The Common Agricultural Policy of the European Union

Carlos San Juan, Jean Monnet Professor. University Carlos III of Madrid

Common Agricultural Policy (CAP)

After trade, CAP is the oldest common policy of the EC/EU – and the most expensive.

Original objectives of CAP:

- increase agricultural productivity
- guarantee a reasonable standard of life to farmers
- stabilize the markets for food of good quality, at affordable prices

and more recently:

- protect the environment and the wellbeing of the animals

Common Agricultural Policy (CAP)

Basic Principals:

- a single market
- community preference
- financial solidarity

Instruments of CAP: Common Market Organizations (CMO) for almost all agricultural products

- price interventions
- subsidies and direct payments
- restrictions on quantities
- rules covering trade with third countries

Common Market Organizations: Products

- Bananas
- Cereales
- Floriculture
- Dried fodder
- Fresh fruit and vegetables
- Processed fruit and vegetables
- Lupins
- Olives and olive oil
- Flax and Hemp
- Eggs
- Pig meat
- Dairy Products
- Rice
- Seeds
- Sugar
- Tabacco
- Cow meat
- Sheep and Goat meat
- Wine
- Poultry
- Other agricultural products

Stabilizing the markets

Why stabilize agricultural markets?

- large variability of supply (depends on weather, plagues etc.).
- demand is not very elastic
- supply is not very elastic in the short run - adjustments take at least a season

$\Rightarrow$ large variability of prices, and of incomes

Public interventions (buying, storing and selling) can stabilize supply and prices

$\Rightarrow$ generate a welfare increase

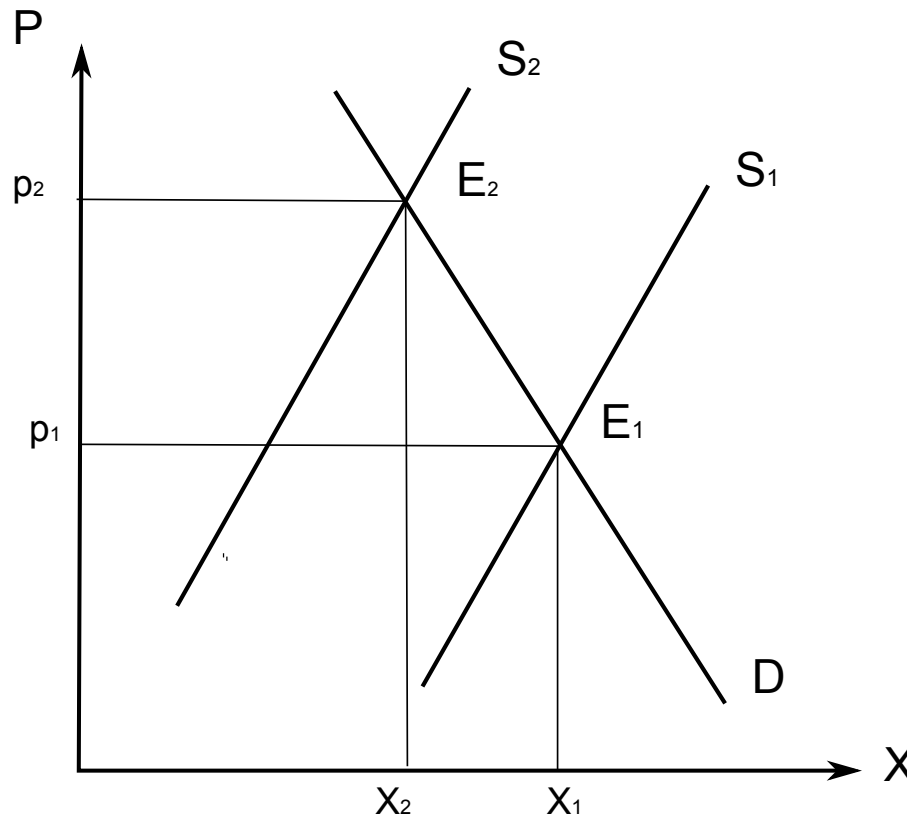
Stabilizing the markets

Equilibriums without intervention:

