

**TOWARDS A SUSTAINABLE EUROPEAN
AGRICULTURAL POLICY FOR THE 21ST CENTURY**

***REPORT OF THE CEPS TASK FORCE
ON
THE COMMON AGRICULTURAL POLICY IN THE 21ST CENTURY:
DOHA, MID-TERM REVIEW AND ENLARGEMENT***

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This report is based on discussions in a CEPS Task Force on The Common Agricultural Policy in the 21st Century: Doha, Mid-Term Review and Enlargement. The members of the Task Force participated in extensive debate in the course of several meetings and submitted comments on earlier drafts of this report. Its contents contain the general tone and direction of the discussion, but its recommendations do not necessarily reflect a full common position reached among all members of the Task Force, nor do they necessarily represent the views of the institutions to which the members belong. A list of participants and invited guests and speakers appears at the end of this report.

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TOWARDS A SUSTAINABLE EUROPEAN AGRICULTURAL POLICY FOR THE 21ST CENTURY

REPORT OF A CEPS TASK FORCE

EXECUTIVE SUMMARY

The Common Agricultural Policy (CAP) of the European Union (EU) has undergone major changes since it was first implemented at the end of the 1960s. The most recent reforms were decided at the 1999 Berlin meeting of the Council of Ministers and are included in the Agenda 2000 agreement.

The Agenda 2000 reforms basically represent a deepening and extension of the 1992 MacSharry reforms, which lowered support prices to reduce market distortions and compensated farmers through “compensation payments” or “direct payments”. In addition, Agenda 2000 streamlined and consolidated expenditures on rural development under the so-called “second pillar” of the CAP.

Yet, despite these reforms, it is unlikely that Agenda 2000 is sufficient to face the challenges of the coming years, such as Eastern enlargement, WTO, and other trade negotiations. In this perspective, it was decided in Berlin to undertake a set of mid-term reviews of some aspects of Agenda 2000 in 2002-03.

The timing and issues are complex. Several major developments, which all affect each other, overlap: the WTO negotiations, the enlargement negotiations and the process itself, the Agenda 2000 implementation, the mid-term reviews, etc. For these reasons, the focus of this report is on strategic policy options that are sufficiently linked to the current CAP system to be “hands on”; yet the report refrains from becoming too specific in policy details. The latter would detract attention from the more important strategic questions. Similarly, the time frame of the report is the medium term, beyond but relevant for the mid-term review.

Key issues in the debate include food safety, environmental and sustainability objectives, WTO and other trade negotiations, Eastern enlargement, rural development implementation, and ensuring a future for European farmers, rural areas, and the food industry. Furthermore, with rising incomes, consumer demands for food quality and safety have increased in recent decades; and this trend has been reinforced by food safety crises over the past few years. Also, social and political developments have added a sense of urgency and increased political clout to the environmental agenda, including animal welfare.

The new WTO negotiations are likely to lead to a further reduction in tariffs, domestic support, and, especially, export subsidies. A substantial reduction of EU export subsidies will have important consequences for some of the commodity regimes under the CAP. Further reductions in distortionary domestic support require adjustments towards decoupled policies and towards payments for public good provisions.

Several other trade initiatives have recently been taken to stimulate both multilateral and regional trading agreements, such as between the EU and Mercosur, and Chile, and the

“Everything but Arms” (EBA) trade agreement. These trade initiatives will have important implications for some markets and CAP regimes.

Up to ten Central and Eastern European countries (CEECs) will become members of the EU from 2004 onwards. This enlargement will reinforce already existing constraints and challenges, including concerns about competition distortion, food safety and budgetary effects.

Most budgetary effects come from the extension of direct payments to CEEC farms. Recent studies put the ultimate budgetary cost of extending the CAP to ten CEECs at €4 to €5 billion annually. Direct payments account for more than half of this amount.

With all these pressures, one should not forget that farming is, first and foremost, a business from which people try to make a living. In order to prosper, such economic activity requires an environment that provides opportunities and sufficient freedom for investment and growth. The desire to introduce new objectives and conditionalities to CAP support should not lead to increasing administrative burdens on farmers, diverting talents and time from their core activities.

The structure of agriculture is changing and enlargement will reinforce this development, requiring appropriate policy instruments. First, employment in agriculture has declined significantly and continuously over the past decades, despite the large subsidies given under the old and the new CAP. It illustrates how the existing agricultural policies are inefficient policy instruments to address the structural problems facing farmers.

Second, EU agriculture is increasingly bimodal: a small number of large farms obtaining most of their income from farming, and a large number of small farms for which agricultural activities provide only a small part of total household income. In the long run, the income growth in farm households is mostly attributable to better integration with the non-farm economy, through opportunities for off-farm employment and incomes, much more so than as a result of agricultural support policies. Policies intended to increase farm household incomes should therefore focus on removing constraints for farming families to participate in non-agricultural employment opportunities.

Significant improvements are required to turn the current rural development measures into an efficient policy instrument. Significant problems remain with the design and the implementation of these measures at various levels: the EU level, national and local levels, due to a variety of constraints. This suggests the need for a careful and critical evaluation of existing measures, taking into account transaction costs and implementation problems.

In light of these considerations, the Task Force came to the conclusion that a sustainable European agricultural and rural policy for the 21st century should:

1. Provide a sustainable policy framework and minimise the bureaucratic and administrative burden for farmers, rural entrepreneurs, and the food industry.

2. Be consistent with and supportive of a European agri-food system that delivers and guarantees safe food, and satisfies minimum hygienic, environmental and animal welfare standards.
3. Integrate sufficient flexibility to deal with a wide variation in rural regions, and in production structures.
4. Continue the policy strategy towards a more market-oriented agri-food system by replacing price support with more direct and less distortionary support instruments.
5. Clearly identify the objectives of the direct payment system and adjust the support system to strengthen the link between objectives and instruments. More specifically the policy should:
 - Make all support conditional upon “good farming practice”, a set of minimum standards in the fields of environment, hygiene and animal welfare.
 - Make payments for farmers and rural entrepreneurs’ contributions to public goods (e.g. environment, landscape, biodiversity, ...) conditional upon clear, well defined, and transparent targets to be met with respect to specific objectives.
 - Make the “compensation-part” of the payments degressive over time, i.e. gradually reduce them, with a clear time path and a sufficient transition period to allow farmers to adjust their investments and activities.
 - Make the remaining payments decoupled from production; this has advantages of better reaching small farmers, lower administration costs, reducing competition distortions in an enlarged EU and thus less WTO constraints.
6. Reinforce and ensure policy efficiency of the rural development strategy. This should include careful design, including rigorous and transparent evaluation procedures, of the instruments to ensure targeting and transfer efficiency; policies focused on removing constraints for farming families to participate in non-agricultural employment opportunities (instead of constraining these by linking support to farming); and coordination of the instruments within the 2nd pillar of the CAP with instruments under the Structural Funds.

