How will CAP reform affect developing countries?

The CAP has been reformed substantially over the past decade. The next step will be taken in 2008 and, like the others, will alter its impact on developing countries – but not by very much. Known as the 'Health Check', to emphasise that it is aimed primarily to deal with a limited set of known problems, it will not affect EU agricultural trade policy. Reform will have a substantial impact on developing countries only when import tariffs are cut across the board (which might happen if the WTO Doha Round is concluded) with the gains likely to exceed the costs. Until then, the combination of Europe's protection for agriculture plus preferences for some trade partners will continue to create winners and losers among developing countries although past reforms have reduced the scale of both the gains and the losses.

Europe's common agricultural policy (CAP) has been reformed substantially over the last decade, and a new round of change (known as the 'Health Check') will be agreed in 2008. As a major producer and consumer of agricultural goods, Europe has a significant impact on world markets. Changes to the CAP alter this impact.

How will the current reforms affect developing countries, many of which have extensive agricultural trade with the EU? Answering that question requires understanding of how the *status quo* affects developing countries – and which elements of CAP policy will change.

The effects of the CAP

The EU continues to provide strong support to its farm sector, but the nature of that support has shifted, especially since 2002 (see Box). Traditionally, policies to keep market prices higher than they would otherwise have been formed a key part of the EU's agricultural support. They included public purchase of surplus output (the famous food 'mountains and lakes'), a few quotas, and high tariffs on competing imports. One consequence was that farmers were encouraged to produce as much as possible.

The food mountains and lakes are no more. More support is now given through direct transfers to farmers (the Single Farm Payment). This is largely unlinked (or de-coupled, in the jargon) to how much or what they produce, but is partly linked to environmental management and rural development. Less support is now given through government policies and actions that support market prices. Direct market intervention buying to support prices, for example, is now limited. Import duties, too, are lower than a decade ago, but there has been less change to this aspect of agricultural support and the EU continues to impose high tariffs on imports of agricultural goods that compete with European production.

But not all supplying countries face these high tariffs. Some developing and neighbouring countries benefit from much lower (or zero) tariffs – and the number has been growing. The African, Caribbean and Pacific (ACP) states have long received preferential treatment as have the Mediterranean, Andean and Central American states. In 2009 the EU's Everything But Arms (EBA) agreement will provide full duty and quota free access for all exports from least developed countries (LDCs) as the last restrictions are removed on rice and sugar. And those ACP states that initialled interim Economic Partnership Agreements (EPAs) in December 2007 have had duty free quota free access since January 2008 (except for rice and sugar which will be phased in).

Protection and preferences create winners and losers

This combination of tariffs that support European prices at levels often higher than the world market, and trade preferences for imports from some countries has created a complicated pattern of winners and losers among developing countries (and communities within them). As the policies change so does this pattern.

There are two groups of winners: those countries and communities that import goods that the EU produces, and those that have preferential access to the European market for their exports. The prices that the first group have to pay for their imports are lower than they would be if there were no CAP and European farmers produced

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less because they were not so strongly supported. The prices that the second group receive for their exports are higher than they otherwise would be because the EU's tariffs keep out some competitors and create attractive prices. The beef exports of Botswana and Namibia to the EU, for example, could not compete with those from Argentina or Brazil if the Latin Americans did not pay higher tariffs.

The losers are those agricultural exporting countries that do not benefit from preferential access to the EU market (like the Latin American beef producers). If they export the same goods as the EU (or close substitutes) competition will push down prices in third markets. If they export to the EU, their sales are limited by the high tariffs they pay and competition with countries that have preferences.

Past reforms to the CAP have reduced the scale of both the gains and the losses. The de-linking of farm support from how much a farmer produces may have led to a reduction in EU output which would tend to increase world prices. The economic analyses that have been made suggest the effects of reform on EU production have been only limited but there has been a marked fall in subsidised European exports – which is good news for competing exporters from developing countries and bad news for those countries that rely on imports and must now pay more. The shift in the method of support has certainly resulted in prices on the European market falling (and so preferential exporters receive less for their goods).

How the CAP has changed

During its first thirty years the CAP was resistant to change but in 1994 the EU implemented 'the MacSharry reforms' in the context of a successful completion of the Uruguay Round of multilateral trade negotiations which caused many EU tariffs to fall. The next step was the Agenda 2000 package which included a reformulation of the aims of agricultural policy to give greater emphasis to environmental policy objectives and the multifunctional role of the European model of farming. It reduced support prices of many important crops and compensated farmers for the revenue losses by an increase in direct payments.

In June 2003 a further set of changes set the parameters within which all subsequent reforms have been designed. Together with further changes arising from budget decisions made as part of the negotiations on the 2007–13 Financial Perspective, the reforms fall under four main headings:

1. the decoupling of the Single Farm Payment from farmers' production;
2. the continuation of the sectoral reform process;
3. the creation of a new European Rural Development Fund, and
4. budget discipline and a new financial mechanism.

What is happening in 2008?

The latest round of CAP reform has been called a 'Health Check' to emphasise that it is aimed primarily to deal with a limited set of known problems. It is tidying up the agricultural policy reforms of the past decade but is not altering trade policy.

The Commission prepared the way in November 2007 with a Communication that proposed a broad outline. It suggested three main questions to be addressed during the Health Check. These are:

1. how to make the system of payments to farmers more effective, efficient and simple;
2. how to render market support instruments relevant to a more globalised world and an EU of 27 members; and
3. how to master new challenges such as climate change, the growth of biofuels, water management, as well as established ones like biodiversity.

Although the Commission floated some ideas on the possible approach to each of these, it made no detailed proposals for reform. These will be submitted following stakeholder dialogue and an on-going impact assessment. Among the broad ideas are the following.