good weather
$\Rightarrow$ good harvest, large supply, equilibrium E_1

or bad weather
$\Rightarrow$ small supply, equilibrium E_2

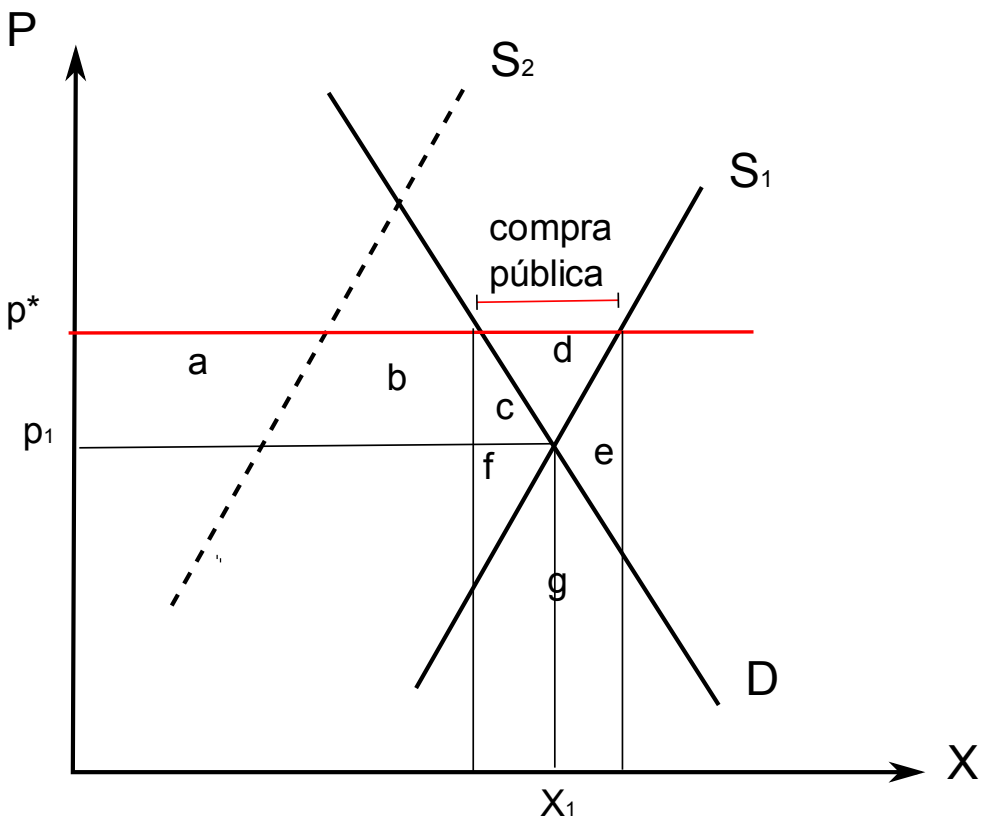
suppose that each situation occours with probability 0.5.



Stabilizing the markets

Good harvest; without intervention: very low price

CAP stabilizes an average price p^* by buying $S_1(p^*) - D(p^*)$

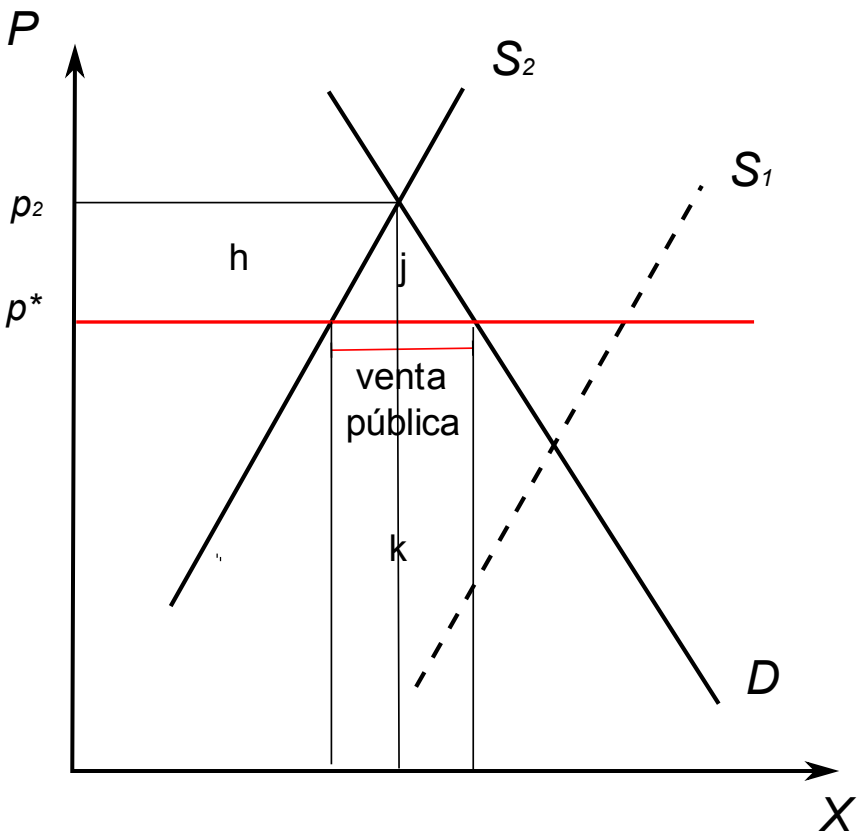


- loss of consumers surplus: **abc**
- gain of producers surplus: **abcd**
- private incomes: **+d**
- public spending: **cdefg**
- the public purchases are stored

Stabilizing the markets

Bad harvest:

Sell the stored quantities $D(p^*) - S_2(p^*) = S_1(p^*) - D(p^*)$ to reduce the price to p^*



- gain of consumers surplus: **hj**
- loss of producers surplus: **h**
- private incomes: **+j**
- public income: **k = cdefg**
- Total benefit of the intervention: $0{,}5\ \mathbf{d} + 0{,}5\ \mathbf{j} > 0$

Common Market Organizations

In practice:

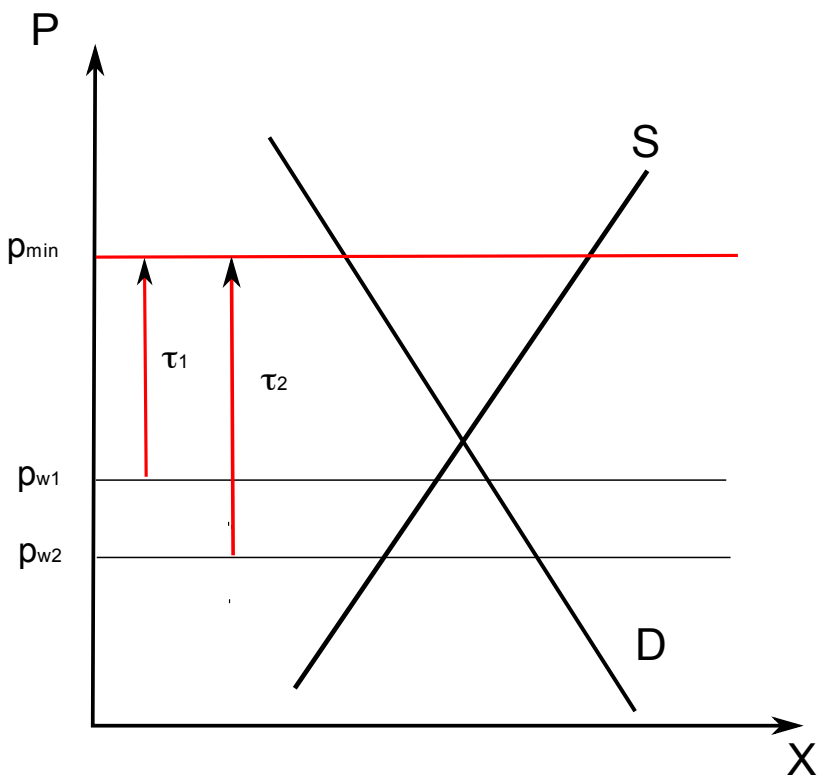
- large increases in productivity

$\Rightarrow$ progressively less need for public sales to stabilize the markets; intervention is almost always purchasing

$\Rightarrow$ public purchases aquire a more redistributive role ("guarantee a reasonable standard of life to farmers")

CMO: Import Levies

Community preference:
Minimum price of imports p_{min}



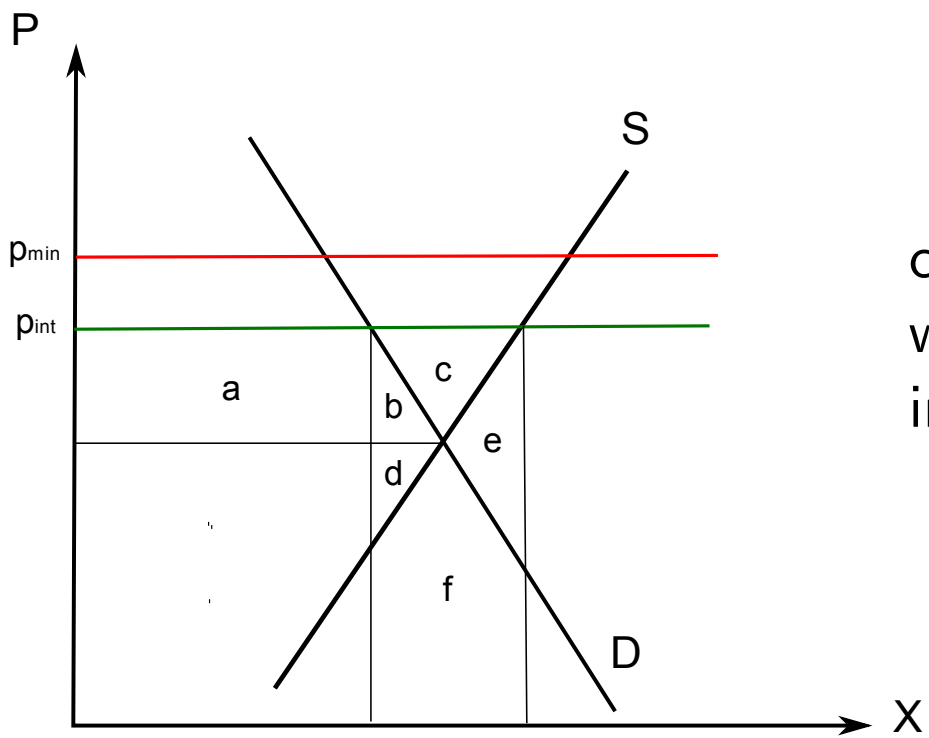
- Import levies
  = variable tariff

$$\tau = p_{min} - p_w$$

- Effect:
  p_{min} does not respond to changes in p_w,
  national market is isolated from price fluctuations in the global markets

CMO: Intervention Price

Guarantee a reasonable standard of living:
Intervention price p_{int} of public purchases