TOWARDS A SUSTAINABLE EUROPEAN AGRICULTURAL POLICY FOR THE 21ST CENTURY

REPORT OF A CEPS TASK FORCE

CHAIRMAN: JOHN BRUTON
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1. Introduction

The Common Agricultural Policy (CAP) of the European Union (EU) has undergone major changes since it was first implemented at the end of the 1960s. The most recent reforms were decided at the Berlin meeting of the Council of Ministers in 1999 and are included in the Agenda 2000 agreement. Several commentators suggested that the CAP reforms included in Agenda 2000 reform package were insufficient to address the problems facing the CAP in the coming years, such as Eastern enlargement and new trade negotiations.¹

The view that further reforms were needed was not entirely disputed by the European Commission itself, which had proposed deeper reforms than were agreed in Berlin.² As a compromise, it was agreed to undertake a set of mid-term reviews around 2002-03, re-examining market developments as well as the situations of the agricultural budget.³ If nothing else, the mid-term reviews were to identify major problems earlier than 2006, the final year covered by the Agenda 2000 agreement.

In addition to existing pressures, several new developments have since reinforced the feeling that the existing agricultural policies in the EU need adjustments to make them coherent with the characteristics of a sustainable agri-food system that are demanded by European society at large.

There are several challenges. First, several Eastern European countries are preparing themselves for accession to the EU as of 2004. Agriculture plays an important role in their economies. An important debate centres on the issue whether CEEC farms can have access to the same CAP benefits as EU farmers, in particular direct payments (DPs). The budgetary schedule of Agenda 2000 does not include adequate provision for such payments.

¹ See, for example, Burrell (2000) and Nuñez Ferrer and Emerson (2000).

² Instead of 30%, as proposed by the Commission, the Council decided to cut the beef support price only by 20%; instead of a proposed cut of 20% for cereal support prices, it was decided at 15%, and dairy reforms have been postponed to 2005, instead of starting in 2000 as proposed by the Commission. Perhaps most surprising, a qualified majority of Ministers of Agriculture initially (in February 1999) agreed with a reform package close to the Commission's proposals. However, this compromise was "re-opened" during the final negotiations at the European Council (of Heads of State and Government) in Berlin in March 1999.

³ Specifically, the Berlin summit invited the Commission to assess the operation of the cereal and oilseed system, investigate the cattle market, present a report on the milk quota system, and examine whether the framework set for agricultural expenditures in the financial perspectives is appropriate. Later, the Council also asked the Commission to prepare a review report on the sugar regime by early 2003, as part of its recent (May 2001) decision to prolong the current regime for another five years (with some changes).

Second, the next WTO round was launched in Doha in the November 2001. At the same time, the European Commission has taken initiatives to open up trade with Mercosur, with the 48th lowest income countries – the so-called “everything but arms” (EBA) agreement – and with the ACP (Asian, Caribbean and Pacific) countries. These trade initiatives have potentially major implications for agriculture since Mercosur includes some major agricultural producers, while the EBA proposal would affect especially the sugar, rice and banana markets.

Third, several European agri-food crises (BSE, dioxin, foot and mouth disease (FMD)) in recent years, in addition to perceived negative impact of the CAP on the environment, have provoked strong reactions from consumers and environmental groups, demanding a radical overhaul of the agricultural practices in the EU and the policies that support these practices.

If nothing else, the debate on agricultural policy in the EU has been very lively and politically prominent over the past months. At the same time, however, the variety of different issues and demands for reform from various sources has made the debate complex.

2. Focus of the Report (Timing and Issues)

The timing of the debate is highly sensitive and the issues are complex. Several major developments, all of which affect each other, overlap: the WTO negotiations, the enlargement negotiations and the process itself, implementation of Agenda 2000 the mid-term reviews (MTRs), etc.⁴ For example, implementation of Agenda 2000 has begun, but the full impact will not be realised until 2006, or later. The mid-term reviews are scheduled to take place in 2002 and 2003, yet the financial framework has been set until 2006. Enlargement with a large number of members is expected to take place in 2004, i.e. during this timeframe. The WTO round has been launched and a commitment has been stated to reach agreement by 2003, the year when the peace clause runs out. The CEECs and the EU have already started aligning their WTO negotiation positions and consulting each other on the negotiations.

For these reasons, this report focuses on *strategic policy options* that are closely linked to the current CAP system to be sufficiently “hands on” yet refrains from becoming too

⁴ The dairy sector illustrates this complexity well. The quota system will, according to current legislation, remain in place until 2008. However, the Berlin summit decided that the milk regime will have to be reconsidered in the mid-term review in 2003, “with a view to eliminate quotas after 2006”. This means that accession negotiations, which include discussion on dairy quota allocations and direct payments, between the EU and the CEECs are happening at the same time as the EU is reviewing these policies and discussing reforms. Furthermore, accession negotiations may be completed for some CEECs in 2002. Hence, with mid-term reviews to be published at the earliest in mid-2002, serious discussions may not start until the fall of 2002 or spring of 2003 which raises several complicated issues of ratification and re-negotiations. Finally, even if the EU decides to liberalise the dairy regime, either for internal political reasons or as a result of the WTO Millennium round, a complete removal of dairy quotas is unlikely to take place before the first enlargement round. Consequently, even with substantial dairy reforms, either the EU must implement quotas in CEECs, or it must manage, at least temporarily, a quota regime in the EU-15 with a no-quota regime in CEECs, presumably within a single market. In addition, policy-makers must address the issue of compensation payments to CEEC dairy farms. These difficult policy decisions are caused by the failure of the 1999 Berlin Council meeting to agree on further and earlier reforms in Agenda 2000, particularly for the dairy sector.

specific in policy details. The latter, in our opinion, would divert attention from the more important strategic questions.

Similarly, the time period on which the report, and its recommendations focuses is the *medium term, beyond but relevant for the MTRs*. The discussion and the strategic recommendations are relevant as a framework for the strategic policy discussions that will unavoidably follow the MTRs, but are also directed at the years afterwards when decisions will need to be taken for the post-Agenda 2000 policy direction.

3. The Challenges

The Agenda 2000 reforms basically represent a deepening and extension of the 1992 MacSharry reforms.⁵ The reforms lowered support prices to reduce market distortions and compensated farmers through “compensation payments” or “direct payments” linked to the area used (e.g. for cereals and oilseeds) or to animals (e.g. beef). While total support to agriculture has stayed more or less constant,⁶ the MacSharry and Agenda 2000 reforms caused a major shift from support through price and market interventions to farm support through direct payments. In the early 1990s, most of the budget was spent on market and price support. Since then, direct payments have increased from less than 10% of the agricultural budget in 1991 to close to 60% by 1997. When Agenda 2000 will be fully implemented, around two-thirds of the budget will go to direct payments, and less than 25% to market and price support (see Figure 1).

