The Future of the CAP and Prospects for Change

The Policy Environment for Agri-food Competitiveness

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I. Introduction

The competitiveness of the European agri-food sector depends upon a number of factors both technological and economic. One of the most pervasive influences is the policy environment, and in particular the set of policies which operate on the market for agricultural goods. Of these policies the most significant is the Common Agricultural Policy (CAP) of the European Union, which has a direct influence on the cost of raw materials for the food sector. It also has a dominant impact on the trade policy of the EU in the agri-food area, and an indirect effect on the politics of food and the attitude to regulation of the food system.

In accordance with its importance, this chapter is primarily devoted to the question "whither the CAP?" Will it evolve in the direction of a rural development policy, assisting the adjustment of families to the changing environment of rural Europe? Or will it be transformed into a fortress to resist the ravages of globalization and liberalization on the weaker elements of European agriculture? Will it swing toward a strict code of health, safety, environmental and animal welfare standards, defining a European Food System more regulated than those of the Americas or Asia? Or will it crumble beneath the weight of successive WTO agreements and become not much more than a schedule of bound tariffs and some residual green box programs?

The direction that the CAP will take depends on a number of factors. It is the intention of this chapter to identify several of these and discuss their influence on the CAP. The primary pressures on the CAP come from the EU's budget constraints, and the Enlargement of the EU to include the first wave of Central and Eastern European countries (CEEC). But in addition, pressure is felt from the growing emphasis on environmental and consumer issues in the direction of agricultural policy, and the imminent next round of WTO trade negotiations. These four elements are treated separately below, but leading to a final section that attempts to bring them together.

It is difficult to predict the timing of change in the CAP. An observer is impressed with the essential continuity of the policy and the difficulty that the Commission has had over the years in moving the CAP from its appointed course. But the policy changed sharply in 1992 with a relatively short, if lively, debate; it adapted to the Uruguay Round commitments with almost no resistance; and now has undergone a further shift in advance of being forced to change by budget, WTO or enlargement pressures. Clearly, the CAP can change quickly if the conditions are right. This means that one needs a long-term perspective on the development of the CAP. This is provided in the next part of this section, which emphasizes the direction of change. But one also needs to be aware that events can cause the CAP to deviate from its path, speed up or slow down progress, or otherwise change direction. These events are discussed later in the paper.

a) Past Reforms

The CAP for many years was resistant to change.[1] With the exception of the introduction of milk quotas in 1984, the basic instruments of the CAP varied little over its first thirty years of implementation. Not that the policy did not change in detail over this time: many twists and refinements were added and complexities introduced. But none constituted "reform" as such. In fact the discussion of reform was discouraged as anti-communautaire and disruptive. Fine tuning to keep budget costs down, coupled with annual price decisions to offset (to a greater or lesser extent) farmers cost increases were the major changes to the CAP.

The first major change in the instrumentality of the CAP was the MacSharry reforms of 1992. The core of the reforms was a nominal cut of 30% in the cereal price, phased over three years, complemented by a smaller cut in the institutional prices for beef and butter. These price cuts were compensated by payments per tonne, translated on the basis of regional yields to a per hectare payment, and headage payments for cows and beef cattle.

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[1] For a discussion of CAP Reform in the period up through the 1980s see Moyer and Josling, 1990.

In addition to the price reductions and compensation payments, the 1992 reforms included a set-aside program that enabled the Commission to reduce cereal hectarage and gain control of surpluses.

The MacSharry reforms both anticipated and facilitated the changes brought about by the GATT Uruguay Round settlement concluded in 1994. The Agreement on Agriculture covered all farm products and required a 20% reduction in the aggregate level of domestic support for agriculture over a six-year period, along with a reduction of 36% in budget spending on export subsidies and a 21% cut in the quantity of subsidized exports. In addition the various types of non-tariff import protection, including the variable levy used by the CAP, had to be converted to bound tariffs, though as discussed later some element of variability still survives. Domestic support programs avoided reduction commitments if they qualified for the "green box" of minimally price distorting subsidies. As a result of the Blair House deal with the US, the compensation payments from the MacSharry reform were included in a "blue box", which meant that they were protected from reduction and from challenge in the WTO.

The importance of the MacSharry reform for internal policy was to shift emphasis away from the support of farm incomes through commodity prices to the use of a mixed system of lower support prices supplemented by compensation payments. This attempt to shift from commodity support to farmer support has significant implications for the food processing sector. It offers the promise of supplies of raw materials at competitive prices and opens up the possibility of improved market access as import barriers no longer needed for farm income support come down. The international importance of the MacSharry reform was that it enabled the EU to agree to the agricultural trade policy reform that was being discussed in the Uruguay Round, and hence allow the Round to finish.

b) CAP Reform and Agenda 2000

Any period of tranquility for the CAP after the conclusion of the Uruguay Round was short-lived. EU enlargement had been on the cards since the fall of the Berlin Wall in 1989. The prospect of enlargement of the EU to incorporate up to ten countries of Central and Eastern Europe, along with Cyprus and Malta, stimulated the Commission to come up with a blueprint for those aspects of the EU policy most affected. This blueprint was launched in 1997 as Agenda 2000. The main thrust of the document was that the budgetary implications of extending the regional and agricultural policies would be insupportable from current resources. Policy changes would be needed in advance of enlargement to enable the EU to withstand the budgetary shock. The changes in agricultural policy followed the pattern of the MacSharry reforms, extended in coverage and deepened. The proposal of July 1997 (detailed in the document of March 1998) was for further reduction in internal EU price for main commodities, to bring them closer to world prices, combined with system of direct payments to compensate farmers for some of loss incurred by lower prices. In addition to the benefits to the EU of being able to welcome new members, the Agenda 2000 agricultural component (which might properly be called MacSharry II) also promised a major advance in the flexibility that the EU would have in the next WTO round. Lower prices should make products more competitive and enable the EU to increase exports without refunds.

c) The March 11 Agreement and the Berlin Summit

A package of reform measures was agreed on March 11, 1999, by the ministers of agriculture, which included most of the elements of the Agenda 2000 agricultural policy suggestions though somewhat watered down.[2] However, as a part of the overall agreement at the Berlin summit two weeks later, this reform package was further weakened. The price reductions agreed at Berlin were 15 percent for cereals and 20 percent for beef. Compensation was agreed for these price cuts, but at a level that is unlikely to fully offset the price decline. For dairy products both the price cut and the quota increases agreed by the agricultural ministers were delayed until 2005, though some special quota incresases are to take effect next year. A number of other changes in the CAP introduced by the March 11 agreement survived the watering down by the Summit. One is the weakening of intervention, replacing the concept of a "floor" with a "safety net". In the case of beef this is set at a level well below that at which payments are made for private storage (so-called intervention B). The reduction in the intervention

[2] One aspect of the Commission's proposal that did not make it past the Ministers was for limits on payments by farm. In addition, the price cuts were scaled down a little and their timing delayed.

price for cereals also implies that there will normally be much less grain purchased by intervention agencies in the future.[3] A new devise, the "national envelope", allows some flexibility for livestock premium payments by country, albeit still within an EU funded limit.

The cereals policy changes continue in the same direction as the MacSharry reforms. The 15 percent cut in intervention price is spread over two years (rather than MacSharry's three). Compulsory set-aside for cereals is retained and "set at 10 percent until the year 2006", an apparent indication that the Commission considers this supply adjustment devise still to be needed. Voluntary set-aside is to be maintained, and made more attractive. Compensation is set at the same rate as for those who produce crops, arguably leading to a situation of complete decoupling. Oilseed and cereal payments are harmonized in three steps, thus making the reference price system redundant and removing the basis for the hectarage limits agreed at Blair House.[4] The result of these changes is to make the cereal and oilseed sectors significantly more competitive with imports and in overseas markets without subsidies.