- price in market: p_{int}
- public purchases: $S(p_{int}) - D(p_{int})$

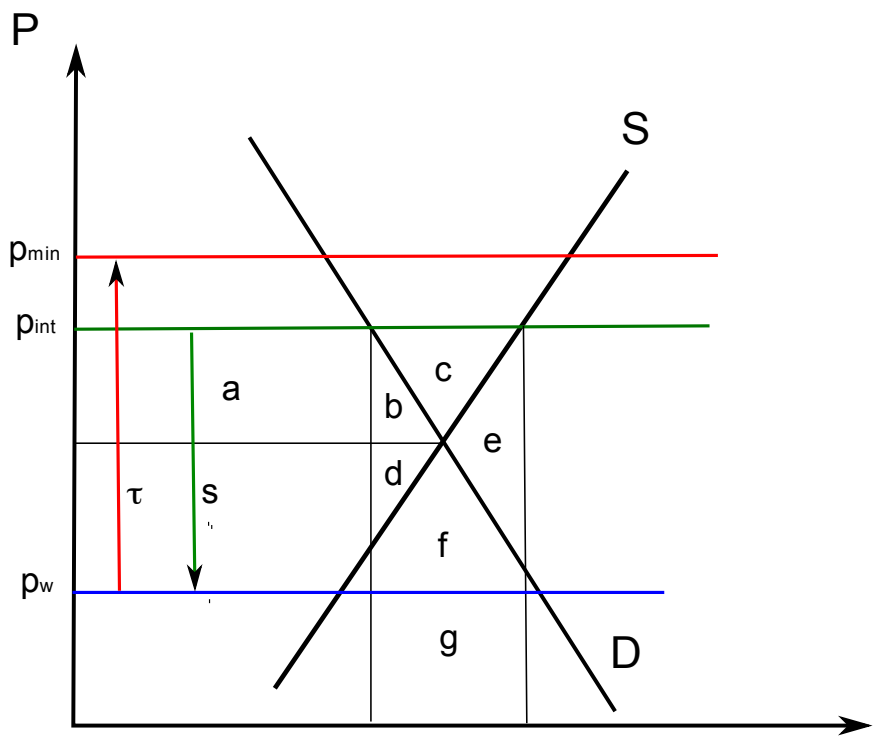
comparing with the equilibrium with tariffs but without intervention purchases:

- loss of consumers surplus: **ab**
- gain of producers surplus: **abc**
- public spending: **bcdef**
- income: **-bdef**

CMO: Export Subsidies

What to do with the purchased goods?

Export to third countries



- Export subsidies
  = variable subsidy

$$s = p_{int} - p_w$$

- public income:
  $\mathbf{g}$=p_w·exports
- income: **-bdef**

Since the EU is a large economy

$\Rightarrow$ p_w decreases due to the exports, s increases

$\Rightarrow$ competitive at any world price, exports never decrease

CMO: Consequences I

- self-sufficient in many agricultural products since the 1980s, the EU became a net exporter,
  but the prices cannot decrease
- excess production
  - storage:
    mountains of butter and meat, lakes of milk and wine etc.
    Eg.: in 1985, store of 70 kg of cereals **per capita**

    (source: Baldwin/Wyplosz 2006)
  - elimination of stores
  - exporting with subsidies, "dumping"
- high cost of purchases &/or subsidies,
  high percentage of the budget of the EC: $>$ 70% in the 1960s & 70s, $>$ 50% in the 80s and early 90s