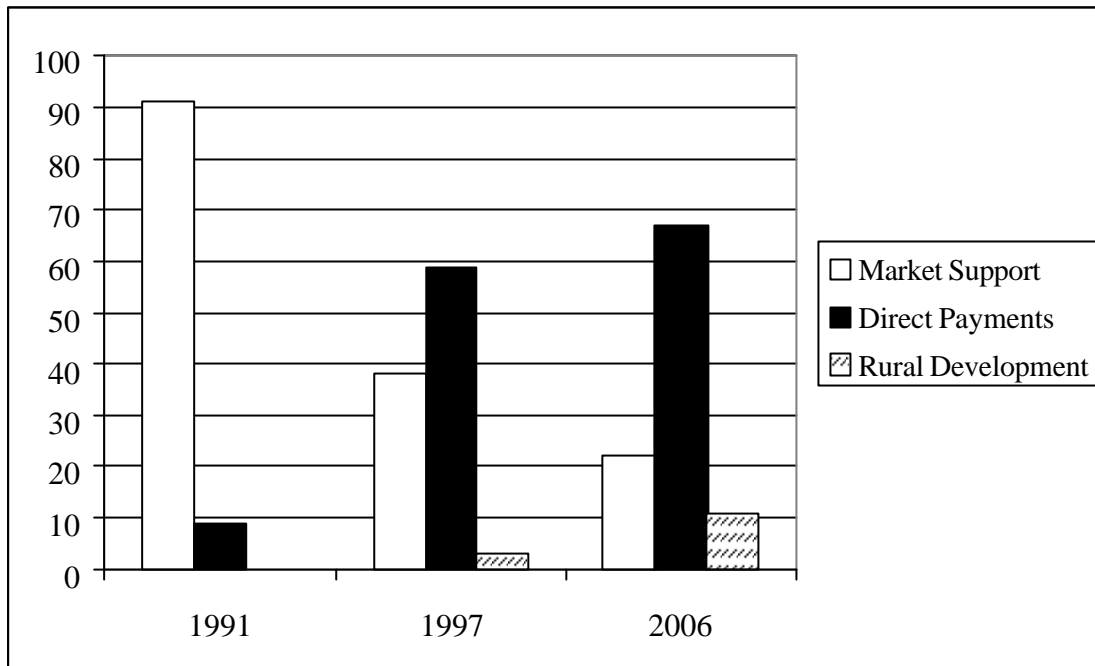
In addition, Agenda 2000 has streamlined and consolidated expenditures on rural development. Expenditures on rural development under the CAP have increased, although this is partly the result of the consolidation of the rural development measures under the so-called “second pillar”.

Despite these reforms, however, it is unlikely that Agenda 2000 will prove sufficient to face the challenges of this decade. Key issues in the debate include food safety, environmental and sustainability objectives, WTO, other trade negotiations and the Eastern enlargement. Last but not least, an important concern is how to reform the policy to take into account all these new constraints, and at the same time provide a future for European farmers, rural areas and the food industry. The report will first review the most important challenges and then present a set of recommendations.

⁵ Under Agenda 2000, price support is reduced further for cereals and beef and the direct payments in these sectors are increased to compensate farmers at least partially for the price cuts. In addition, direct payments for oilseeds will be phased down to the aid level of cereals, and the specific support regime for oilseeds will be abolished. A similar reform entailing support price cuts and the introduction of direct payments is foreseen in the milk sector, but only from 2005 onwards. Also, in the table wine sector, price support mechanisms are simplified, together with a limited introduction of new planting rights and reconversion aid.

⁶ Support to agriculture may have actually increased, because compensation through direct payments was based on gross revenue declines, while net incomes have declined much less. For example, OECD calculations on transfer efficiencies of OECD agricultural policies suggest that the average net income gains from market and price support in OECD countries was only 20% (OECD, 1997). This means that, after factor markets etc. have adjusted to the new situation, a gross income decline of, say, € 100 is causing a smaller net income decline. Hence compensation based on gross income decline is overcompensating, the extent of which depends on the transfer efficiency of the direct payments, which are also less than 100%.

Figure 1. Distribution of the EU agricultural budget (1991-2006)



▪ **Food safety**

With rising incomes, consumer demands for food quality and safety have increased over the past decades. This general trend has been strongly reinforced by several food safety crises over the past years, which have put food safety at the top of the agricultural policy agenda. Both the BSE crisis and foot and mouth disease (FMD) started in the UK and spread to the continent afterwards. The dioxin crisis started in Belgium, but had EU-wide effects through trade restrictions from other countries.

There were several important effects. First, consumers reacted forcefully to these events by reducing consumption significantly, albeit temporarily. Second, consumers and environmental groups put agricultural production processes and animal welfare issues at the top of the agenda. These strong reaction contrast sharply with the rather passive attitude consumers display towards traditional agricultural policy issues. Third, there were significant political impacts. In Germany, both the Minister of Agriculture and the Minister of Health Affairs had to resign in the wake of the discovery of BSE in the country. Two ministers, including the Minister of Agriculture, also had to resign in Belgium following the discovery of dioxin in the food chain, and the dioxin scandal contributed to a major electoral defeat of the governing parties. Finally, the EU budget faced significant additional expenditures both because of increased intervention purchases and because of additional policy measures to contain BSE and FMD.

Although several economists argued that these crises had little, if anything, to do with the Common Agricultural Policy (see e.g. Tangemann, 2001), consumer groups and environmental organisations called for an overhaul of the EU's agricultural policy in their aftermath. They argued that massive government subsidies to farming practices that did not adhere to appropriate food safety, environmental and animal welfare standards were unacceptable.

▪ **Environmental considerations**

Criticism by environmental groups of the CAP is not new. They argue that the CAP is a main source of increased environmental pressures, e.g. through stimulating more intensive use of pesticides and fertiliser and through expanding certain production activities into marginal and environmentally sensitive areas, e.g. through extensive use of irrigation.

While the environmental critique is not new, the social and political developments as described in the previous paragraph have added a sense of urgency and a increased political clout to the environmental agenda in the CAP discussion. A sign of the increased importance of this factor can be seen in the recent initiatives of some major players in the EU food industry. Not only have several of these companies publicly recognised the importance of sustainability, with a major emphasis on environmental considerations, but some have also set up initiatives within this framework (see Laan, 2002).

There is now a strong coalition of environmental groups, official representatives of EU member states and food industry representatives that is committed to the belief that a CAP for the 21st century must pursue its traditional objectives in a manner that is consistent with environmental sustainability objectives. Moreover, they explicitly demand a public policy that clearly defines objectives for environmental protection and integration within CAP measures, accompanied by commensurate financial support. Doing this would require profound changes in the current CAP.

▪ **WTO**

The new WTO negotiations, which were officially launched in Doha, will have important implications for EU agriculture and the CAP. The negotiations are likely to lead to a further reduction in tariffs, domestic support and, especially, export subsidies.

