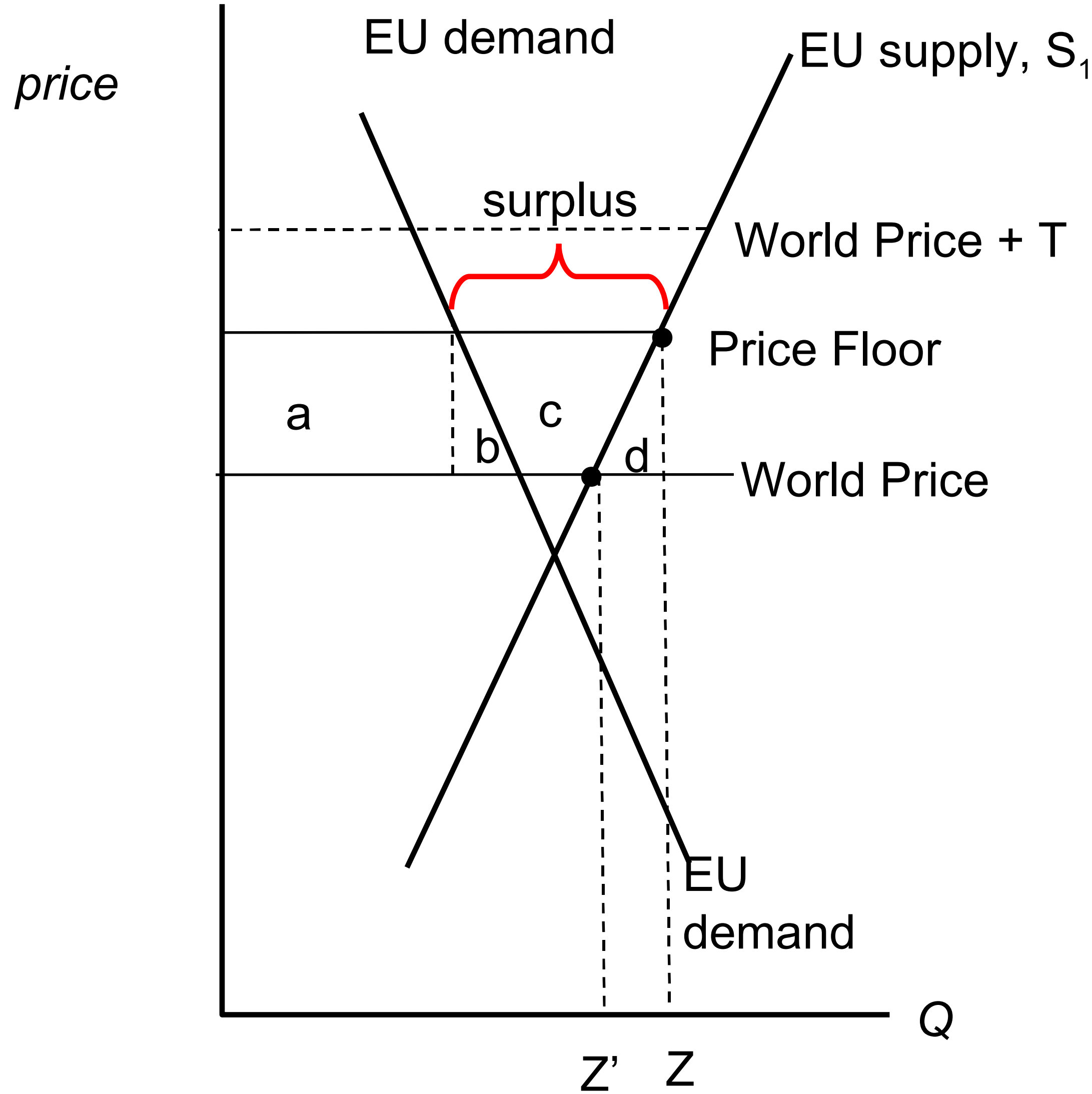
Figure 12.8 Extremely uneven distribution of CAP payments, 2006

Source: DG-Ag 2006

The new economic logic of the CAP

- Continuing lobbying power of farmers
- Lowering or eliminating price floors in line with compensation payments for farm owners
- Decoupling of payments from production

The decouple with compensation system



CAP Reforms

- Supply control attempts:
  - 1980s supply ‘controls’ to discourage production.
  - Generally failed.