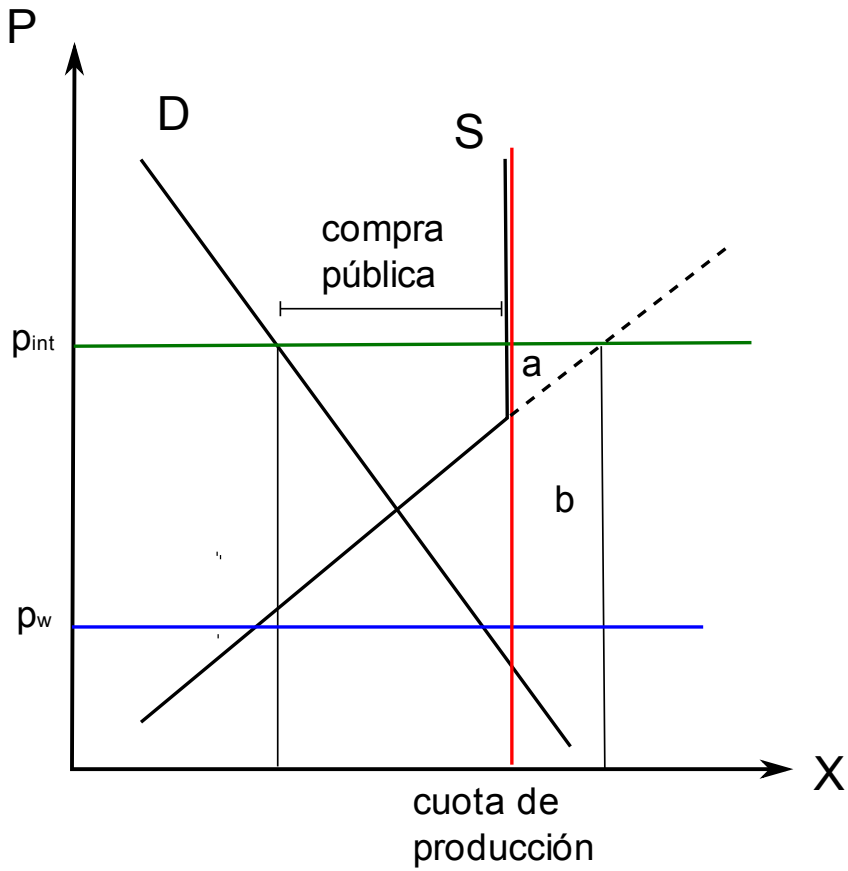
CMO: Consequences II

- distortions in global markets because of agricultural protection and subsidised exports,
  conflicts with agricultural exporters in GATT negotiations
- conflicts between net contributors and receivers of CAP within the EC
  Margaret Thatcher: "I want my money back" $\Rightarrow$ UK rebate
- intensive production $\Rightarrow$ negative effects on environment and animal welfare
- regressive redistribution between large/small farms and rich/poor consumers
  The Queen receives more than €1.5 millon, Nestle some €30 millon

  (source: Baldwin/Wyplosz 2006)

CMO: Production Limits

Pressure to reform CAP to avoid overproduction;
first modifications in 1983: limits on milk production



Compared to intervention without production limits:

- supply is reduced to the quota
- intervention: public purchase of quota $-D(p_{int})$
- consumer surplus: unchanged
- producers surplus: lose **a**
- government: saves on export subsidies **ab**
- income: **+b**

1992 reforms of CAP

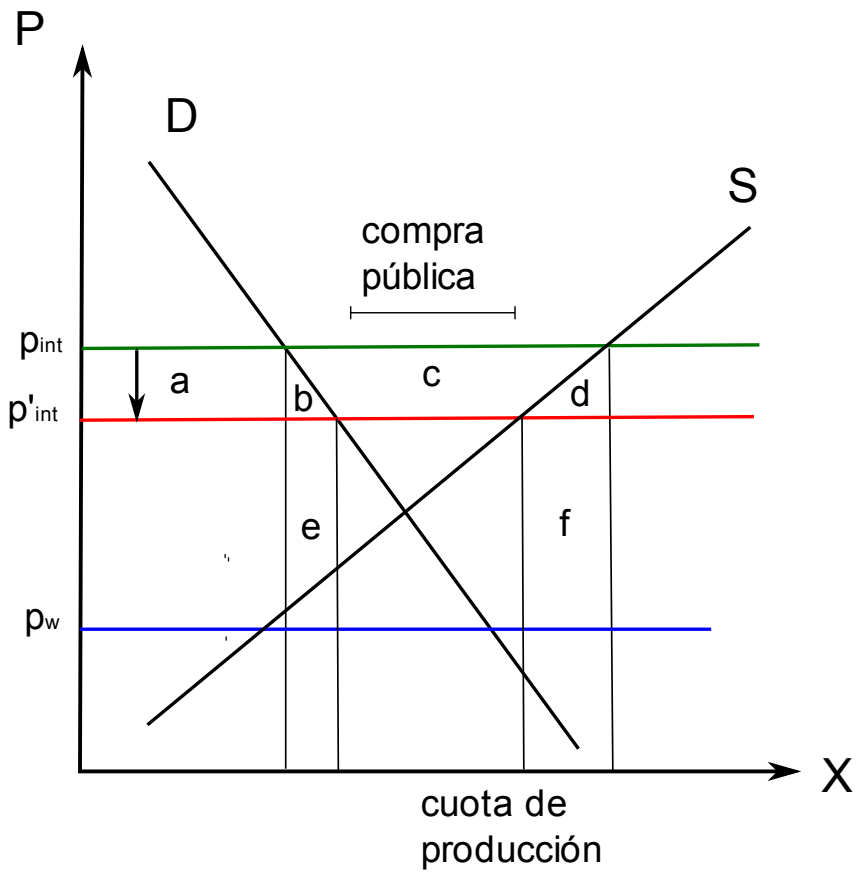
Pressure to reform CAP because of overproduction, high cost, negociations in the Uraguay round of GATT

1992 MacSharry Reforms (Ray MacSharry, Commisioner of Agriculture)

- reduction of intervention prices for some products (wheat, beef)
- retirement of a percentage of land from production (leaving it to lie fallow)
- direct payments to compensate for the resulting loss of income, but only if they continue producing the same product