Export subsidies are the prime subject of criticism by the EU's trading partners. The next WTO round will likely lead to a substantial reduction, if not elimination, of EU export subsidies. In any case, a substantial reduction will have important consequences for some of the commodity regimes under the CAP.

The Uruguay Round Agreements Act (URAA) imposed constraints and reductions on trade-distorting domestic support.⁷ While the international political coalitions in the debate on the reduction of domestic support are complicated by the recent surge in

⁷ Agricultural domestic support is classified in three "boxes", depending on how trade distorting the policies are. The "green box" is a category of so-called "non- or minimally trade-distorting" support policies, which are not restricted under WTO rules. The most trade-distorting policies are in the "amber box". A considerable amount of domestic support in the EU (and the US) was classified as "blue box" support, linked to supply management measures. The "blue box" includes the EU's direct payments which were introduced under the MacSharry and Agenda 2000 reforms. The URAA includes a due restraint provision (the "peace clause"), which is in force until the end of 2003. Domestic support measures that comply with the URAA commitments [whether included in the AMS (aggregate measure of support) or exempted in the blue box] cannot be challenged under the Agreement on Subsidies and Countervailing Measures rules (as long as support for individual commodities does not exceed the level decided in the 1992 marketing year).

distortionary support to US farmers,⁸ it is unlikely that the WTO negotiations would end without an agreement to further reduce trade-distorting support, although ex ante it is hard to predict how much, and whether any special agreement for blue box-type support would be continued.

To defend the continuation of trade-distorting agricultural subsidies, the EU is emphasising the joint production of public goods, under the concept of “multi-functionality” and “non-trade concerns”. The “European farm model” emphasises that farming is a *multi-functional* activity which not only results in agricultural production, but also produces environmental public goods (e.g. rural landscapes), high quality food, decent animal welfare standards, rural development, etc., all of which are valued by European society. Hence, it is argued, governments should reward (subsidise) farmers for these multi-functional, public good effects which are not rewarded by the market.

Analyses of the multi-functionality concept,⁹ among others by the OECD, come to the conclusion that from an economic perspective it is often more efficient to use different, more direct and targeted, policy instruments to address these public good objectives than to support farmers in the form of direct payments or price support.

Moreover, commentators have argued that the current CAP is itself inconsistent with the European farm model. Or as Louis Mahé (2001, 15) recently formulated the dilemma: “The European model of agriculture is defensible, [but] the European model of agricultural policy is hard to defend as it stands.” In this context, the CAP will need to be changed in order to make it consistent with the EU’s own concept of the European farm model and, hence, to be able to plausibly argue that the support is contributing to public good provisions.

▪ Other trade negotiations

The WTO is not the only trade arrangement affecting EU agricultural and food markets and the CAP. Many developing countries have preferential access to the EU market under special agreements, such as the former Lomé, now Cotonou Agreement.¹⁰ Since the 1999 WTO conference in Seattle, the position of the developing countries has become more important in international trade negotiations.¹¹

Several trade initiatives have recently been taken to stimulate both multilateral and regional trading agreements. Among the latter are initiatives for liberalising trade

⁸ The 2002 US farm bill both increases support to US agriculture and retreats from the previous farm bill’s strategy to decouple support from production; much of the support under the new farm bill is coupled.

⁹ For a discussion see, for example, OECD (2001), Latacz-Lohmann and Hodge (2001), Mahé (2001) and Mullarkey et al. (2001).

¹⁰ To illustrate the extent of this factor, consider that among the 141 participants in the WTO, many of them developing countries, the EU has special trading agreements with almost 100.

¹¹ One should not forget that developing countries are a heterogeneous group. They are heterogeneous by the structure of their economies and their international comparative advantage in agriculture and food production; and heterogeneous in the costs and benefits from current EU agricultural and trade policies. In highly regulated EU markets, such as the sugar and banana market, preferential trading agreements may yield major benefits to some of the developing countries that enjoy this access, such as ACP (African, Caribbean and Pacific) countries. Therefore, developing countries have quite divergent preferences on reform of the CAP commodity policies and trading regimes.

between the EU and Mercosur, and Chile. With members such as Brazil and Argentina, it goes without saying that liberalisation of agricultural trade within such an agreement would have a major impact on EU agri-food markets.

Another initiative, the “Everything but Arms” (EBA) trade agreements will allow all imports of the 48 poorest countries without restrictions into the EU market. The Everything but Arms proposal was heavily opposed by interest groups from the rice, sugar and banana sectors. These lobbying efforts resulted in some revisions of the Everything but Arms proposal before it was adopted by the Council. The revisions have reduced the impact on those sectors, but only temporarily. Liberalisation will be phased in for several years for the three sensitive products. For example, tariff quotas for sugar will gradually increase from 2001 onwards, but tariffs cuts will only start in 2006 and full liberalisation will occur in 2009. Nevertheless, these trade initiatives will also have important implications for these markets and CAP regimes.

▪ **Eastern enlargement**

Up to ten Central and Eastern European countries (CEECs) will become members of the EU from 2004 onwards. Much has been written on the agricultural implications of accession.¹² Several aspects are important for agricultural policy in an enlarged EU. The general message, however, is that enlargement will reinforce existing constraints and challenges.

First, the CEECs are not a homogeneous bloc, and certainly not in agriculture. Countries such as the Czech Republic and Slovakia are characterised by a domination of very large-scale farming organisations, while other countries such as Poland, Slovenia and Latvia are dominated by small-scale family farms. Some of the countries and regions are fit for highly competitive agricultural production – e.g. the Hungarian grain areas – while others are more likely to face major competitive pressures from EU imports. The heterogeneity of these regions reinforces the demand inside the EU-15 to develop a policy strategy that takes this heterogeneity and regional diversity explicitly into account.

Second, the integration of the CEECs into the CAP will make it more difficult for the enlarged EU to stay within its current WTO constraints. While the market effects of the enlargement process will be less dramatic than some observers initially predicted, the impact will be significant and will underline the need to shift from support policies based on market interventions and export subsidies towards less distortionary policies. Further reductions of trade restrictions and support under the new WTO round will reinforce these pressures.

Third, the enlargement process will cause or reinforce budgetary pressures. These come both from the CAP and from the structural policies. Concerning the CAP, most budgetary effects come from the extension of direct payments to CEEC farms.¹³

¹² See for example, European Commission (2002), Hartell and Swinnen (2000), Tangermann and Banse (2000).

¹³ Enlargement will also have important budgetary and intra-EU distributional implications for the structural funds. Without any changes in the rules, most of the regions currently benefiting from structural funds would lose this support and most of the structural support would shift to the association countries, as their income is considerably lower than the EU average. In 2001, Spain received 63% of the structural

Agenda 2000 did not include provisions for extending direct payments to CEECs. Several arguments were advanced at the time including: there is no need to compensate CEEC farmers for price reductions; direct payments will distort the CEEC economies and constrain restructuring; the benefits of direct payments in CEECs will dissipate outside of agriculture since land is owned in several countries by urban households owing to the land restitution process; there are huge implementation problems and administrative costs of DPs; and finally, there is more need to support restructuring and modernising CEEC agriculture (see European Economy, 1996).