The price cuts for beef, a twenty percent decrease in the basic price spread over three years and the introduction of a lower intervention price, are designed to make beef more competitive with imports. Tariffs on beef imports were not lowered as part of the package: this might come with the next round. A complex set of premia paid for beef cattle help shield the farmer from the effects of the price declines. Regional ceilings for premium rights have the effect of keeping stocking densities under control and introducing a form of partial decoupling of payments from output. Extensification premia are also increased to encourage less intensive livestock systems.

The milk policy which had escaped largely unscathed by the MacSharry reforms was the subject of significant change in the agricultural minister's agreement. However, the final version of MacSharry II the start has been delayed until 2006. An overall increase in milk quotas of 2.4 percent could take effect from that year. Compensation will be paid in the

[3] The monthly increments to the intervention price are also removed.

[4] Though the oilseed limits formed part of the package that allowed the Uruguay Round Agreement on Agriculture to be completed, they were introduced in settlement of the longstanding GATT dispute over the impairment of access into the EU for US and other soybeans.

form of an aid, supplemented by national envelopes (EU funds distributed at the discretion of the country), again phased in over the period 2003-05.[5]

[5] Of the other sectors, the one most directly impacted by MacSharry II is wine, where there has been a consolidation of previous legislation. Preventive distillation, compulsory distillation and support distillation are each abandoned, but a new crisis distillation option is introduced. The effect on the competitiveness of the sector is likely to be minimal. Sugar was deliberately left out of the "reform" package once again, but may well come under scrutiny in the next WTO round. Fruit and Vegetable regimes have recently undergone changes of their own. Pigmeat, Poultry and Egg regimes are now largely operated by tariffs at the border. In addition, the March 11 agreement gives an encouraging reference to the need for developing the rural development policy as the second pillar to the CAP, though little of any substance is specified.

II. The EU budget

Agriculture spending and its impact on the size and shape of the Community's budget has been an ongoing issue. The Commission noted in 1981 that agriculture spending was growing faster than the growth of the Community's budgetary resources (Fennell, 1997, p.165). Having reached 68% of total spending in 1985, the burden of the Common Agricultural Policy has since declined below 50% of the budget. This happened as the Commission managed to control spending on the Common Agricultural Policy, especially as to reflect the diminishing share of the agricultural sector in the overall economy. Since 1988, the annual rate of increase of the 'agriculture budget guideline' has been limited to 74% of the growth (nominal increase) of EU GDP, and this constraint has become increasingly strong as economic growth has slowed in the early 1990s (Ockenden and Franklin, 1995, p.20). The decline in agriculture's relative budgetary importance has been accompanied by a marked increase in the proportion of the budget dedicated to the Structural Funds, which finance the regional and social policies designed to raise employment levels and close wealth gaps between EU regions. Presently, one third of the budget is spent via the Funds, compared to one sixth in 1988.

The nature of the budgetary pressures will be changing as a consequence of the 1992 reforms. The compensation of expenditure has shifted and this trend will continue in the future. As the cost of support shifts from the consumer to the taxpayer, the short-term goal of the Commission is to increase the size of the agricultural budget. Only in the long term will the reform bring about reductions in the EU agricultural finance. In the mean time however, as support is no longer done through higher prices but through direct payments, future increase in the CAP budget are likely to be politically difficult to achieve. In addition, two important pressures will affect the future CAP budget. One will come from the cost of continuing to reform the agricultural policy, the second will be related to the prospect of absorbing new applicants to the Union. EU spending and its distribution among Member States will be significantly affected by enlargement. Given that the applicant countries have relatively low levels of income, they should be expected to be large beneficiaries of spending under the Structural Funds. At the same time, the proposed reform of structural actions will also lead to greater concentration of resources that may affect the distribution of spending among the current 15 Member States.

a) *Budget Reforms and Agenda 2000*

While following the logic of 1992 MacSharry Reforms, the reforms planned under Agenda 2000 are based on a much tighter control of EU spending. Whereas agriculture is expected to continue to be constrained by the so-called "agriculture guideline," other categories of expenditure should increase much more modestly. In global terms, the reform is expected to lead to an initial increase in CAP spending until 2003/2004 followed by stabilization as implementation of the reform is completed. EU spending should not exceed 1.22% of GNP in 2006, with spending in the original Members being kept at 1.10%. Maintaining the own resource ceiling is the Commission's response to wanting to impose on the Community's expenditure the same budgetary discipline that will be required for Member States to support sound economic growth. Even subject to this limit, the economic growth expected should generate additional resources by 2006 in an enlarged Union of around ECU 20,000 million at 1997 prices. This would leave a margin at the end of the period between total appropriations for payments and the own resource ceiling. This margin will be necessary to cover requirements should economic growth turn out lower than expected and also prepare the completion for transitional arrangements applying to the first countries to join and for the accession of the other applicants.

While maintaining the agriculture guideline beneath the ceiling should save EC 3,700 million by 2006 in market intervention expenditure and export funds, direct compensatory aid will, by the same date, cost an extra ECU 7,700 million. Expenditure on new rural development measures and across-the-board measures for fisheries will be added to the existing accompanying measures (agri-environment, re-forrestation, early retirement) at a cost of ECU 1,900-2,100 million. Pre-accession aid is determined at some ECU 500 million a year for modernizing agriculture in the applicant countries. Expenditure connected with the accession of a first wave of new Member States for market organization measures, accompanying measures, and specification modernization aid totaling ECU 1,700 million immediately upon accession should total ECU 3,900 million at the end of the period. Resources available for the entire period would represent a total of ECU 275,000 million (1997 prices).

b) Renationalization of the Budget?

Since the introduction of direct payments in 1992, considerable budgetary discord in the EU has revolved around the issue of subsidiarity and the idea that some elements of the CAP should be funded by national governments (Ockenden and Franklin, 1995, p.22). The budgetary issue is controversial considering the fact that there is a significant difference between the Member State's share in the marginal financing of the EU expenditure (i.e., their share in EU GNP) and their share in CAP expenditure. Recent discussion of budgetary imbalances have drawn attention to the relative prosperity of Member States and to the possibility of granting a budgetary correction to a Member States experiencing a severe imbalance in relation to its relative prosperity. In this respect, the performance of the compensation mechanism for the United Kingdom set up with the 1984 Fontainebleau agreement is questioned by Member States and the legitimacy of the decision is being reviewed. As the Commission reports, the British rebate distorts the whole system of contribution. The UK has 16.1% of the EU GNP and pays 11.9% of the budget. In contrast, Germany has 26% of the EU GNP and pays 28.2% of the budget costs, Greece 1.5% and 1.6% respectively, France 17.2% and 17.5%. The only other country with a disproportional share of the budget is Italy with 14.2% and 11.5%.