CMO: Reduction in the Intervention Price

p_{int} is reduced to p'_{int}

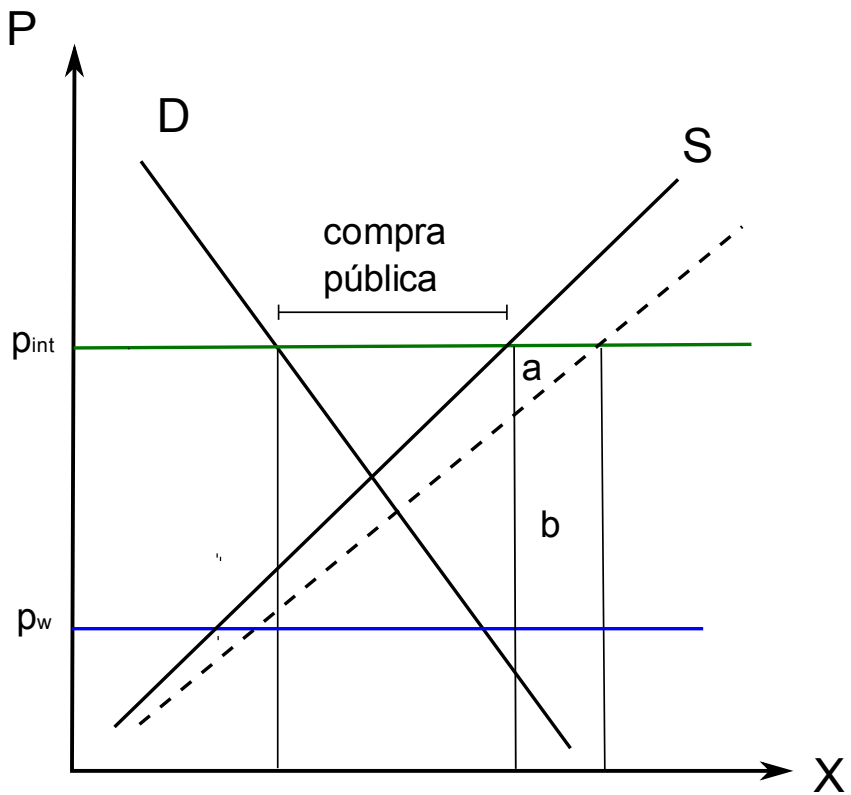


- more demand, less supply
- consumers surplus: **+ab**
- producers surplus: **-abc** compensated with public transfers
- intervention: public purchases $S(p'_{int}) - D(p'_{int})$ decrease, difference from p_w decreases $\Rightarrow$ s decreases
- government: saves **bcdef**
- income: **+bdef**

Compared with a production limit with the same effect on supply: additional increase in social welfare **be**

CMO: Retiring of land from production

Retiring x% of land in production (**we assume** the least profitable)



- supply decreases x%
- intervention: public purchases decrease
- consumers surplus: unchanged
- producers: lose **a**
- government: saves **ab**
- income: **+b**

Effect: similar to a production limit

Reforms to CAP – Agenda 2000

Pressure to reform CAP because of negociations in the Doha round of the WTO, costs still high, & environmental affects

1999 Agenda 2000

- further reduction of the prices of goods reduced in 1992
- reduction of prices also in other sectors
- "cross-compliance": environmental criterion for being able to receive the direct payments
- new element, "second pillar" of agricultural policy: supporting rural development

CAP reforms of 2003

Pressure to reform CAP from negociations in the Doha round expansion to countries with important agricultural sectors

2003 Fundamental reform of CAP, "Fischler-Reform" (Franz Fischler, Commisioner for Agriculture)

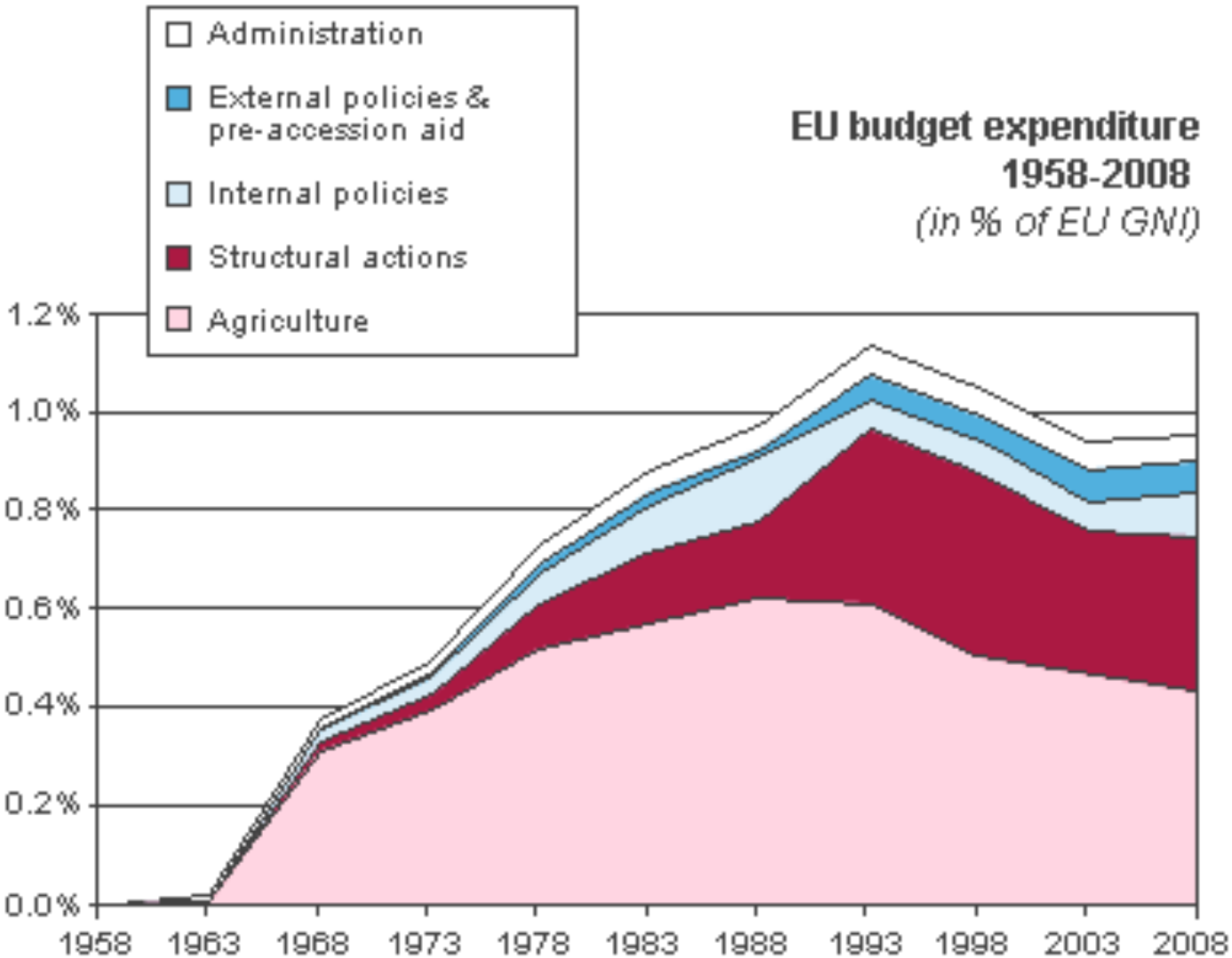
- decoupling of the production aid:
  Single Payment Scheme (SPS) replaces various subsidies and direct payments (& able to produce any product without losing the aid); calculated based on
  - payments received during 2000–2002 (historical model, in Spain) or
  - number of hectares (regional model)
- condicionality: farmers must comply with standards in environment, animal welfare and food safety to receive payments

