An introduction to the Common Agricultural Policy: Principles, objectives and orientations

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AN INTRODUCTION TO THE COMMON AGRICULTURAL POLICY: PRINCIPLES, OBJECTIVES AND ORIENTATIONS

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1. THE ROLE OF AGRICULTURE IN THE EU - ORIGINS OF THE CAP

Since the establishment of the European Economic Community (1957), the agricultural sector has played a central role in the formulation of the total economic and commercial policy of the new foundation, as it was envisaged by the Treaty of Rome. There are several reasons for this:

Firstly, agricultural activity has always counted one of the most essential parameters of European social and cultural life in general. Secondly, agricultural sector has historically been a main source of tensions between the European nations and countries. Thirdly, European farmers have carried - and still continue to do so - great political weight in the parliamentarian regimes of the European democratic systems. Fourthly, and most importantly, in post-war years and after the tragic experience of World War II, a strategic choice for most European countries was the rapid achievement and guarantee of **food security**.

The last target was actually a prerequisite for the stabilisation of the newly established Organisation as well as for its further development. It could therefore be claimed that the very perspective of the Community integration as such was based, to a certain extent, on the assumption that the common objectives for agriculture set by the founder members could be attained.

Therefore, right from the very beginning, agriculture was accorded "special treatment". The inclusion of agricultural products into a "common market" was considered to be a "*sine qua non*" condition for the success of the operation of the initial six (6) Member States. For the whole Community, agriculture was to be subject to common rules which would comply with the basic orientation of a customs union, which is:

* The full abolition of any barriers on the internal frontiers (tariffs, duties etc.) to achieve free movement of the agricultural products among the Members

* The formation of a Common Customs Tariff concerning trade with the third countries.

In that sense, as far as agricultural markets are concerned, the existence of a Common Agricultural Policy (CAP) prevents the Member States from exercising their own "independent" national policy. Once a State becomes a full member of the Community, the responsibility for selecting and using the measures and instruments necessary for the formation and management of the agricultural policy in its entirety is ipso facto transferred to the Community Institutions, especially to the Council of Ministers (for agriculture) and to the EU Commission. The right of each Member State to decide its own agricultural policy is practically limited by the obligation to co-decide with its partners on any regulations applied to agricultural markets covered by CAP.

Apart from the above mainly "economic" reasons, there was one more, of political importance, that suggested the special treatment and full incorporation of the agricultural sector into the Customs Union.

The first visualisers of the Community considered that a European Union could not be created unless it could be guaranteed that the economic and commercial interests of all the partners (especially of the two biggest ones, Germany and France) would no longer provide the basis for the outbreak of intra-European crises. Consequently, the primary interests of the two countries would have to be secured through the full integration of their economies following their accession to the Community.

In the case of Germany, this objective would be fulfilled if the market access for its competitive industrial products to the other Member States was significantly improved, while, at the same time, Germany rather favoured the protection of its agricultural sector, mainly of cereals.

On the other hand, France was the largest producer and exporter of agricultural products in Europe. The accession of France to the EEC would expose its industry to German competition; consequently, as a counterbalance to the German advantage, France should benefit from a corresponding respective improvement in the market access for its agricultural products.

Therefore, the establishment and development of CAP was mainly based on the "smooth" operation of the Paris-Bonn axis. Each time there was a common belief and "mutual understanding" between the two parties, CAP developed spectacularly; as a result of quite rapid decisive steps the two countries constituted the driving force behind a more integrated Europe. On the contrary, when there were some conflicts, things became "tough" for the Community as a whole.

Of course, this does not mean that the interests and the will of the other Members were ignored. It should be mentioned that each time there were new accessions, CAP was enriched with new elements (see below) in order to meet with the needs of the new Member States, even though the emerging problems were of limited importance for the founder Member States.

Nevertheless, the Community agricultural sector as a whole accounts for about **2.5 % of the total Gross Value Added**, while agricultural commodities represent almost **9 % of total exports** and **11-12 % of total imports**. Taking into account the other upstream and downstream activities, such as inputs purchased by farmers, food processing and distribution, wholesale and retail sales outlets, rural tourism and occupations concerned with leisure time, it is true that agriculture has a much wider impact on the European economy than figures for output and trade indicate.

On the other hand, the contribution of the sector to employment, although dramatically changed over the last decades, continues to be substantial in social terms since about 16 million people (5.3% of the total employment) still work on farms, of which 8 million are farm heads.