The factors which have played the greatest role in determining the trend of the UK rebate and its fluctuations from year to year have been the differences between the rate of growth of the UK economy and that of the other Member States and the instability of the exchange rates. Since the end of the 1980s, the economic cycle of the UK has been markedly different from that of the rest of the Union. In addition, the pound sterling has greatly fluctuated vis-à-vis the other European currencies between 1992 and 1997. While the rebate mechanism has been effective over the years in reducing significantly the UK's budgetary imbalances, it is now argued that the conditions that prevailed at the time the mechanism was decided do not apply anymore. In addition, the budgetary imbalances of the UK are no longer unique. In recent years, four more countries -Germany, the Netherlands, Sweden, and Austria- have had budgetary imbalances as large as the UK's. The prospect of enlargement to include poorer countries from Eastern Europe also calls for reform.

c) Current Debate

Current budgetary discussions are of particular importance due to the implications the eastern enlargement will have on budgetary balances. During the period 200-2006, the Commission is not expecting any changes in the relative budgetary position of the current Member States. This might however warrant requests for corrections as the new accessions will inevitably mean deterioration in the budgetary position of the current Member States. The German six-month presidency of the European Union was expected to bring fundamental reform to the CAP as farm reform was one of the most fundamental elements of Germany's plans for the needed restructuring of EU financing.

The Agenda 2000 negotiations were expected to be difficult, angering Europe's powerful agricultural lobby and pitching countries which otherwise have interests in common against each other. In this respect, the political agreement reached on Agenda 2000 with respect to agriculture came as a much-needed yet surprising consensus. While cuts in prices guaranteed to farmers for beef, cereals, and milk will be phased out, farmers will be paid directly instead. The other surprise came as the Germans decided to abandon "co-financing," a scheme under which national governments would have shared the costs of subsidizing farmers in their respective countries. German's proposal was directly linked to its wish to substantially reduce its net contributions to the EU budget from the present DM22bn a year. This figure puts Germany by far as the biggest contributor to the EU budget.

III. Enlargement

In June 1993, at the meeting of the European Council in Copenhagen, the EU held out the prospect of full membership to ten Central and Eastern European countries (CEEC). Each of these had signed Europe Agreements that were meant to prepare the economic path for membership. At the time, the process by which to integrate the largely agricultural economies of Poland, the Czech Republic, Slovakia, Hungary, Bulgaria, Romania, Estonia, Latvia, and Lithuania was left undecided (Ockenden and Franklin, 1995, p.70). Yet, the prospective eastern enlargement, which is now thought to happen by 2003 at the earliest, presents a significant challenge for the CAP and the likely course of agriculture in the EU. The budgetary costs of extending the CAP to the CEEC, as well as the prospect for integrating the CEEC in conformity with GATT trade commitments, raises the question of how such pressure will allow a continuation of the current CAP. If the CEEC were to adopt the current CAP, higher prices would result, thereby raising serious budgetary problems for the EU as well as causing the expanded EU to exceed its WTO commitments. This realization led the Commission to the view that, in order to integrate the CEEC, the EU will need to reform the CAP first.

a) Agriculture in the CEEC

In the applicant countries of Central and Eastern Europe, agriculture is relatively more important than in the EU in terms of area, contribution to GDP, and especially share of total employment. On average, over 22% of the workforce in the CEEC is employed in agriculture for a total of 9.5 million workers, compared to 5% or 8.2 million in the EU. Agriculture contributes 9% to the GDP of the CEEC compared to 2.4% in the EU (European Commission, 1998, p.326). With enlargement, the Union's agricultural area will increase by 60 million hectares (ha) to close to 200 million ha. Of the 60 million ha, two thirds will be arable land, adding 55% to the EU's existing arable area of 77 million ha. The agriculture labor force projected at around 6.6 million in 2000 for the existing EU will be expected to at least double, with the average available agriculture area per person employed in the candidate countries being 9 ha compared to 21 ha in the existing EU.

The reforms of 1990-1992 designed to transform the CEEC from centrally planned to market economies have undoubtedly obscured the true agricultural potential of the region. The consequent liberalizing of prices, production, and trade that resulted from abandoning central planning caused a sharp contraction in income and led to a fall in consumption of most foods, especially meat. Falling demand, combined with input prices rising much faster than output prices (input prices have tended to move to world market levels while agricultural output prices have tended to stagnate or rise much less in the face of falling demand) resulted in lower output. While there have been some signs of recovery since 1993-1994, in particular in the crop sector, agricultural output in most candidate countries is still much below pre-transition levels. Slow recovery is mainly due to major initial structural handicaps such as definitive settlement of property rights, capital constraints, and inefficient downstream sector.

An important consequence of the CEEC market reforms has been a deterioration of the balance of trade between the CEEC and the EU. The significant drop in agricultural output has reduced export availability to the EU, which for many candidate countries is the most important agri-food trading partner. At the same time, increased agriculture and food imports of the CEEC from the EU have grown significantly after the reforms. The CEEC's growing imports from the EU are partly due to shifting consumer preferences in the region towards products such as tropical commodities and western style processed food (Buckwell and Tangermann, 1997, p.326). The growing trade imbalance is also caused by the pronounced differences in protection rates that exist between the CEEC and the EU. While support to agriculture has slightly increased in the CEEC through intervention and border measures, in most cases support prices are still lower than in the EU. In addition, farm gate prices in candidate countries are in general substantially lower than those in the EU. In 1995, farm gate prices in the candidate countries were in the range of 40-80% of the EU level. The highest prices were generally for cereals, oil seeds, and protein crops, while the gap was larger in relative terms for beef, milk, and dairy products, sugar beets, and certain other vegetables and fruit.

While the initial impact of market reforms has led most of the CEEC recently to experience declines in agriculture output and to become net importers of agricultural and food products, the weight of the CEEC agriculture sector will nonetheless be a true challenge to the CAP in the future. Indeed, while the increases in population and agricultural area are in proportionate terms comparable to the 1973 enlargement of the

EC from six to nine, the absolute number of CEEC involved makes this enlargement of a different order than all previous ones (Buckwell and Tangermann, 1997, p.310). Also, the gap in income levels and the increase in the agriculture population will pose much larger problems than previously. Integrating these economies will result in a much larger increase of the agricultural sector compared to the overall economy. In the coming years, the large differences that exist between the candidate countries and the EU in terms of protection levels, gaps in agricultural prices, legislation and implementation of Internal Market requirements will make it difficult for a number of countries to apply the acquis communautaire without some form of transitional measures. Considerable adjustment pressure will be imposed on the candidate economies as they adopt the CAP, as well as on EU members as they seek the means to finance and compete with the CEEC's agriculture sector.

b) Impact on EU budget

In the agricultural sector, extension of the CAP in its present form to acceding countries will likely imply an important yearly cost. Actual estimates of the budgetary cost of extending the CAP to the CEEC vary from 2.4 billion ECU to more than 37.6 billion ECU.[6] The Commission's own figures come somewhere in the middle of this range.[7] Assuming a hypothetical scenario of all ten associated countries joining in 2002 and fully applying the CAP in its current form, the European Commission estimates that the budgetary impact of enlargement would represent an additional cost to the EAGGF Guarantee section in the order of 11 billion ECU per year by 2005. Of the total increase, direct payments would be close to 7 billion ECU and the accompanying measures (agri-environmental action programme, afforestation, and early retirement) 1.5 billion ECU. Market support measures (essentially intervention and export refunds) for the CEEC would cost up to 2.5 billion ECU, largely absorbed by the dairy sector. Enlargement

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[6] Explanations for the wide range of the estimated cost of enlargement are mainly due to assumptions regarding the year of accession, the commodities analyzed, the elements of CAP included, the EU support levels, world prices, the supply response, the technology progress and economic growth in CEEC, and the extent to which URAA constraints have been incorporated in the analysis. (Hartmann, 1992, p.70)

[7] Data used in this section are primarily drawn from the information provided through summary reports and impact studies done by the European Commission and which can be found at the European Commission Web site under DGVI.

would however have greater budgetary implications if new Member States are eligible for compensatory aids. Extending compensatory payments to farmers in the new Member States would represent about 2/3 of additional expenditure. As a result, the agriculture guideline would not suffice to finance additional expenses induced by enlargement (i.e., intervention measures on markets and accompanying measures), even when taking account of the envisaged reforms of the CAP.