Most of these arguments against extending direct payments to CEECs can also be made against providing direct payments to EU-15 farmers. There are more effective ways of supporting income and of modernising agriculture also in the EU-15. Direct payments become capitalised in land values and benefit interested parties other than poor rural households or farmers, depending on the land markets in the member states. Finally, in some regions, such as former East Germany and in Sweden, farmers currently benefit from direct payments without actually having experienced a price decline with accession.

The argument that EU-15 farmers should be treated differently from CEEC farmers, except for the duration of a transition period, is untenable, both from the single market perspective and on political grounds. This then raises the issue whether direct payments have to be provided to CEEC agriculture or whether direct payments should be reduced in the EU-15.

A European Commission paper (2002), presented early this year, proposes a transition period of several years during which time direct payments will be gradually extended to CEECs, starting from a 25% level at the time of accession in 2004, and gradually increasing to 100% by 2013.¹⁴ By design, the budgetary implications of the Commission paper fit neatly into the Agenda 2000 financial framework (see Table 1).

In addition, Agenda 2000 has streamlined and consolidated expenditures on rural development. Expenditures on rural development under the CAP have increased, although this is partly the result of the consolidation of the rural development measures under the so-called “second pillar”.

funds budget of €31.5 billion. While 10 of Spain's 17 regions currently receive EU structural funds because their per capita incomes are below 75% of the EU average, Spain fears that all but the two poorest regions would lose support from the structural funds after enlargement. A large share of these funds would then go to Poland under current EU rules. According to some estimates, in fact 30% of the total structural funds would go to Poland. Some EU-15 countries that currently benefit most from the structural funds are demanding a change in the rules and a transition period so that they would not lose most of their current benefits with enlargement.

¹⁴ In addition, this same paper presents quite a bit of debate on the calculation of the DPs, the allocation of production quotas, etc. DPs are based on historical bases of output, factor use and yields. While the CEECs argue that the historical reference period should be the pre-1989 period given the dramatic fall in output and yields that have attended the transition, the European Commission is arguing that the pre-1989 period was completely artificial and that output, factor use and yields were the result of a Communist central planning system that has no relevance to a market economy and can therefore not be used as reference period. The Commission accepts the argument that the early transition situation is not a relevant situation either, so their proposal is to use the most recent period as reference for basing the indicators for the DPs.

Table 1. Budgetary implications of the European Commission's draft common position of February 2002 (€ million, 1999 prices)

	2004	2005	2006
Direct payments	25%	30%	35%
- Commitments	-	1173	1418
- Payments	-	1173	1418
Market expenditures			
- Commitments	516	749	734
- Payments	516	749	734
Rural development			
- Commitments	1532	1674	1781
- Payments	748	1187	1730
TOTAL			
- Commitments	2048	3596	3933
- Payments	1264	3109	3882
Berlin amounts foreseen for agriculture (including SAPARD)			
- Commitments	2970	3450	3920

Despite these reforms, however, it is unlikely that Agenda 2000 will prove sufficient to face the challenges of this decade. Key issues in the debate include food safety, environmental and sustainability objectives, WTO, other trade negotiations and the Eastern enlargement. Last but not least, an important concern is how to reform the policy to take into account all these new constraints, and at the same time provide a future for European farmers, rural areas and the food industry. The report will first review the most important challenges and then present a set of recommendations.

Most CEECs have quickly reacted that this scenario is unacceptable, and that more direct payments should be given.

More important from the budgetary perspective is that the scenario says nothing about what would happen after 2006. Two recent studies converge on the ultimate budgetary cost of extending the CAP to ten CEECs (and Malta and Cyprus) at an estimated €4 to €5 billion annually.¹⁵ Direct payments account for more than half of this amount.

To get a feeling of the relative size of the subsidies, note that agricultural value-added (i.e. GDP) in the CEEC-10 was less than €8 billion in 1999. Hence, €15 billion of support from the EU budget would amount to more than 70% of the 1999 agricultural

¹⁵ See Weise et al. (2001), Silvis et al. (2001) and IBO/LEI/ (2001) for details and Swinnen (2002) for a summary. The variation in the budget estimates hinges on assumptions on quota allocations, reference yields and areas for direct payments. All of these variables are part of the negotiation process between the EU-15 (proposing lower levels) and the CEECs (demanding higher levels).

GDP in CEEC-10. Moreover, total support to agriculture is even higher because one has to add non-budgetary transfers from consumers through price and trade interventions. The OECD PSE (producer support estimate) indicates that, on average for 1998-99, for the EU-15, €67 billion were transferred to farmers through market support (including non-budgetary transfers). A rough estimate of the non-budgetary transfers to CEEC-10 farmers with accession would add another €-10 billion (all in 1999 prices). In total this means that the expected transfers to CEEC farmers in 2007 under the CAP may be larger than the value-added created in agriculture in those countries.

From this perspective, in combination with the Commission's proposal to provide extra support for structural programmes – which are obviously more needed in CEEC agriculture – the policy scenario in the commission paper is sensible.

Moreover, the possibility, as outlined in the Commission paper, to provide the payments on a flat rate per hectare basis should be supported. Providing flat rate payments reduces important market distortions inherent on the DP system as it is applied in the EU-15. They have the additional advantages of being much easier to implement, they imply less administrative costs and can be largely decoupled (and hence “green” in WTO terms).

Fourth, while there are important positive elements in the proposal as discussed above, there is a major and fundamental problem in terms of competition distortion. A fundamental criticism of any differential in the treatment of CEECs in terms of direct payments is that this would clearly cause a distortion of competition between East and West European farms in a single market. With direct payments paid per hectare or per animal, they are linked to production, and hence an unequal payment of direct payments within a single EU market would distort competition between CEEC and EU-15 farmers. This is a significant shortcoming of the current proposal, and the challenge is to find a solution to this problem while keeping the important positive characteristics of the proposed policy scenario to make it an integral aspect of a sustainable agricultural policy in an enlarged EU market.

Finally, enlargement will also reinforce food safety concerns. A rapid restructuring of farming practices and food processing enterprises is taking place in CEECs and will continue in the coming years. Nevertheless, there remains considerable concern in the EU that hygiene standards of the CEEC food processing plants and safety controls will still be deficient at the time of accession. This is both a concern from the perspective of both consumer protection and internal competition.

▪ **A future for European farmers**

One should not forget that farming is, first and foremost, a business from which people try to make a living. In order to prosper, such economic activity requires an environment that provides opportunities and sufficient freedom for investment and growth. The desire to introduce new objectives and conditionalities on CAP support should not lead to increased administrative burdens on farmers, diverting their talents and time from core activities, such as producing food of the best quality and price.