It should be noted that, apart from the differences and disparities among the Member States, Community agriculture has always presented (and still presents), some special common characteristics that differentiate it from its major competitors in the industrialised world (USA, Australia, Canada, etc.). Some of these characteristics could be mentioned as follows:

- There is a comparatively higher proportion of the population employed in agriculture (7 % in 1990, compared to 2.7 % in USA). For most Member States, agricultural activity plays a key role in providing employment opportunities in rural areas, in stimulating their economic advance and/or in promoting regional development.

- There is a comparatively higher number of agricultural holdings (8 million holdings, three times higher than in the USA) with a definitely smaller average size (15 ha in EU compared to 185 ha in the USA). In actual fact, the majority of European farms are still quite small, since 5 million holdings are under 5 hectares in size.

- The special status of the farmers in the social and cultural life of Europe, along with their considerable political weight, is still a reality.

- The geophysical and environmental peculiarities of Community agriculture (extended mountainous areas, soil exhaustion due to extensive use, etc.) put a natural limit on the yields and the economies of scale of the large majority of holdings. At the same time, agriculture plays a key role in ensuring a sound environment in Europe, by promoting the farmers as prime guardians of the countryside, as well as by encouraging environmentally-friendly production.

Despite the important structural changes that have taken place during the last decades, the dissimilarities originating from the above characteristics still exist (40 years and more after the establishment of the EEC) and constitute a source of contradictions on policy orientation matters, mainly between the EU and the USA, which were reflected in the course of the multilateral negotiations in the GATT (Uruguay Round).

In the 1990s, the role of agriculture in the Union has been widened:

- As an economic activity, agriculture not only has to guarantee food security, but also provides **high-quality** food and non-food products responding to new consumer requirements which are efficiently produced and competitively priced in both internal and external markets.

- There is a growing recognition that agriculture plays an increasingly important role in the maintenance, protection and development of the **environment**.

- Agriculture is an important factor contributing to a balanced economic and social life in rural areas and should therefore be an essential part of the development efforts of a sustainable, multi-sectoral integrated **rural development policy**.

2. PRINCIPLES AND OBJECTIVES OF CAP

The Treaty of Rome in 1957 envisaged the creation of a "Common Market", including agriculture. Therefore, the Common Agricultural Policy reflects the strong will of the founder members to create a framework of support and protection for Community agriculture by ensuring an adequate standard of living for their farmers and by meeting the food requirements of their consumers.

A. Principles

All the rules constituting CAP are based on the **three fundamental principles** governing the creation of the European Common Market as a whole:

- **The Single market**

According to this principle, agricultural products move freely in the internal market (within the geographical limits) of the EU, where all the national markets in fact operate like "regional" markets. Therefore, custom duties and tariffs, quantitative restrictions on internal trade and all other measures having equivalent effect, as well as any kind of subsidies with a distorting effect upon the free movement of the agricultural products among the Member States, are abolished.

To achieve the operation of a single market, a common customs tariff was set up, common rules on internal competition introduced, common institutional prices and aids decided and fixed monetary parities maintained, while since January 1st 1993 legislation and controls on technical matters (veterinary, plant protection, animal feed etc.) have been harmonised, so that those controls are no longer applied at the internal frontiers at between the Member States but at the level of the particular enterprises.

To complete the organisation of the single market, the internally free movement of agricultural products was enforced through the application of common measures and by ensuring the central management of internal support and external protection.

- **Community preference**

On the basis of this principle, **Community products have priority of the internal market access**, thus enjoying a certain level of protection against similar imports from third countries.

The maintenance of Community Preference dictated the need for the operation, either absolutely or to a certain extent, of a mechanism which would secure that the prices of the products produced in the Member States would be quite stable and high enough (higher than the import prices) to encourage an increase in production and productivity. In this way, it was believed that the influence of any excessive world supply and price fluctuations on Community production and income would be limited and certainly kept under control.

- **Financial solidarity**

The operation of CAP rules and mechanisms concerning the organisation of the markets is totally financed, in principle, by the Community Budget, irrespective of the significance or the strength of the production in each Member State. To avoid any distortion in terms of competition in the functioning of the single market, the use of national inflows is prohibited unless the Community Institutions decide on a co-financing procedure through national budgets.