Whether CEEC farmers need compensation even though they are not supposed to suffer a loss of income in acceding to the CAP is a topic of much debate. Since CEEC farmers will enjoy a price rise on accession, and not a fall, it has been argued that compensation is unjustified (Brittan, 1999). Paying aids to the CEEC will only add tremendous pressure on the budget. While excluding new members from compensations that benefit the rest of the EU members might be inconsistent with the principle of *acquis communautaire*, the nature of the payments will most probably have changed in the future. Indeed, if compensation payments continue evolving - as they appear to be - to become social, regional, or environmental supports, claims that CEEC farmers are ineligible will be more difficult to make (Buckwell and Tangermann, 1997, p. 329). As the CEEC are strong candidates to receive such payments large flows of funds should then go toward them.

In the end, integrating the CEEC will likely renew the debate toward reviewing compensation schemes. Net contributing members will likely argue on the basis of subsidiarity, arguing that it is logical that nationally determined rates be financed nationally. Poorer countries will likely argue that richer countries will distort markets by providing more generous support to their farmers. The outcome of such debates will make a big difference to the impact of the CAP in the CEEC as well as the access of the CEEC to the CAP (Buckwell and Tangermann, 1997, p.330).

c) Implications for the CAP

Aside from budgetary constraints, other difficulties will arise over acceding CEEC economies to the CAP. As stated previously, the CEEC agricultural production is high relative to the EU and will most likely increase in the long term after the initial effects of the economic reforms dampen. As the CEEC are natural producers of the principal products of the CAP, they will pose problems for the EU's agricultural policy, whether as partners or as competitors (Ockenden and Franklin, 1995, p.74). First, any imports from the CEEC into the EU is likely to displace domestic production, which will then have to be purchased and stored in the EU, or exported with subsidy. In addition, there is the potential for increased competition on particular areas of the Union or Member States (Fennel, 1997, p.417). Given the location, climatic conditions, as well as the range of commodities of some of the CEEC, any negative impact might be felt disproportionately in the Southern Member States whose agricultural structure and level of productivity is the weakest of the Union. The Cohesion Fund policy is already an issue as special funds are attributed to Greece, Portugal, Spain, and Ireland to improve their infrastructures. The accession of the CEEC to the Union is likely to require a revision of the cohesion policy as well as what will be the adverse effects on the existing recipients of the funds.

As partners, the CEEC will force the EU to accommodate both enlargement and WTO commitments. To date, most of the CEEC are already members of the WTO and thus signatories of the Uruguay Round Agreement on Agriculture (URAA). Yet, the base period for subsidized exports already gives the CEEC little latitude and some countries have on occasions already exceed their URAA commitments. In addition, from the projections made by the EU Commission for the main commodity markets, adoption of the EU *acquis* will tend to increase surpluses in most sectors of the candidate countries. As CEEC export quantities rise in the future, so might their attempts to increase their import protection. This would put a severe strain on the EU's own subsidized export volumes and raise the question of how CEEC and current Members States will harmonize their WTO commitments.

There are three possible ways by which member states could align their domestic support and minimum access policies as well as the value and volume of their subsidized exports. First, EU members could reduce their own subsidized exports to make way for the CEEC. Second, the CEEC, as part of their entry conditions could be imposed strict production controls thereby creating slack in their individual URAA schedules. Third, the EU could try negotiating higher export subsidy volumes with other WTO members. Of the three scenarios, the last one seems most unlikely. As foreseen under the Uruguay Round, while further agricultural negotiations are planned by the year 2000, future negotiations should revolve around the nature, size, and timing of further cuts in domestic agricultural supports, import tariffs, and subsidized exports (Buckwell and Tangermann, 1997, p.328). As WTO constraints further prevent the enlarged Union to sell its surpluses on third world markets, there is little guarantee that WTO partners will offer the EU the opportunity to renegotiate its Uruguay Round commitments. Instead, the combination of problems posed by the integration of the CEEC is very likely to prompt the EU to reform its policies, including adjustments in present support schemes with more focus on direct income support as well as rural development. As suggested in the Agricultural Strategy Paper of 1995, this plan should in fact be the medium term strategy of the EU (European Commission, 1995).

IV. The Greening of the CAP

Originally, the primary concern in the EU was to increase productivity and farm income, stabilize markets, achieve food security, and permit the free movement of goods among Member States. Little concern was given to the impact of production, including agriculture activities, on the environment. In the Treaty of Rome of 1957, which established the European Community and laid down the foundations of the CAP, nowhere is the word “environment" mentioned. Over the years however, provisions in favor of the environment have been introduced in legislation as political attention has shifted increasingly towards environmental problems. Although various policy implementations in favor of the environment were made beginning in the 1970s, the most influencial factor in legitimizing the improvement of environmental quality was the Single European Act (SEA).

The SEA, which was designed to amend the Treaty of Rome to speed up decision-making, not only resulted in facilitating the creation of a single European market, but also introduced a number of important changes in Community Environmental policy and policy-making. The Treaty of Rome, by not explicitly calling for environmental protection, had failed to provide EC policy-makers with a framework for balancing the environment with other goals, including that of integrating European economies. As a result, differences among national regulations for food labeling, processing, and food composition, presented a recurrent source of trade frictions within the EU (Vogel, 1995, pp. 56-97). The SEA, rather than simply removing trade barriers as laid under the Treaty of Rome, associated for the first time harmonization with the improvement of environmental quality.

The impact of the SEA and the renewed emphasis on the environment also led to important policy statements by the Commission in regards to the future development of the CAP. In the Green Book “Common Agriculture Policy Perspectives” (July 1985), the Commission acknowledged that the protection of the environment should be one of the major functions of agriculture. The Book drew a clear line between giving financial incentives for the provision of environmental amenities by agriculture and the necessity to diversify agricultural income sources. In addition it sought to combine extensification of agriculture production with the need to control agricultural surpluses. In the document "Our Farming Future" (1988), the Commission called for rules limiting some damaging agricultural practices and encouraging practices with beneficial effects on the environment. These rules were to be accompanied by incentives or compensatory measures.

The increasing focus on integrating environmental protection in all EU policies and on combining environmental requirements with agricultural production were linked in part to the fact that the CAP has often been criticized for the decline in the environmental quality of the European countryside. Intensification of land-use has created environmental problems through the increased use of fertilizers, pesticides, water resources, equipment, and additional feeds of livestock. In 1992 a new political push was given when the Commission adopted the Fifth Environmental Action Programme, with agriculture as one of the five target sectors. The idea emerged that environmental policies should be combined with agricultural market and income policies in a mutually beneficial way and become an important pillar of the CAP. When CAP reforms were discussed and approved the same year, efforts were made to overcome the externalities associated with agricultural price supports (intensive production) as well as to incorporate positive environmental aims among the objectives of the CAP. In regards to the 'structural aspects' of the CAP, it was recognized that concern for the environment should also become a major component of the Community's rural development strategy.