Few young people are entering farming in the EU-15 today. Employment in agriculture has declined significantly and continuously over the past decades. Agricultural employment, measured as “full-time farm equivalents”, has decreased by more than 3%

annually, on average, over the past decade in the EU-15, while the number of farms has declined around 20% over the same time period.

This dramatic decline in agricultural employment in the EU has occurred despite the large subsidies given under the old and the new CAP. It illustrates how the existing agricultural policies are inefficient instruments to address the structural problems facing farmers. OECD studies indicate that price support, the traditional CAP instrument, is a highly inefficient instrument to support farm incomes, since only 20% of gross costs to taxpayers and consumers ends up as additional income for farm households. Moreover, it is well known that the vast majority of price support benefits end up with the largest farms. The transfer efficiency of direct payments is higher, although leakage also occurs here, depending on how they are implemented. In terms of distribution, the direct payments as implemented in the EU still benefit disproportionately the larger farms: the largest 25% of farms receive between 40% and 50% of direct payments in Germany, France, Spain and the UK (Blandford, 2000).

Increasingly, EU agriculture is characterised by a bimodal distribution of farms: a small number of large farms that tend to obtain most of their income from farming and a large number of small farms for which agricultural activities provide only a small part of total household income. On average, in France the share of non-agricultural incomes in farming households is 30%; in Germany it is even 70%. Non-agricultural activities in rural areas make key contributions to farm household incomes. Studies show that, in the long run, the income growth in farm households is mostly attributable to better integration with the non-farm economy, through opportunities for off-farm employment and incomes, much more so than as a result of agricultural support policies (Gardner, 2000). Therefore policies intended to increase farm household incomes should focus particularly on removing constraints for farming families to participate in non-agricultural employment opportunities instead of constraining these by linking support only to farming. This is not only important from the perspective of rural development but also for farm household incomes themselves.

The accession of the CEECs will reinforce this bimodal distribution and development – and the need for appropriate policies to deal with them. All countries have a large number of small-scale, part-time farms, and many also have large-scale farming companies. The latter dominate in countries such as the Czech Republic, Hungary and Slovakia.

In combination, these considerations yield several implications. First, support should be decoupled as much as possible – both to increase transfer efficiency and to avoid waste in income distribution. Second, a sustainable development of full-time farming should be based on a long-run competitive agriculture, which in combination with an efficient food industry, should target both internal and external markets without having to rely on export subsidies. Third, a sustainable policy for supporting incomes of rural households that are not likely to become competitive farmers in the long run should be based on reducing constraints for their integration in the non-farm economy. This can be done by a variety of policies targeted at improving the functioning of factor markets in rural areas, investments in infrastructure and transitional support for investments linked to new activities. The latter can be addressed to an important extent through rural development policies.

▪ **Implementing rural development and the second pillar**

With Agenda 2000, the importance of rural development policies in the CAP has grown considerably. The Agenda 2000 decisions imply a considerable overhauling, streamlining and consolidation of the EU's rural development policy under the CAP. The growing importance of rural development seems to follow from the official reference to it as the "second pillar of the CAP":

[The rural development policy] will in the future be applicable in all rural areas of the Union and is meant to become the second pillar of the CAP. This sounds ambitious, and some critics rightly say that in terms of resource endowment, we are still far away from a real second pillar. This may be true, but the structures to get there have been put in place, the foundations have been laid down and if there is a political will to build on these foundations in the future, it can be done. Moreover, it may be worthwhile to think more about new approaches to rural development, relying much more on measures of financial engineering to mobilise synergies between public spending and private capital, between grants and credit instruments (Ahner and Scheele, 2000, p. 19).

Much remains to be done, however, to turn the current rural development measures into an efficient policy instrument to address its objectives. A recent evaluation of the implementation of the rural development measures and the Special Accession Programme for Agriculture and Rural Development (SAPARD) in CEECs (Dwyer and Baldock, 2002) points out some significant problems both with the design and the implementation of these measures: EU, national and local levels. The report concludes that "the reality of the implementation may not match the rhetoric and the positive aspirations that have preceded it" (p. 10). The implementation problems are due to a variety of constraints. If anything, the evaluation suggests the need for a careful and critical evaluation of existing measures, taking into account transaction costs and implementation problems.

There is also a need for further consolidation and integration with other programmes. Non-agricultural activities play an increasingly important role in the well-being of farmers in industrialised countries (Blandford, 2000). Even in most rural areas of the EU, agriculture is no longer the most important economic activity, and growth and "rural development" come primarily from other sectors. As documented in the previous section, most farming households obtain a significant and growing share of their household income outside agriculture, and non-agricultural activities are important for farming households. So far, the rural development policy under the CAP is heavily biased towards agriculture. Out of the seven subgroups of measures, five are completely or importantly linked to agriculture. Yet there are also measures targeted at rural areas and rural development under the structural policies of the EU. Hence a better and more thorough integration with these other measures would contribute to the broader rural development strategy.

Summary of the Challenges

In conclusion, important changes to the current policy are needed to address the challenges as outlined above, and to create a sustainable CAP for the 21st century. Key challenges to be addressed include:

1. A sustainable agricultural policy needs to anticipate major future developments, both positive and negative, in order to provide a stable framework for the years ahead for all involved, including farmers and the food industry.
2. The CAP needs to be consistent with the aim of the European agri-food system to deliver safe food.
3. Negative environmental externalities of the EU agri-food system need to be significantly reduced and positive environmental effects stimulated.
4. Market distortions in both internal and external markets should be reduced.
5. Enlargement will reinforce the need to keep budgetary implications under control and reinforce the need for a policy strategy that can cope with a wide variation in rural regions and agricultural structures.
6. The process of integrating the accession countries should not cause competition distortions in an enlarged EU market.
7. Policy instruments should be closely linked to policy objectives.
8. Enlargement will reinforce the need to be able to cope with major variations in regional characteristics, preferences, and production structures; and, hence, the need for integrating regional variations in policy within a generally agreed strategy of agri-food policy and rural development, without distorting internal competition.
9. Economic sustainability of farming requires a policy and institutional environment that provides opportunities and sufficient freedom for investment and growth.
10. A sustainable policy should also include considerations of the administrative implications for the agents involved in the implementation of the policy.
11. Rural development measures should be evaluated carefully, taking into account implementation problems, to turn these measures into an effective second pillar of the CAP.

4. Task Force Conclusions/Recommendations

1. *Good governance implies providing a sustainable policy framework and minimising the bureaucratic and administrative burden for farmers, rural entrepreneurs and the food industry.*

The policy strategy has to provide farmers and rural entrepreneurs with a clear framework for the years ahead, and one that is sustainable given the objectives of the CAP and the internal pressures and external constraints under which European agriculture and rural areas will function. This is needed to give the entrepreneurs the right signals for investment in the long run and the necessary stability. Good governance therefore implies signalling important future changes to come.¹⁶ Necessary transition periods can then be established and farmers, rural entrepreneurs and the food industry can adjust their activities accordingly.