The principle of Financial Solidarity led to the establishment of a special Community Fund, the well-known **European Agricultural Guidance & Guarantee Fund** (EAGGF, or in French, FEOGA).

The three fundamental principles have to be considered as interlinked, in the sense that no one can reasonably exist without the others. However, after the latest developments in world and Community agricultural markets, they are not all three of the same significance. In particular the appeal of "Community preference" has been put rather under question. However, they all still have a strong legal appeal.

B. Objectives

The institutional base of CAP is laid down in Articles 38 to 47 of the Treaty establishing the EEC (Treaty of Rome, 1957). More precisely, Article 39 sets out five objectives to be pursued by a CAP, as follows:

(1) To increase agricultural productivity by:

* promoting technical progress

* ensuring the rational development of agricultural production

* the optimum utilisation the factors of production, in particular labour.

(2) To ensure a fair standard of living for those engaged in agriculture, by increasing their individual earnings

(3) To stabilise the (agricultural) markets

(4) To assure the availability of supplies

(5) To ensure reasonable prices for the consumers

The same Article lays down that, in the application of the CAP, the following must be taken into consideration:

- The social parameters of agriculture (structural and natural disparities among the various regions)
- The need for appropriate adjustments
- The fact that agriculture constitutes a sector closely linked to the European economy as a whole.

The Single European Act in 1986 introduced an additional general objective, which was broadened by the Treaty on European Union in 1992, under the title **The Environment** (Title XVI). This title of the Treaty calls for the integration of environmental protection requirements into the definition and implementation of other Community policies (including agriculture).

Finally, the Treaty on European Union (1992) explicitly recognised (Article B) **economic and social cohesion** as a general priority objective (together with the other two economic objectives of a Single Market and European Monetary Union). The Treaty develops this new objective in Title XIV (originally introduced in the Single European Act), obliging all sectoral policies (including agriculture), to take cohesion objectives into account.

C. Areas of action

For the attainment of the CAP objectives, the following specific areas of action have been organised and developed; they are areas which include certain policy measures and instruments:

- **Agricultural Markets**

Article 40 of the Treaty of Rome envisaged the creation of a "Common Organisation of Market" (COM) for each agricultural product or group of products, leaving the Council of Ministers to decide the mechanisms for their achievement, mostly depending on their nature.

This area of policy already covers more than 95% of the Community agricultural products. It should be noted, however, that according to the nature and the importance of each group of products, significant differences existed in the level of support and protection applied.

- **Structures**

This area covers the medium and long-term structural problems of Community agriculture, so as to promote its competitiveness by the speeding-up (among other things) of the required major structural adjustments.

In fact, Article 42 of the Treaty of Rome states that the Council may grant aid for the protection of farms operating under difficult structural or natural conditions. In this framework, a number of structural measures were put into force gradually, aiming at the modernisation of infrastructure, the improvement of efficiency of agricultural holdings, the promotion of capital investments, the granting of direct aid for the improvement of incomes in less-favoured areas, education and professional training and the encouragement of young farmers etc.

In 1988, the Community approach to structural problems became more integrated, a matter which was reflected in the reform of the Structural Funds. 4 regional and 3 horizontal priority Objectives were set up, of which the structural actions relevant to agriculture and rural development were concentrated into Objective 1 (development and structural adjustment of underdeveloped regions), Objective 5a (adjustment of the agricultural and fisheries sectors) and Objective 5b (development and structural adjustment of rural areas).

In the mid '90s, in the light of eastward enlargement, it has been declared that structural problems of agriculture have to be faced through an integrated rural development policy.

- **External aspects**

These are constituted by the external dimension of the CAP at a multinational or bilateral level, or at the level of other International Organisations (OECD, FAO etc.). In fact, the total Foreign Policy of the EU almost always includes certain agricultural aspects: trade negotiations and preferential agreements are often concluded and free trade areas designated, and development initiatives are undertaken in favour of the less developed countries, as well as urgent or regular food aid and technical assistance being provided for.

- **Financing**

The finance for the above policies is mostly supplied by the Agricultural Fund (FEOGA), particularly by its two Sections:

* The "Guarantee Section", which finances the total expenditure accruing from the operation of the COMs, (including the compensatory payments and the accompanying measures introduced by the 1992 reform).