The 1990s have seen no diminution of the environmental and health pressures for further change of the EU agricultural production system and the policies that drive it. Proposals for major reform towards a greening of the CAP have already been set out under Agenda 2000. Under the new framework, the "European model of agriculture" should be strengthened in two ways. First, by basing payments support to farmers on return for the provision of environmental services. Second, by maintaining a living countryside and protecting Europe's rural heritage, making rural development the second pillar of the CAP. As a result, the CAP now seems to embody a series of schemes that indicate the beginning of a process of transforming itself from essentially an agri-food policy to a rural environment and rural development policy (Baldock and Lowe, 1996, p.301). A second conclusion is that although the new instruments under the CAP take better account of the environment, it is still too early to measure their effects. The demand for higher environmental and food safety standard are likely to continue playing a major role in the already difficult discussions of agricultural trade, both at the EU and at the world level.

a) Improvement of Environmental Framework of CAP

The 1992 CAP reforms were intended to make the agricultural sector more competitive through a switch from price support to direct payment as well as to combine the control of agricultural markets with extensification of agricultural production (Scheele, 1996, p.4). The main consideration underlying the encouragement of farmers to use less production intensive methods was to reduce the impact of agriculture on the environment as well as the creation of unwanted surpluses. The core of the Commission's strategy was the introduction of an environmental scheme that combined the extensification of Common Market Organizations (CMOs) with specific measures tailored to the situation of individual Member States. The measures, commonly referred to as 'accompanying measures,' included an agri-environmental program (Regulation 2078/92), a measure of afforestation of agricultural land (the forestry aid scheme, Regulation 2080/92), and an early retirement system (Regulation 2079/92) (Baldock and Lowe, 1996). In the CMOs for cereals and oilseeds, reforms led to obligatory set-aside of land and to a general extensification of crop rotations. In the beef sector, the premia were made conditional on respect of maximal stocking rates. Additional financial incentives were granted to less-intensive farmers with stock levels that do not exceed 1.4 livestock units (LU) per hectare. The market regime for fruit and vegetables was changed to require producers to promote integrated pest control and adopt other environmentally friendly production techniques.

The agri-environmental scheme under Regulation 2078/92 was designed to encourage farmers to fulfill an important function as stewards of the environment and the countryside by remunerating farmers on a contractual and voluntary basis for the provision of environmental services and the use of environmentally sound practices. Promotion of farming practices compatible with the environment includes payments for the rearing of local breeds in danger of extinction, the cultivation of plants endangered by genetic erosion, and the maintenance or introduction of organic farming. Payments are also provided to ensure the upkeep of abandoned farmland in rural areas and the management of land for public access and leisure activities. The agri-environmental scheme is complemented by a scheme providing for 20-year set-aside for ecological purposes as well as measures designed to improve the training of farmers with regard to farming and forestry practices that are compatible with the environment.

Due to the diversity of natural and agricultural structures, agri-environmental measures are implemented by zonal programs at the Member State level. Farmers participating in the zonal programs are paid in return for associated income losses. The scheme requires that farmers engage themselves for at least 5 years, except for the set-aside scheme where the time period is 20 years. The upper limit of the premia which are granted on an annual basis are defined by the regulation while specific premia which are set up on a regional basis must be justified by calculations provided in the context of zonal programs. Since 1993, the Commission has notified 163 zonal programs for adoption, and 152 programs have been adopted.

While pursuing the same objective of control on agricultural markets with new attention given to the environment, the 1992 CAP reforms also reflected the sentiment that enough farmers must be kept on the land in order to save the natural environmental and traditional landscapes. The EU policy was motivated primarily by the fact that although it represents only 2% of total GDP and a share of total employment of 5.3%, the agricultural sector remains the major user of the available land in rural areas. Defined as those with a population density of less than 100 people per square kilometer, rural areas in the EU are inhabited by 17.6% of the total EU population, and account for over 80% of the total territory. In addition, more than half -56%- of EU agricultural land is defined as Less-Favored Areas (LFAs) because difficult natural conditions in these areas result in low agricultural productivity. As agriculture remains a dominant influence on the rural environment, the EU sought to develop rural areas to ensure that Europe’s rural heritage does not decline in parallel with its traditional economic base. The EU also introduced a territorial dimension to its interventions as to enable agricultural holdings in these LFAs to also benefit from direct aids and specific measures.

b) Consumer Safety and Technology

While the consumer voice in Europe, insofar as agriculture is concerned, has generally been weak and poorly focused, growing concerns over food safety have emerged as important and highly contentious issues in the European Union. During the last two decades, European consumers have been exposed to a number of food contaminations. The most talked-about illness outbreaks were traced back to botulism in nut-flavored yogurt, methanol in wine, salmonella in poultry, eggs, and powdered milk, lead in milk powder, benzene in bottled water, listeria in cheese, and the use of illegal hormones in beef cattle (Vogel, 1995, p.44). Also, a particularly contentious issue has been the extent to which the use genetically modified organisms (GMOs) in the food system is harmful to consumer health and to the environment. Concerns with transgenic crops, such as those with herbicide resistance implanted in their genetic make-up have centered around the possibility of unpredictable crosses with species and hence the development of herbicide resistant weeds (Josling, 1999). An additional fear is that consumers that suffer from plant-related allergies may react to the presence of genes from those plants to which they are allergic (IPC, 1998).

Historically, the European Commission paid relatively little attention to questions of food hygiene, focusing instead on food composition and labeling (Vogel, 1995), p.45). In the future, the impact of public perceptions about the quality of products combined with a growing demand for higher food safety standards will play a determining role in the evolution of farming practices as well as agriculture policies. Public concerns about food hygiene and the adequacy of national controls will pose an important challenge to intra-Community trade and also represent an important economic challenge to both farmers and food producers. Beginning this year for example, public demand for animal welfare and safer food led new and expensive rules on pig raising in the United Kingdom. As other European farmers have not yet been faced with the same regulations, the selling prices of the British farmers are higher, reflecting the added costs of providing “safer” food from "contented" pigs. As other European farmers move in to provide the British market with cheaper pig meat and byproducts, British farmers protest that shoppers seem to be willing to pay less for food produced to lower standards elsewhere.

With the growing internationalization of the food industry, new products emerging from the mastery of biotechnology also result in trade conflicts over food safety issues. The conflicts arise from differences in regulations, which are imposed on food trade in order to protect plant, animal or human health from disease or other affliction as a result of trade. Recently, the most contentious EU agricultural trade issue has been with the US in the area of Sanitary and Phytosanitary Standards (SPS) and other technical barriers to trade. The issues include disputes over the import of hormone-treated beef into Europe, the potential EU ban of beef by-products ("specified risk materials") that may harbor vectors of Bovine Spongiform Encepalopathy (BSE, or Mad Cow Disease) and that over the regulation of the use and labeling of GMOs (Josling, 1999). It is likely that the issue of Bovine Somatotropin (BST) in milk production will also raise trade problems, as it is legally used in the US but may not be in the EU.

New technologies are an increasingly important element in forming the background to future agricultural policy due to their impact on yield levels and on food health. Yet, new techniques and their implications for health and safety issues are controversial. Even where the science is sound and the benefits to the environment proven, there may be "irrational" consumer fears (Ockenden and Franklin, 1997, p.51). This in part explains why the approval of GMOs in the EU has been so slow and consumers have pressured the government not to import foods processed from GMOs (USDA, 1998). In the future, one might expect consumer preferences to become more important in future policy developments affecting food safety. Likewise, any prospect for technological developments within agriculture will be constrained by public perceptions about the quality of products and the effect on the environment.

c) The Future Impact of the Environment

In the coming years, agri-environmental measures will gain even greater importance within the CAP, becoming the central mechanism for integrating the environment into agriculture policies. Under Agenda 2000 the Commission proposed an increase in the budget allocated for agri-environmental measures and the integration of other complimentary measures as part of a new generation of rural programs. The Commission foresees agriculture to further adapt to changes in consumer preferences, market policy and trade rules. Agri-environmental measures will support a sustainable development of rural areas and respond to society's increasing demand for environmental services.