Good governance also implies minimising the administrative and bureaucratic burden for the agents in the field. Everyone recognises that there is a very important role for public policy, both at the EU level and at the national/regional level, to ensure an agri-food system that is sustainable and addresses the demands of European society. However, the implementation of such public policy should be designed such that it allows sufficient flexibility for farmers, rural entrepreneurs and the food industry to react creatively to investment opportunities and changing environmental conditions, and minimises bureaucratic and administrative costs, while addressing the policy objectives. This concern should be kept in mind when considering whether to introduce new conditions for CAP support.

2. *The agricultural and food policy of the EU needs to be fully consistent with and supportive of a European agri-food system that has to deliver and guarantee safe food, and satisfy minimum hygienic, environmental and animal welfare standards.*

There should be no trade-offs on the issue of food safety. Ensuring food safety is a basic precondition of any agricultural/food policy.

That said, one should recognise that, given the inherent safety problems with biological products, complete food safety is impossibility – and consumers should be made aware of this. This applies to traditional food products as well as organic foods.

Specific policies should include minimal hygienic, safety and phytosanitary requirements as conditions for CAP support. Yet a more comprehensive approach to food safety requires closer monitoring and a supply-chain approach. The latter is needed, since the CAP may to some extent change the way farms produce agricultural products, but has only a limited impact on the rest of the food chain. Hence food safety issues for consumers should be addressed as part of a much broader approach, relying also on the food industry's capacity to monitor, and its

¹⁶ A recent study by the Dutch Ministry of Agriculture showed that neither market developments nor weather changes were considered as the main worries of farmers, but rather uncertainties regarding government policy affecting their incomes (see Massink and Meester, 2002).

responsibility to deliver, the products throughout the chain, and on close monitoring by an independent regulatory public authority.

A sustainable agricultural policy for the future should also be based on minimal requirements regarding the impact of the agricultural activities on the environment and animal welfare. This implies that in order to obtain any support, be it income support or support in the rural development policy, compliance with minimum standards in the fields of environment and animal welfare should be a requirement, and should be enforced.

An important consideration here is to ensure that the introduction of new conditions does not cause a major increase in administrative and bureaucratic burdens.

3. *Integrate sufficient flexibility to deal with a wide variation in rural regions, and in production structures.*

There are major variations in regional and rural characteristics and natural conditions within the European Union. These differences translate into differences in local preferences and policy demands. A sustainable policy should allow for these different preferences and needs to be addressed. This, unavoidably, implies a certain degree of decentralisation of policy-making and implementation.

The accession of the CEECs will reinforce the heterogeneity in European agriculture. This is obviously the case with new regions coming into the EU. However, the CEECs are also quite heterogeneous in terms of land use and farming structures. While all these countries have a large number of rural households where farming contributes only part of the income often from small-scale farming, full-time farming activities differ widely. In countries such as Poland and Slovenia, small-scale farms dominate agriculture. Yet, in countries such as the Czech Republic, Hungary and Slovakia a substantial share of the agricultural production comes from very large-scale corporate farms that have survived the transformation. While some of these may yet disappear in the coming years, a significant number of them are likely to become part of the agricultural system in an enlarged EU, and will be quite successful and competitive in the single market.

The best way of coping with such major variations in regional characteristics, preferences and production structures is to design a general strategy of agri-food policy and rural development that allows for important regional variations in policy-setting and implementation in specific policy areas (such as rural development instruments) and that ensures that such policies do not distort internal competition. Continuing the policy direction towards a market-based policy system and by decoupling farm and rural support from production will facilitate these objective. To avoid potential conflict with the single market, strict control by the Commission may be indispensable.

4. *Continue the policy strategy towards a more market-oriented agri-food system.*

Continue the general policy towards a market-based agri-food system, by replacing price support with more direct and less distortionary support

instruments. This will allow EU farmers and the food industry to operate in a more flexible environment and to benefit from international export opportunities. Moreover, it would provide a more consistent overall policy framework, which will also make it easier to decouple income support from production.

This general reform process needs to be continued in the sectors under scrutiny in the Mid-Term Reviews, such as cereals and beef, and considered for other sectors. The main sectors that are still subject to high price support and highly regulated production systems are the sugar and the dairy sectors. Yet a combination of important developments will make significant changes in both sectors unavoidable.

The implementation of the Everything but Arms (EBA) agreement, and potentially the alignment of market access of other developing countries with EBA countries, will have a major impact on the EU sugar market. In combination with significant reductions of export subsidies in the future, e.g. following the next WTO round, will require a complete rethinking of the EU's sugar policy. The same reform strategy already implemented in other sectors, such as cereals, would have important benefits from the perspective of the overall policy strategy, as it would make it easier to shift to more decoupled payment systems such as flat-rate per hectare payments for crop products.

In the dairy sector, Agenda 2000 already introduced a modest shift to a more market orientation. Pressures for going further will increase with a reduction of export subsidies, combined with implementation problems of the dairy regime in Eastern Europe (Colman et al., 2002; MTT, 2002).¹⁷ Furthermore, the quota system has the paradoxical effect that high price supports are needed to compensate dairy farmers for increased production costs due to expensive quota purchases. While this effect differs from one member state to another, as the national quota allocation systems differ, the additional costs, as well as the constraints they impose on farm growth and investments, are significant.¹⁸

There are significant budgetary implications of such reform: estimates put the total amount of extra budget required at around €2 billion in the short run and €4.3 billion when they are fully implemented, of which two-thirds are for the EU-15 and one-third for the CEEC-10.¹⁹ Financing this within the current EU-15 would require a degressivity equivalent to, i.e. gradual reduction with, less than 20% of current direct payments (IBO/LEI, 2001).

¹⁷ A recent study on the effects of phasing out the milk quotas in the EU concludes that “the present policy has become expensive and largely ineffective” (Colman et al., 2002).

¹⁸ The additional costs attributable to leasing of milk quotas in the United Kingdom are equivalent to 12.5% of total farm revenue from milk production. Such additional costs represent a major burden for anyone attempting to enter dairy farming in the United Kingdom or to increase the scale of their operation (Colman, 2002).

¹⁹ Under the scenario that dairy reforms of 15% price reduction with 50% compensation implemented under Agenda 2000 is repeated from 2007-09; sugar reform of twice 15% price reduction with 50% compensation (as in dairy, one in 2003 and one in 2007); one third of the costs would be for sugar, two-thirds for dairy – based on simulations in IBO/LEI (2001).

5. *Identify the objectives of the direct payment system and adjust the support system to strengthen the link between objectives and instruments.*

A prominent central element in the debate on the CAP is the future of the direct payments. Direct payments feature in the WTO discussions, in the budgetary aspects and in the CEEC accession negotiations – and potentially also in the discussion of how to address environmental and animal welfare demands.