CAP reforms of 2003

2003 other elements of the "Fischler" reforms:

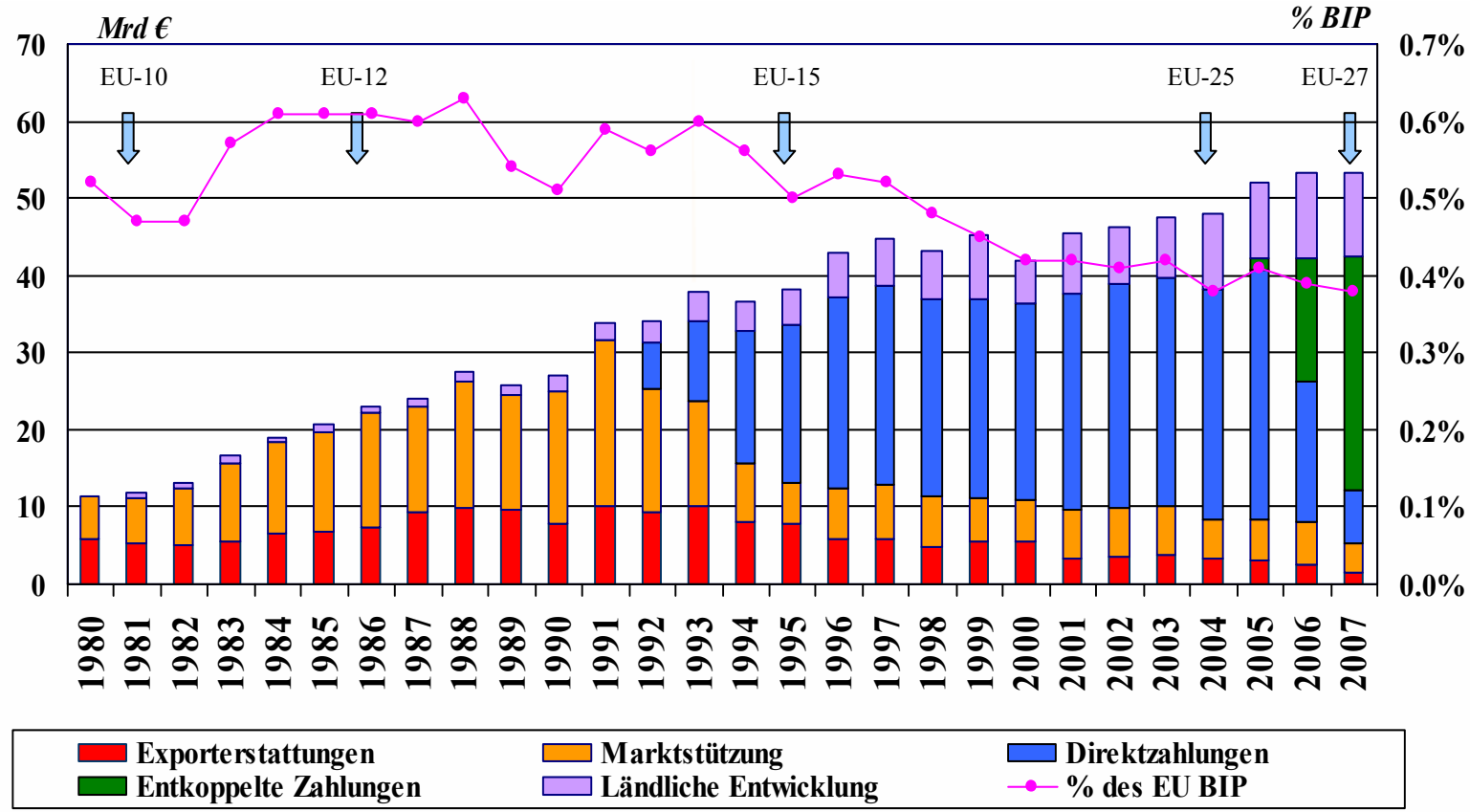
- liberalization of markets
  eg. "phasing out" of milk quotas: gradually increasing until eliminated in 2015
- however trade protection remains high
- gradual introduction of the SPS in the new member countries
- partial re-nacionalization of agricultural policy:
  - countries decide how to calculate the payments
  - can choose to maintain a relation with production