As aspirations continue to grow towards a more environmentally friendly and quality-oriented agriculture, rural areas will continue to be increasingly important in fulfilling environmental and recreational functions. The future of the EU rural development policy was discussed at a major European conference held in Cork, Ireland, in November 1996, where Member States agreed to make rural development a second pillar of the CAP (Buckwell, 1997). The major change in the architecture of the rural development policy will result in most of the funds available for the rural development expenditure being allocated from the Guarantee rather than the Guidance Section. In addition, the new regulation on rural development will replace nine old regulations and provide Member States with the opportunity of defining their own priorities and make their particular choice among the schemes contained in the regulation.

Although the agri-environmental regulations have a limited impact on agriculture for now, especially as they are supported by payments to farmers, their importance will increase in the future, thereby renewing some of the ongoing debates among the Member States. First, while the measures constitute only a minor portion of the total CAP budget, less than 4% by 1995, future funding of these appropriations may spur new budgetary debates. The measures under Regulation 2078/92 are co-financed from the EU total budget, which provides 50% of the payments for all areas and 75% of the payments in Objective 1 areas (i.e., currently most of the Mediterranean countries, Ireland, the eastern Länder of Germany, and the Highlands of Scotland) (Scheele, 1996, p.40). By introducing the notion of subsidiarity into agriculture policy, the regulation leads to considerable variability in national and regional responses to the regulation (Baldock and Lowe, 1996, p.298). While the capability of regions to co-finance the agri-environmental measures are offset partially by the much greater level of assistance available under Objective 1 regions, the varying support levels across Member States is raising questions of unfair competition and market distortion. Considering the ongoing debates surrounding budget issues, it is safe to predict that tensions between environmental measures and income support objectives will be a recurrent theme in the future.

The extent to which environmental regulations affect EU agriculture in the future will depend on the uniformity of environmental policies across nations and whether these policies are used as disguised barriers to trade (Babinard, 1999). During the last two decades, agricultural trade barriers came down at the same time that environmental awareness increased in many parts of the world. For the agricultural sector, concerns of diminished competitiveness had not been a major issue because most conservation and environmental programs have been voluntary and implemented with subsidies (US Congress, 1995). Recently however, concerns have been raised in respect to the geographically diverse costs that may result when an environmental regulation is targeted at a particular geographic site or environmental problem. If, for example, EU farmers have to face stringent nitrogen regulations and penalties, is it unfair to import competitors' products from regions with less stringent regulations and 'undermine' the domestic market? To agree to this proposition would legitimizes protecting the home market from such 'unfair' competition.

Concerns over the effects of environmental policies on agricultural trade are more valid when considering the fact that agricultural production creates a number of externalities. Yet, little empirical work exists at the moment on the trade effects of environmental policy in the agricultural sector. Looking at the effects of environmental policies in other industries should provide some insight on the regulatory effects, though the basic structure of agriculture makes the effects difficult to estimate accurately.

The balance of environmental and health concerns on the agri-food system is to make participants in that system much more aware of public opinion. Politicians are reacting, and will continue to react, to the issue of the day. The public is reacting to press reports that often dramatize the health and environmental issues, giving weight to scandals and disasters but ignoring the not-so-newsworthy beneficial aspects of the sector. The agri-food business will have to learn to live with this tendency to legislate by reaction to scares and disasters. Long-term confidence in the responsibility of the agricultural and food systems to make sound decisions on environmental and food safety issues will take time to become established.

V. The influence of the GATT

The Uruguay Round marked the beginning of an era of internationally-agreed constraints on domestic farm policies. There is no reason to believe that this trend has run its course. The Uruguay Round itself specified the next step, the initiation of discussions by the end of 1999 on the continuation of the process of liberalization of trade in agricultural goods. The Commission, in framing its Agenda 2000 proposals, had in mind the need to go into the next Round with a less defensive position than in the Uruguay Round (European Commission, 1997). To see the likely effect of these negotiations on the CAP it is necessary to step back and look at the impact of the Uruguay Round commitments.

a) The CAP and the Uruguay Round Commitments

The Uruguay Round established a new set of rules for trade in agricultural products. This included the conversion of virtually all existing non-tariff barriers and unbound tariffs to bound tariffs, banning new export subsidies and limiting those in existence, categorizing domestic support instruments on the basis of their trade distortion, and imposing the use of scientific risk assessment when health standards exceed international norms. In addition, a series of schedules was agreed for the reduction of tariffs, the phase-down on export subsidies, and the scaling back of trade-distorting domestic support.

However, it would be wrong to think of the Uruguay Round as opening up markets and moving far toward free trade. It is true that tariffs were to be cut by 36 percent on average over the period 1995-2000.[8] But the degree of discretion allowed to each country in their conversion procedure for non-tariff barriers led countries to set their bound tariffs somewhat higher than necessary. This was exacerbated by the fact that for many commodities, the base protection rates (internal price less world prices expressed as a percentage of world prices) were historically high. In addition, countries were allowed to

[8] This schedule applied to developed countries: developing nations were allowed a smaller cut in tariffs (and export and domestic subsidies where used) over a longer period of time.

limit the tariff cut to 15 percent for "sensitive" items, restoring the average by larger cuts in sometimes marginal products.[9]

As a result, some of the tariffs that emerged from the Round are so high as to preclude trade under normal circumstances. For the EU, these bound tariff rates were set at 250 percent for sugar, 237 percent for beef, 341 percent for butter, and between 150 percent and 170 percent for grains (Harvey, 1997, p.386). In the case of cereals, a further constraint was added, that the "duty paid price not exceed 155 percent of the intervention price".[10] But tariff-rate import quotas (TRQs) were also agreed, to keep open previously preferential access and to reach a minimum of 3-5 percent of consumption, though the EU, along with the US and many other countries, is under-filling these quotas (Josling, 1998). For a few commodities, those where the tariff was based on the base period grain levies (pigs, poultry and eggs), the level of protection actually rose as a result of the Uruguay Round. CAP reform had reduced cereal prices and hence costs, whereas border protection was still reflecting the pre-reform situation (IATRC, 1997).

In the case of export subsidies the UR constraints have proved much more binding for the EU. In the markets for coarse grains, dairy products, olive oil, beef, poultry and fresh and processed fruits and vegetables, export subsidies have been limited as a result of the WTO constraints (Tangermann, 1999). Only in the case of wheat have the constraints been less effective than might have been expected. First, the EU ran down surplus stocks from 1993 to 1996, taking advantage of the impact of the MacSharry reforms on the surpluses, and then in 1995 and 1996 sold wheat without subsidies onto a high-price world market.[11]

In regards to domestic support, price-based subsidies paid to farmers had to be reduced by 20% (in aggregate) over a period of 6 years. This proved no challenge for the EU as a result of the MacSharry reforms, which pulled down administered cereal prices enough to

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[9] The EU reduced tariffs on wheat, beef and butter by the full 36 percent, but opted for 20 percent reduction for sugar.

[10] This in effect re-imposed a variable levy. Similarly with vegetables, the current trade regime makes use of "entry" prices to trigger additional levies. These systems will come under attack at the next round.

[11] Under the rules of accumulation, the EU was able to "bank" some of its export subsidy entitlements for use before the year 2000. This has been useful as prices for cereals on world markets tumbled in the past two years.

leave plenty of scope for other programs.[12] The Aggregate Measure of Support (AMS) for the EU is already below the commitment for the year 2000, and will be further reduced by the MacSharry II reforms of March 1999.