Any discussion on the future of DPs first requires coming to terms with the instrument's objective. While the MacSharry proposals of 1991 referred plainly to “a system of compensatory payments...to compensate losses of income caused by the reduction in institutional prices”, the Agenda 2000 document used terms such as “direct payments”, “direct income payments” and “direct compensatory aids” (Beard and Swinbank, 2001). The change in terminology reflects a shift in thinking about the nature of the payments and their role in the CAP.

Hence, what is the objective of the DPs in the CAP of the 21st century? Are they compensation for past price declines to allow restructuring during a transition phase? If so, there is a good argument for reducing them gradually after an adjustment period. Or, are they measures to support farm income, in which case one could gain importantly in terms of transfer efficiency by targeting them better to low-income farm households, by linking them directly to farm income and by decoupling them from production. Or perhaps they should serve as a reward to farmers for specific activities, such as environmental practices, in which case, the payments should be made conditional upon specific contributions of the farms.

This logic of linking payments more closely with the policy objectives leads to more specific recommendations, as detailed below.

- Make *all* support conditional upon “*good farming practice*”, a set of minimum standards in the fields of environment, hygiene and animal welfare that can be expected from all farmers without any need for special compensation – and a similar conditionality could be imposed on other rural entrepreneurs or the food industry benefiting from EU support – and enforce this conditionality.
- Make payments for farmers and rural *entrepreneurs' contributions to public goods* (e.g. environment, landscape, biodiversity, etc.) *conditional upon clear, well defined, and transparent targets* to be met with respect to specific objectives.

Public goods contributions are likely to require important regional differentiation, and can be included in Pillar II. At the same time, Pillar II payments, also under review at the Mid-Term Review, should include measures to assist farmers in the restructuring process towards more sustainable production processes.

- Make the “*compensation-part*” of the payments *degressive* over time, i.e. gradually reduce them, with a clear time path and a sufficient transition period to allow farmers to adjust their investments and activities. This degressivity of at least part of the payments has the major advantages of:
 - reducing the budgetary pressure, and as such
 - facilitating the enlargement process,
 - reducing competition distortions in an enlarged EU,

- freeing up funds to be spent for compensating dairy and sugar producers for market reforms in those sectors, and
- freeing up funds for rural development policies.

While modulation of the direct payments could also be used for some of these objectives, degressivity has advantages over modulation²⁰ by being:

- simpler to administer,
 - more transparent and
 - less competition-distorting among production structures.²¹
- *Decouple* the remaining payments from production. This can be done, for example, by applying a flat rate per hectare for all farms, possibly in combination with a further simplified and decoupled support scheme for small holdings by providing lump-sum payments based on proof of environmentally-friendly maintenance of production capacity only.²² This system has major advantages of:
- better reaching small farmers,
 - lower administration costs,
 - reducing competition distortions in an enlarged EU and
 - less market distortions.

For small farms, providing support as a fixed amount simply based on “good farm practice” requirements would go a long way into the direction of real decoupling. An idea presented by Commissioner Franz Fischler to set €2,500 as the upper limit for this measure would imply that more than two-thirds of all EU agricultural holdings would fall within this scheme. The proposal not only has important potential improvements for the EU-15, but certainly also for the accession countries and the process of enlargement. For example, in a country such as Poland, the large majority of its farms would fall within this category. By reducing the administrative requirements for obtaining support, it would make payments accessible for more, and especially, the smallest and poorest farms.

²⁰ The recent problematic experience of France with modulation illustrates some of the difficulties of applying complex modulation procedures.

²¹ There is potentially also an advantage based on the complexities of working out the modulation agreement which has significant implications for regional governments. For example, a 2001 German government proposal on modulation ran into major difficulties because of financial implications for the regional governments. Despite the clear reform intentions and a great deal of political capital used, the German minister, Renate Künast, failed to overcome opposition from the federal states (Länder) to introduce the maximum modulation and use the funds for rural development and agri-environmental measures. The agreement reached in July 2001, only allows 2% of direct payments to be committed to rural development projects in 2003, which is considerably less than the amount proposed by the government. Furthermore, the budgetary situation of the regional governments is further complicated in Germany as they are faced with strong pressures to reduce budget deficits but have little room to cut spending in the short run as most of their expenditures have structural characteristics.

²² A more radical option is to completely decouple the entire direct payment support so that it would fit into the green box. This is the essence of the proposal launched by Beard and Swinbank (2001) and Swinbank and Tangermann (2000), to convert, through several steps, the current system of direct payments into a system of bonds, which would be truly decoupled, i.e. no longer linked to land use or animals.

An important additional advantage of the decoupled system is that it has much more chance of being considered as green box in the WTO. Tightening some environmental conditions (“cross-compliance”) of the payments in itself is unlikely to make blue payments green. Although the green box does specifically provide for “payments under environmental programmes”, mere cross-compliance does not meet the criteria set by the green box for those payments.

6. *Reinforce and ensure policy efficiency of the rural development strategy.*

Rural development should not be seen as an instrument to satisfy WTO constraints or pressure from environmental groups. It makes more sense to make rural development – in the full meaning of the concept – the objective of EU policies, and not an instrument to address political constraints.

A broad rural development strategy should include a focus on non-agricultural rural activities and objectives. In most rural areas of the EU, agriculture is no longer the most important economic activity, and growth in non-agricultural activities plays an increasingly important role in the well-being of farming households. The policies should focus on removing constraints for farming families to participate in non-agricultural employment opportunities instead of constraining these by linking support to farming. This is not only important from the perspective of rural development but also for farm household incomes themselves. In the longer run, growth of income in farm households comes from better integration with the non-farm economy, through opportunities for off-farm employment and incomes.

A broader rural development strategy than is permissible under the current “rural development” pillar of the CAP (where most of the funding goes to agricultural-related activities) can be achieved by broadening the target of the pillar, and/or by integrating it more strongly with the objectives and policies of other EU policies, such as the structural funds. This requires a stronger and more explicit complementarity of instruments within an overall EU rural development strategy.

That said, it is important to put in *a word of caution* on the efficiency of the policy instruments in this field, and to ensure that new instruments and policies being set up under the rural development heading will effectively deliver what is expected from them, and deliver it to the region and people at which they are targeted. Rural development policies should be carefully designed with these aims in mind, and there is a need for a rigorous and transparent evaluation procedure to enhance the transparency and transfer efficiency of these instruments.

In summary, reinforcement of the rural development policy should include:

- policies focused on removing constraints for farming families to participate in non-agricultural employment opportunities (instead of constraining these by linking support to farming);
- coordination of the instruments within the 2nd pillar of the CAP with instruments under the structural funds; and
- careful design, including rigorous and transparent evaluation procedures, of the instruments to ensure targeting and transfer efficiency.

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