- The Single Payment System for farmers needs to be simplified.
- There will be a case-by-case analysis of the areas in which the linking of farm payments to production of specific products remains relevant.
- The Commission will look into the possibility of introducing some form of limit on payments, both at the higher end (to reduce gradually support levels as overall payments to a farmer increase) and at the lower end (to ensure that only genuine farmers receive it).
- The existing supply management tools (such as intervention buying) need to be examined to determine whether they still serve any valid purpose.
- A full examination of the cereal intervention system is currently underway and will consider whether the new model of intervention for maize should be extended to other feed grains.
- Although the role of set aside has become much less relevant, means to preserve its environmental benefits have to be identified (for example through rural development) if it is to be abolished.
- There is a need to prepare for a 'soft landing' for the dairy sector before the milk quota system runs out in 2015 (including the framing of support measures for mountain and other vulnerable regions).
- On the 'new challenges' of climate change etc. the Communication mentions some possibilities but only in the most general terms.
- Payments for environmental and rural development activities (the 'Second Pillar' of the CAP) need to be strengthened and the possibility is floated of increasing existing

compulsory modulation (in EU10) by two percent annually during the budget years 2010 – 2013, and analysing appropriate ways to take this into account whilst respecting the current distribution of rural development funds between member states.

The result of the Health Check will be to extend to most corners of European agriculture the new approach developed this decade. Its direct effects on developing countries will depend on whether or not it leads farmers to change either their pattern of production or their total level of output, and on whether it alters European market prices. None of these is easily predictable – especially in the current (possibly temporary) context of record world food prices.

Economic modelling of the effects of reform on production and prices is inconclusive. A summary in 2006 of seven studies, for example, found that despite falls in the area under cereals and of beef and dairy herds, prices rose only very modestly and changes to poultry and pork production are very small (Gohin, A., 2006, *Assessing CAP reform: sensitivity of modelling decoupled policies*). Given this limited effect, a recent ODI study suggested that there is unlikely to be a significant effect across-the-board on developing countries as a result of purely agricultural policy change by the EU until it reaches the point at which support to farmers is very substantially decoupled from production decisions, and the overall subsidy is very low (ODI, 2008, *The Options for CAP Reform and their Implications for Developing Countries*).

In the meantime, though, there is a different route of reform that might produce larger effects on developing countries. Extending the full or partial liberalisation of EU agricultural trade policy would produce significant effects on developing countries. If as part of the WTO Doha Round there were sharp cuts in EU tariffs across-the-board on all agricultural goods imported from all supplying countries the result would be a European agricultural market that is much more similar than it is at present to the domestic market for manufactures.

Which developing countries and communities would win and lose from broad and deep EU liberalisation? The principal winners would be those countries able to increase their production at low cost. Among the developing countries these could include Argentina, Brazil, India, Pakistan and Indonesia. The 'losers' would be those countries that are less competitive but have preferential access to the EU market (such as the ACP sugar and beef exporters).

Conventional economic theory suggests that the gains from such substantial liberalisation will exceed the cost, although of course there will be adjustment costs for the losers. But what if agriculture is liberalised piecemeal through regional trade agreements with some trade partners and a continuation of high tariffs or other restrictions on some goods? In the absence of a bold multilateral liberalisation, the assumption that gains will outweigh losses no longer holds. Incremental liberalisation towards some trade partners could produce greater losses (for less competitive, traditional supplies like the ACP) than gains (for the more competitive states).

The broad lesson is that until internal CAP reform shifts up a gear the changes to European policy most likely to affect developing country's agricultural interest will be those on trade. And they need to be monitored very closely.

Zusammenfassung

Die Gemeinsame EU-Agrarpolitik (GAP) wurde in den letzten zehn Jahren grundlegend reformiert. Der nächste Schritt wird 2008 erfolgen und wird, wie die anderen, die Auswirkungen der Reform auf die Entwicklungsländer verändern, jedoch nur in begrenztem Umfang. Als so genannter Gesundheits-Check, der primär auf eine begrenzte Zahl bekannter Probleme ausgerichtet ist, wird sie die Agrarhandelspolitik der EU nicht beeinflussen. Die Reform wird spürbare Folgen für die Entwicklungsländer nur dann haben, wenn die Einfuhrzölle generell beschnitten werden (was bei der WTO-Tagung in Doha beschlossen werden kann), so dass die Erträge künftig die Kosten übersteigen. Bis dahin werden durch die Protektionsmaßnahmen der EU für die Landwirtschaft und Präferenzregelungen mit bestimmten Handelspartnern weiterhin Gewinner und Verlierer in den Entwicklungsländern entstehen, auch wenn durch frühere Reformen das Ausmaß von Erträgen und Verlusten bereits verringert wurde.

Resumen

La Política Agrícola Común (PAC) de la Unión Europea (UE) ha sido sometida a sustanciales reformas a lo largo de la última década. El siguiente paso se dará en 2008 y – al igual que los demás – alterará su impacto sobre los países en desarrollo, aunque no en gran medida. La reforma en cuestión – llamada "chequeo de salud" para subrayar su objetivo de lidiar con un conjunto limitado de problemas conocidos – no afectará la política de comercio agrícola de la UE. Las reformas sólo tendrán un efecto radical sobre los países en desarrollo si se llega a reducir la gama completa de aranceles (cosa que podría llegar a suceder si se concluye la Ronda de Doha de la OMC). En ese caso, las ganancias probablemente superarán a los costos. Hasta ese entonces, la protección que Europa otorga a la agricultura – en combinación con sus preferencias por algunos socios comerciales – seguirá generando ganadores y perdedores entre los países en desarrollo, si bien las reformas anteriores han reducido la magnitud tanto de las ganancias como de las pérdidas.