It is fair to say that the URAA and the MacSharry reforms together changed the face of the CAP. Separating the effect of the two is perhaps not fruitful, since they were inter-related processes. But the changes that were introduced in the first half of the 1990s have made a fundamental difference in the role of government in the agricultural market of the EU. The switch from commodity intervention as a result of high prices to direct payments has a major implication for agri-food firms. They are no longer so much involved in the process of price support, nor are they so tied to the fortunes of the farmers. The politics of agricultural policy has been decoupled from that of the food business (Josling, 1999).

b) Potential for Further Reform in the Next Round

Unlike in the Uruguay Round, where the negotiators started with vastly different ideas about the objectives of the talks in agriculture, the general objective of the next Round in agriculture is quite clear. Article 20 of the UR Agreement on Agriculture set down a legal obligation to resume the discussions on agriculture by the year 2000. The article indicates clearly that the aim of these negotiations is to continue the reform process that was started with the UR and to achieve "a substantial progressive reduction in support and protection." The issue is not whether such talks will take place and what will be discussed, but how long will they last and how much additional support and protection reduction will be possible.

If the next Round is seen essentially as a continuation of the last, this implies that the framework is likely to be similar to that which emerged from the Uruguay Round and which is now embedded in the Agreement on Agriculture. Thus the three main areas for discussion will again be market access, export competition and domestic support. Issues that are sometimes thought of as “new” will probably be handled largely within this now familiar framework. The question of the allocation of tariff rate quotas (TRQs) is clearly one of market access, and can be addressed under that agenda item. Countries have

[12] The MacSharry compensation payments were placed in a special "blue box", designed to avoid the issue

indicated a wish to confront the issue of state trading in agriculture, but that topic can usefully be separated into the components of market access (state trading importers) and export competition (state trading exporters). The use of export restraints may also be challenged in the next round, in part as a reaction to the concern over food security in importing countries. But this also can be subsumed under the heading of export competition. Thus by expanding somewhat the definition of the three major agenda items one can incorporate the “new” as well as the “old” issues.

Other "new" issues may be less easy to accommodate. The question of the working of the Uruguay Round Agreement on Sanitary and Phytosanitary Measures (the SPS Agreement), though technically separate from the URAA, will no doubt be discussed in part in its agricultural policy context. The question of GMOs, discussed earlier, will also impinge on the talks, though in what context is not so easy to predict. It is not clear that the issue is one for the SPS Agreement to handle. Unless countries ban GMOs in foodstuffs (domestically produced as well as imported) explicitly for health reasons, or in order to stop an infestation of a plant or animal disease, the SPS Agreement would not apply. Countries might try to reopen the SPS Agreement to include GMOs, but that may not prove possible. The alternative is to have a separate "understanding" on the testing, adoption and incorporation of GMOs.

An additional issue that may well complicate the next Round is that of animal welfare. The question will arise whether countries have the right to ban imports of livestock produced under conditions not acceptable to consumers or their spokes-groups. Again, the SPS Agreement does not directly address this eventuality. If the regulation protects the health of domestic animals then it falls under the Agreement, but any attempt to restrict the actions of overseas farmers would not appear to be covered by the SPS Agreement. This again argues for a new interpretation under the WTO of how to deal with issues of this nature.

Is there a possibility that the banana issue will come to haunt the next trade round? This seems unlikely. The more probable scenario is for agreement between the US and the EU as a part of the launch of the new round. Certainly it is in the interest of the EU to

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as to whether direct payments tied to acreage control stimulated or restrained production.

dispatch this problem from the agenda before entering further trade negotiations. It does not help to carry the burden of an unresolved adverse panel decision into talks about the future.

More difficult to foresee is the impact of China and Russia on the next Round. As major agricultural countries they will have a significant impact on the market balance. The conditions under which they are admitted will influence other countries. Their own position on some of the crucial issues will in itself be important. The pace of the Round could be slowed by the process of entry for China and Russia. On the other hand, the vast new markets which could open up as a result of their entry may well push other countries to reduce trade barriers of their own.

c) The EU's Position in the Next Round

The European Union approaches the new Round of agricultural trade negotiations in somewhat of a quandry. On the one hand the lesson taken by many in Europe from the experience of the Uruguay Round was that Europe had exhausted all its energies defending the CAP from attack. This meant that the EU had no time to develop a positive strategy to pursue changes that it would like to have seen either in trade rules or in the policies of others. The notion that it had already “reformed” the CAP, with dairy quotas in 1984 and a budget ceiling in 1988, was not convincing to its partners. Even after the introduction of the MacSharry reforms in 1992 it was clear that the EU still required high border protection to preserve its domestic policy. On the other hand, to go into the next Round in a position of strength would require further reforms in advance of the talks. This has been widely rejected by EU farm groups as well as by the French government. As a result, the set of modest reforms agreed in March 1999 will have to be supplemented later as the final package becomes clear.

On market access, the EU is going to be unreceptive toward any sweeping cuts in tariffs. Though an exporter, it still feels under pressure from competing imports of temperate zone goods. As a result it would like to see Asian markets expand, but cannot move too far from its traditional protection of the domestic market. A modest across-the-board reduction in tariffs is likely to be the preferred outcome. But the EU will be vulnerable on the issues of the widespread use of specific tariffs, the use of reference prices for fruits and vegetables and the high degree of excess protection for cereals as afforded by the bound tariff relative to the “maximum duty-paid import price” for cereals which was agreed in the Uruguay Round. The position of the EU on state trading is unclear: as an exporter there are good reasons to believe that the EU would side with the other exporters to put additional disciplines on such agencies.

On export subsidies, the EU is likely to argue that they are essential to the clearing of markets, at least for the next few years. Whether the EU could be persuaded to end them in principle is not clear. The Commission would rather not have to use them as instruments of policy, but it would be unacceptable to lose market share too rapidly in the cereals and dairy markets as a result of not being able to lower offer prices. Export credits are not used in Europe and there are no single-desk sellers. The EU is likely to go along with further constraints on these two activities.

One of the most contentious issues is likely to be the “size” and “composition” of the green box. For the EU the green box represents a possible way out of the dilemma of how one satisfies political imperatives for the maintenance of farm incomes and at the same time how one lives within the constraint of the WTO. Payments, perhaps from national sources, aimed at recompensing farmers for the “multifunctionality” of European agriculture, would be allowed even if not totally consistent with current definitions of trade-neutral instruments. Whether the EU will argue that the concept of the green box needs to be changed or merely that different policies will be allowed to slip into the box is not clear. Moreover the Commission runs the significant danger of raising the expectations of European farmers that the multifunctionality card can be played to gain more protection at the border – an idea which would certainly deadlock the talks from the start.

On the blue box, the EU is likely to defend it in the early stages but could change its own compensation policies without too much inconvenience (and to domestic advantage) to make them compatible with the green box, as did the US in the FAIR Act. If the compensation payments were not made "green" then the EU will want to maintain the 'blue box' because reforms will result in increase of payments in beef and cereals, and introduction of 'semi-decoupled' direct payments in dairy sector.

With respect to other matters, the EU has indicated that it would like to reopen the SPS agreement so as to be able to take into account situations where consumer concerns are hanging over markets. Action taken for these reasons runs foul of the SPS agreement unless there is scientific basis for consumer fears. The concern is that relying on science alone will result in politically unacceptable solutions and hence to a lack of credibility of the WTO rules. In addition, the EU may want some continuation of the Peace Clause, to avoid continuous WTO challenges of the day-to-day operations of the CAP.

