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The Common Agricultural Policy

Overview

1. Key concepts

- Elasticity: Low elasticity = the demand for a good is relatively inelastic when the quantity demanded does not change much with changes in price

- Self-sufficiency: self-sufficiency is > 100 when domestic production exceeds demand

- Externality: An externality occurs when a decision causes costs or benefits to third parties

- Capitalization: Capitalization = farmland values are closely tied to the income generating capacity of the land

- Political asymmetry: Political asymmetry = the fact that well-organized groups have more political power than non-organized groups

- Balanced-budget rule: A rule that budgets should always be balanced

2. The agricultural sector

- Agricultural markets are more unstable than other markets. Causes: a) on the demand side, agricultural products are vital necessities and so have very low price elasticity, B) on the supply side the weather may cause large fluctuations in the production volume.

- Figure (next page): Illustration of the “hog cycle” – it all begins with a sudden rise in the demand from D1 to D2

- Table: The sector as a whole - falling share of GDP and employment for the EU (in percentage):

Indicator	1950	1960	1960	1970	1980	2000	2003 *	2003 **
GDP	12	8	6	4	3	2	2	2
Employment	30	21	13	10	7	4	4	5

*   = EU-15
** = EU-25

- Main cause: The low elasticity for food products

- The size of farms: the average farm size doubled between 1960 and 2003

- Farms with more than 100 hectares represented 6 per cent of the number of farms and 43 per cent of the land

- Table: Self-sufficiency ratio for selected agricultural products, 1960-2000

Product	1960	1973	1974	1981	1990	2000	2000 **
Wheat	90	111	103	117	127	116	113
Maize	64	67	58	66	77	97	100
Sugar	104	116	91	135	128	137	131
Wine	89	101	99	102	112	113	n/a
Butter	101	118	101	120	121	n/a	n/a
Powdered milk	139	191	208	411	272	n/a	n/a
Beef	92	85	92	105	101	103	n/a

3. The structure of the CAP

Objectives of the CAP

a) increase productivity
b) ensure a fair standard of living for farmers
c) stabilize markets
d) ensure supply
e) ensure reasonable prices

Contradictions, for example:

b) versus c)
c) versus d)
a) versus c)

Guiding principles

1) a single market = removal of barriers
2) community preference = EU priority
3) financial solidarity = cost-sharing

4. Traditional mechanisms of the CAP

- buying surplus goods – intervention process
- import quotas/ levies
- export subsidies

Too great a success?
When the CAP was set up, the EU was not self-sufficient in most agricultural goods

But its success led to problems:
1) Guaranteed high prices encouraged overproduction
2) storage costs – 2 “butter mountains” and “wine lakes”
3) environmental damage resulted from over-intensive farming
4) 20% of the farmers received 80% of the CAP budget
5) trade restrictions led to trade disputes

6) export subsidies depressed world prices

Consequently:

By the early 1990s, the CAP came under pressure to be reformed:

- from consumer and environmental groups (pesticides, fertilisers, landscape, “mad cow”)
- from states outside the EU during international trade negotiations due to the fact that the GATT/WTO agreed on world wide liberalisation of trade in agricultural products
- from ministers of finance in order to reduce the EU’s budget outlays
- from (in the late 1990s) the enlargement of the EU by new Member States with important agricultural sectors

5. CAP reforms

Milk quota system, 1984:

Milk quotas at the individual farm level
1) the advantages are principally to reduce budget costs due to reduced overproduction
2) ease the strain on external relations because of reduced exports
3) prices on milk products are kept high
4) capitalization of the quotas = rent-seeking by quota owners

MacSharry Reform 1991-92:

1) price cuts (cereals, beef)
2) direct income support
3) set-aside scheme
4) accompanying measures

Fischler Reform 2003-05:

1) single payment to farmers decoupled from production
2) cross-compliance with objectives concerning the environment, safety and quality of food, animal welfare, and the landscape

New CAP

1) prices of agricultural goods in the EU are increasingly set by the free market
2) addressing market failures of the CAP: negative externalities (the environment) and information asymmetry (food quality and safety)

6. CAP policy making

“Iron triangle” = 1) Council of Ministers, 2) officials of the Commission, and 3) European-level farming interests

1) Council of Ministers
- agricultural ministers are often from parties that are supported by farmers
- agricultural ministers have their own supporting committee, Special Committee of Agriculture

2) Commission
- agricultural interests are, to a certain extent, protected by the Commission
- the commissioner has always come from a farming state
- DG Agriculture is powerful and the largest DG in the Commission
- close networks with agriculture

3) Farming interests at the national level
- COPA, influential and well-resourced

1) + 2) + 3): Vested interests in defending the CAP

The undermining of the iron triangle:

1) social, economic and political changes in the EU have reduced the power of agricultural interests:
- fewer and larger farmers
- falling share of GDP

2) new external pressures for the CAP to be reformed:
- agricultural subsidies became part of GATT/WTO

3) enlargement in 2004 with 10 new Member States (including Poland)

7. Explaining CAP expenditures

Three important issues:
1) the size of the agricultural budget
2) the relative decline of the agricultural budget
3) why some individuals, regions and Member States are net winners while others are net losers

Four explanations

I) The EU budget is an equilibrium outcome of a **bargaining game** between the governments

Each government makes a cost-benefit calculation: how much am I willing to pay/ take out of the EU budget
= how much it believes it will gain/lose from the EU's non-fiscal policies (single market, EMU)

- expansions of the budget = losers from the process of economic integration demand fiscal compensation

- cuts in the budget = those which benefit most from the budget can be "bought off" with other policies

Empirical evidence:

The more a Member State is a net importer from the rest of the EU, the more it receives from the EU budget
– Exceptions: Ireland + Denmark, they are wealthy export-oriented states, but (until recently) net recipients from the EU budget
- Explanations: governments with anti-European citizens will demand more from the EU in return for their continued participation in European integration

II) The power of particular **interest groups**

The logic of collective action theory
= groups that can secure concentrated and selective benefits tend to be more able than groups with diffuse interests to organize with the goal of influencing the policy process
= political asymmetry between well-organized farmers and non-organized consumers
- farmers lobbying through COPA create a powerful lobbying group

III) Strategic behavior by the **Commission** to promote its own institutional interests

- the Commission can use its agenda-setting powers in the expenditure game
- what are the interests of the Commission:

a) to promote European integration
b) to secure approval of its policy proposal from key Member States and influential groups

IV) Institutional rules of the **expenditure game**

- the multi-annual budgetary bargains are decided by unanimity between national governments in the Council
= everyone must win, otherwise individual Member States will exercise a veto
= governments exchange support for each other's policies

- the annual CAP budget is decided by qualified majority voting
= this enables the majority to redistribute resources from the minority or from the meekest groups (consumers)

EU budget characteristics
- the “balanced-budget” rule places a significant institutional constraint on the EU budget
= the EU was forced to reform the CAP before the enlargement in 2004

8. CAP and business strategy

- *European agro-business*: the CAP is the regulatory framework that, first and foremost, determine its operations within the EU and out of the EU

- *Retail chains*: the CAP has a great impact on the selection of meat, fruits, etc. that can be sold in stores

- *Non-agro-business*: changes in the CAP influence what can be sold to farmers

- *Non-European agro-business*: the CAP is the regulatory foundation for whether or not it is possible to penetrate the European markets