CAP reforms



source: European Commision

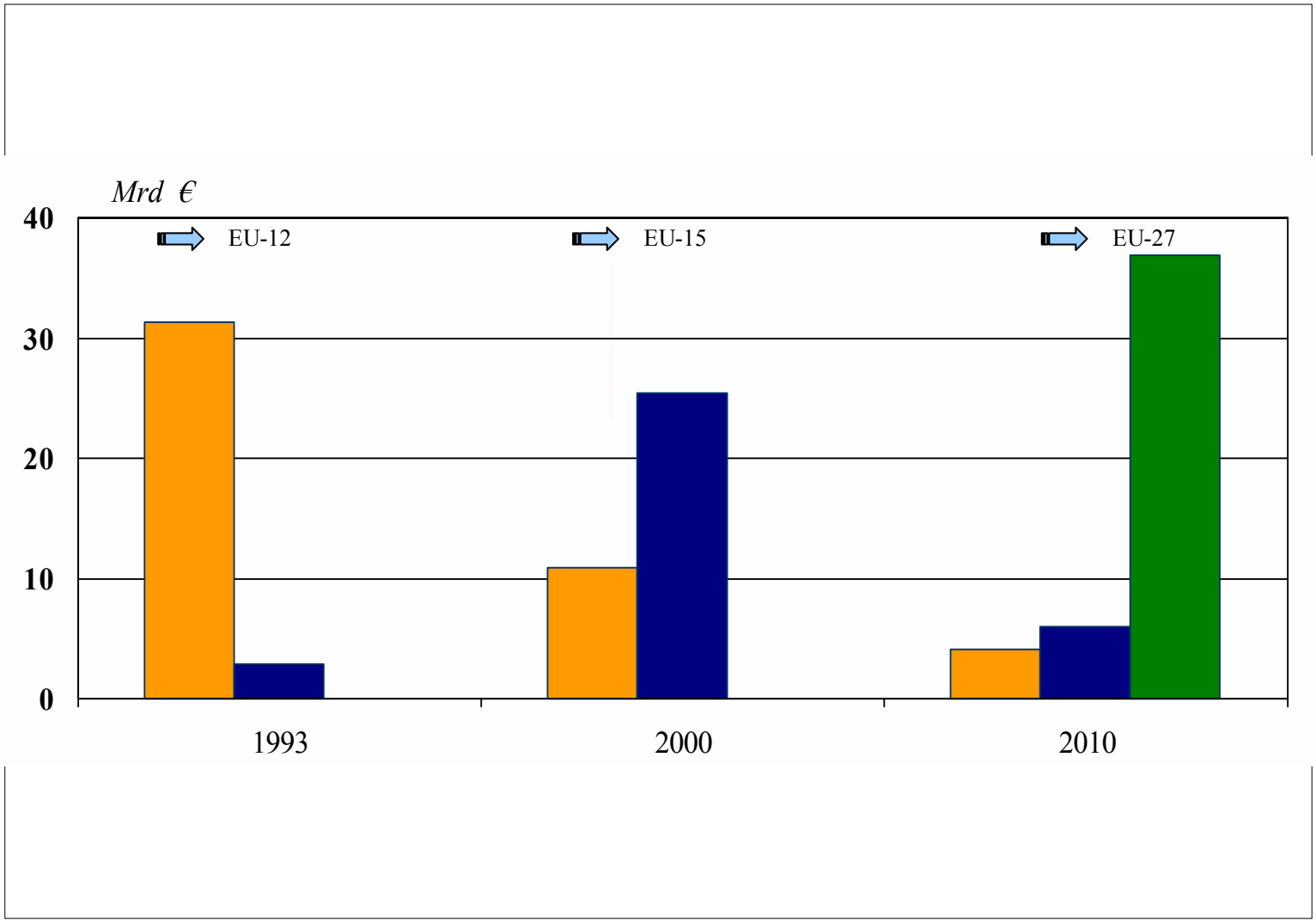
CAP reforms



red – export subsidies, orange – intervention, blue – direct payments,
green – decoupled payments, purple – rural development, line – % of GDP

source: John Bensted-Smith (2009)

CAP reforms



orange – price interventions, blue – direct payments, green – decoupled payments

source: John Bensted-Smith (2009)

CAP reforms

2006 Reform of CMO in sugar, still the most protected product (excluded from the previous reforms):
Doha requires the elimination of the export subsidies

2008 "Health Check" for the 2003 reforms, minor changes until 2013: modernize and simplify the OCM, redirect funds to rural development;
unify the seperate OCMs for the 21 sectores into a single OCM

2013 Debate over the objective and instruments of CAP in the next financing period