VI. Future Policy Environment

On March 11, 1999, the Ministers of Agriculture agreed by weighted majority to introduce a reform package based on the suggestions contained in Agenda 2000. Two weeks later that agreement was modified by the European Council (Summit) at Berlin, as a part of the package of budget measures. Taken together, these two developments make it more difficult to chart the course of the CAP in the future. Certainly it represents a continuation of the policy of price decreases and compensation premia for two major sectors for the next three years. It is broadly consistent with the budget guidelines given the agriculture ministers by the Finance Council. But uncertainty still persists. For one thing the package could come up against the budget ceiling if the current depression in world prices continues. The issues surrounding the equity of budget shares are also unlikely to disappear after the Berlin Summit. Will the resignation of the Commission delay the implementation of the reforms? Will the European Parliament feel the need to become more involved in agricultural policy? Will this change the tone of the debate and suggest new directions? Or will the Council take over from the Commission the initiative for reform and emphasize preparation for enlargement and the next round? In spite of these uncertainties, it is useful to assume that this "round" of reform has run its course with the European Council package and focus on the next stages.

a) Future Directions of the CAP

There is little doubt that the process of change in the CAP will continue. The pressures on the CAP were discussed above. The budget issue will be a permanent source of discontent both by those that consider the spending on agriculture to be disproportionate to the size of the sector - or even the magnitude of the problems facing the farming sector of the EU. Further CAP reform is also very likely as a result of pressure from enlargement, with the payment of compensation to the CEEC for price declines in the existing EU members being particularly controversial. It is clear that the WTO round will again require some adjustment to the CAP, however fervently ministers may wish to think that they have already taken adequate steps in the MacSharry II reforms. And the pressure from environmental and food safely concerns will increase rather than decrease over the next few years.

The main question is therefore not whether the CAP will undergo further changes but when this will happen? At the moment it looks as if the next reforms will be considered in 2003, about four years time. At that time the WTO and the enlargement timetables will coincide. The incentive for the end of the next WTO round, as far as agriculture is concerned, is the expiry of the Peace Clause in 2003. After that date, if no extension has been negotiated, much of the protection against WTO challenge will be removed from the instruments of the CAP (and other countries), suggesting that there might be "open season" on challenges to policy instruments, in particular where import markets have been shrinking. The negotiations with the front-runners in the membership stakes, together with Accession treaties and ratification processes, will also be winding up about the same time. The Year 2003 may well become a firm target for the first wave of CEEC members. Some changes in the CAP will be needed at that time, despite the convenient fiction that it is the new applicants that have to adapt. This suggests a "MacSharry III" that would be implemented in about 2005 which would complete the process started 13 years earlier.

It is unlikely that this "completion" of the CAP reform started in 1992 would in itself qualify as a "rural development policy" for Europe. It would need to be supplemented by actions that would improve infrastructure and employment opportunities in rural areas, including the support of non-farm enterprises. The Berlin Summit gave encouragement to these areas of policy, as the "second pillar" of the CAP. This could prove advantageous to food processing and other agri-food sectors, which could take advantage of such improvements.

Can one assume that this process of policy reform, based on lowering support prices until intervention and export subsidies are no longer normally needed and paying farmers direct hectarage and headage payments, will continue? Other futures are possible, and if the crystal ball is cloudy it is because these alternatives are only too plausible. At the other end of the spectrum from the policy outlined above is the development of "Fortress Green Europe", built upon the defense of the "European Farming Model" and what might be called the "European Food Model". Such a development would have significant implications for the competitiveness of the agri-food sector. It would also represent a significant shift in the EU's external trade policy and have an impact on global trade conditions. It is worthwhile exploring some of these implications in order to have a more complete picture of what might happen in the future.

The "European Farming Model" is a construct which depicts European agriculture in ways that are sharply distinct from the "American" model, which presumably obtains in Canada, Australia, Argentina, Brazil and other countries where land is less limiting and urban populations do not impose so much on rural activities. The main features of such an agriculture are smaller farms, usually owned and operated by a family, in an environment which is valued by rural and urban people alike for more than the production of commodities.[13] Attributes such as lower chemical use and more animal-friendly livestock rearing conditions can easily be associated with this environmentally sensitive agriculture.

The issue is how can this "model" be "protected". Two obvious ways are at hand. One can rig the prices of inputs and final products so that the income of anyone who wants to farm in this way can have the same living standards as non-farmers in the same country. Or one can establish proxies for farming technologies, population densities and environmental amenities and devise ways or rewarding the desirable (and penalizing the undesirable) patterns. The first is doomed to repeat all the mistakes of the past forty years, when it became obvious that high commodity prices and profits drive up output levels but have a negative impact on such desirable traits as quality and environmental sustainability. It would also fall afoul of trade rules negotiated on the assumption that manipulation of commodity prices was inconsistent with international obligations. The second requires the willingness of the EU to fund new programs aimed at preservation of amenities and higher-cost technologies.

The "European Food Model" could fare better. So long as imports and domestic goods are treated equally, it is not a violation of the WTO to impose high quality standards. Where such standards are for the protection of plant, animal or human health there is a requirement that they be based on a risk assessment, but even this limitation is absent for regulations aimed at environmental goals or those of public order or morality. Moreover,

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[13] The heterogeneity of farming both in Europe and in the other countries mentioned weakens the empirical case for such a distinction. But the perception is more important than reality in this matter.

requirements for labeling are not subject to international regulation other than that they should not be discriminatory. One can quite easily imagine a set of strict European food standards that aim to define notions of quality, authenticity, wholesomeness and naturalness. This might seem at first to complement the farming model based on small family concerns and environmentally-friendly practices.

There are reasons to think that this path is not as easy as might be imagined. First, it is difficult to argue that European standards are "higher" than those, for instance, in the US or Japan. In some cases the European standards are clearly less rigorous, as in the case of the use of unpasteurised milk for cheese production. Secondly, the trade-off between tradition and modernity denies the real beneficial impact that technology can have on consumer satisfaction. Thirdly, it is by no means clear that the consumer will be prepared to pay extra for food produced to European standards if other types of foodstuff are also available. But to force consumers to make such choices, by restricting their access to other foods, puts a heavy burden on poorer consumers (and is likely to be illegal under trade rules). And lastly, it risks turning European food processors and manufacturers back into regional rather than global firms. This would have severe consequences for the competitiveness of the sector. Without a significant home market, the food companies are unlikely to achieve the scale needed to be a global competitor. And the chances are high that domestic firms would be restricted by the European regulations even if producing for the overseas market.

b) The Global Environment

The likelihood of such a development as the retreat behind the green walls of Fortress Europe will be influenced by changes in the global environment. Among the many aspects of that environment that will impinge on the European agri-food system perhaps the most direct is the state of world food markets. One possible scenario calls for a period of firm prices. This would on the one hand make it easier for continuation of trade liberalization. Farmers would be less worried about a collapse in farm incomes if world prices were firm. But on the other hand budget pressures would ease, allowing governments to proliferate programs to meet specific political requests. There would be more concern about shortages and more arguments for keeping up the capacity of

European agriculture to generate surpluses for the rest of the world. On the other hand, a period of depressed prices is not necessarily much better for policy developments. At such times, policy-makers are likely to be under pressure to assist farmers. Reducing market barriers may be difficult to do when farm returns are depressed.

In fact, what is more likely to happen is that some sectors of agriculture will have reasonably buoyant markets, in particular when products are high value-added and differentiated, while others will find a continued reduction in relative price. The best markets will tend to be overseas, rather than in Europe, except for specialty crops. The competitiveness of the food sector will be held back if the farming sector continues to emphasize the undifferentiated commodities rather than the higher-value, consumer-oriented foods. The agri-food sector will prosper as the consumer takes over from the producer as the main engine of policy.

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