- 1992: MacSharry Reforms:
  - Cup prices and compensate farmers with direct payments.
  - Essential to complete the Uruguay Round.

- June 2003 Reforms:
  - Similar to MacSharry reforms in spirit.
  - Still not enough to allow Doha Round to finish.

CAP Today

- Two pillar structure:
  - Direct payments and price support
  - Rural Development
- Planned spending of first and second pillar 2007-2013: increasing role of second pillar, especially in new member states

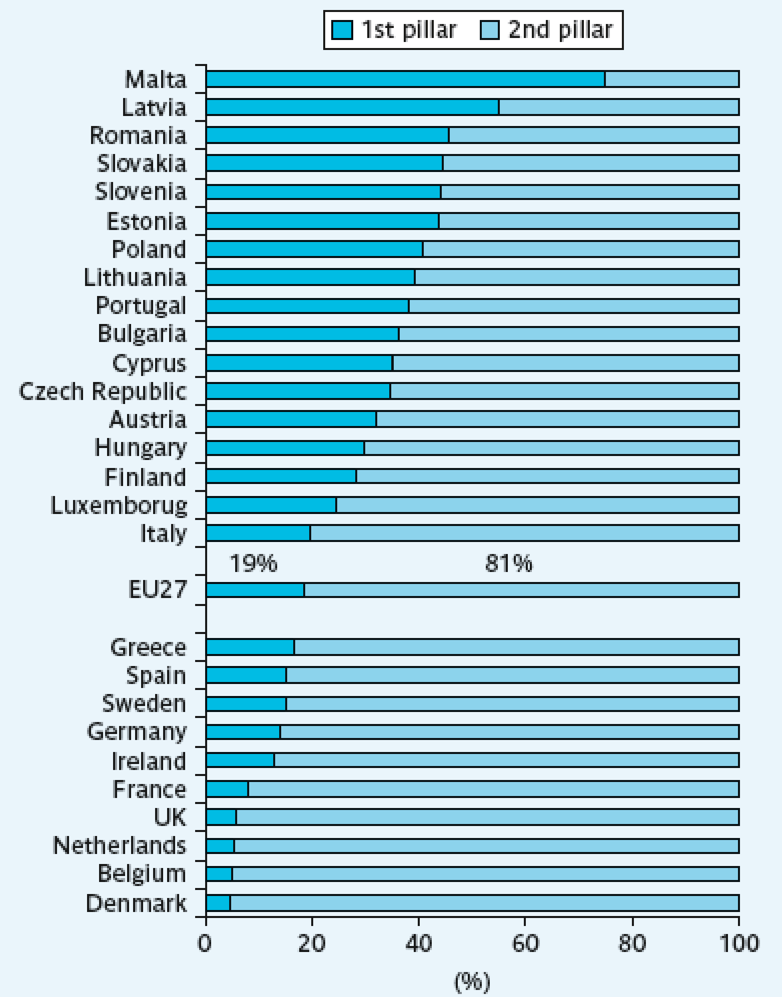


Figure 12.10 Planned spending on first and second pillars, 2007–13, by member

The first CAP Pillar

- Single Payment Scheme as backbone of the system
  - Based on historical payments in EU15
  - Money per hectare in new member states with amount limited by national ceilings

- Condition of compliance with environmental, food safety, animal welfare rules

- Exceptions and reforms in sugar, vegetable sector, wine sector

The second CAP Pillar

- Funding shift: from direct payments to rural development

- Areas covered by second pillar:
  - Quality incentives and support to meet standards and covering of animal welfare cost, technical advice
  - Improving agricultural competitiveness, sustainable land management, improving quality of life in rural areas

Remaining challenges

- Not all payments decoupled
- Continued industrial farming and pollution
- Larger landowners benefit most
  - E.g. publication of beneficiaries data by European Commission
- Farmers only get half of the support
  - Benefits input suppliers, agrichemical firms, landowners who are not farmers