* The "Guidance Section", which finances a certain percentage of the structural policies approved and applied either horizontally or in a certain State, while the rest is paid from the national budgets (co-financing procedure). Such measures are:

- Aid for the modernisation of holdings
- Installation of young farmers
- Aids for processing and marketing
- Diversification of production.

Since 1988, the Single European Act has laid down that rural development action is also co-financed by the Guidance Section together with the **European Regional Development Fund** and the **European Social Fund**. In the 1995 budget, the share of Guidance was about 10% of the total farm budget.

3. THE BACKGROUND OF CAP MECHANISMS - KEY CONCEPTS AND TERMINOLOGY

Following Article 40 of the Treaty, the basic operation of CAP was defined by the Council of Ministers for Agriculture in their meeting in the Italian town of Stresa in 1958. It was decided that the objectives of Article 39 were to be achieved by a Common Organisation of Markets (hereafter referred to as COM) based on **a market price support system**.

Cereals were the first set of products to become subject to the rules of a COM in 1962, while common prices were applied in 1967/68. Soon the model of cereals was broadly reproduced for other agricultural products of main interest to the founder Member States. By the end of the Sixties, the Council had adopted COMs concerning cereals and rice, milk and milk products, beef, sugar and olive oil (mainly to the satisfaction of Italy). Then, more and more products were introduced into a COM so that today, there are only a few of minor importance which still remain outside common rules (olives, potatoes, honey, etc.).

The legal framework of each COM is composed of the basic Council Regulations followed by their amendments, supplements, extensions, adjustments, revisions etc, decided upon by the Institutions in accordance with the market situation and trends that influence the supply and demand situation for the individual products. Therefore, the COM should be considered an **evolving process** and it is an indispensable part of Community Law (Agricultural *Acquis Communautaire*).

A set of common rules and institutional measures is included in each COM, relating to the whole cycle of production, processing and marketing of agricultural products. The set (institutional prices, intervention, withdrawals, production aids, storage, quotas, export refunds, import levies etc.) constitutes the **support and protection system** of Community Agriculture.

Certainly, differences existed in the COMs across the products, since the rules and instruments were not of uniform effectiveness. In principle, the system introduced by each COM depends on the natural and other market characteristics of the product concerned (perishability, transferability, solidity, sufficiency, export-orientation, production-deficit etc.). It is certain, however, that the economic dimension of each product, linked with the interest of particular founder Member States, played the most crucial role in choosing which system should be established, in compliance with the timing of the internal balances and the external obligations of the EU.

Therefore, the level of support and protection ensured through the CAP is not equal but varies from product to product, being particularly effective, strict and much higher when it covers the so-called "basic" products (cereals, sugar, dairy, beef, etc.), but being insufficient in sectors such as fruits and vegetables, wine, olive oil, ornamental plants and flowers, tobacco, cotton, etc.

The fact that the first case deals with products mainly produced in regions of the northern Member States of the present EU and participating significantly in the flows of world agricultural trade is not incidental, while the second case deals mainly with products of the Mediterranean regions, in which, among other things, there is a much larger number of small inefficient farm holdings.

Although the method established varies from product to product, as mentioned above, the basic model behind almost all the COMs was designed, up to 1992, on the basis of a **price support mechanism.** For simplification purposes, a brief and global description of the mechanism is given below.

Each COM assures a **minimum price** (**support or intervention price**) to the Community producers. This price acts as a "**guarantee**" to the producers that the market price of their product will not fall below this fixed minimum level. More explicitly, the intervention mechanism (for those products provided for) is an instrument applied by the public (Community) authorities themselves. When there is a surplus production and the market price tends to fall below the intervention price, the authorities are obliged to "open" the intervention organisation and purchase the surplus production (under certain conditions) at the price fixed. The product purchased is stockpiled at the authorities' expense and, when appropriate, resold at subsidised prices in the domestic or (usually) world market on the authorities' responsibility. This effectively meant that, at least in the first stages of CAP, producers were guaranteed minimum prices, independent of market developments.

At the same time, an **indicative price** (or **target or guide price**) is fixed, representing the desirable level at which it is estimated that a satisfactory income level for the producers is ensured. This price is considered to be theoretical, fixed on the basis of political rather than economic criteria, and reflects the desirable level of marketing under "optimum" conditions. Its aim is to guide and set a ceiling for fluctuations in market prices.

The minimum price is fixed at a level lower than that of the indicative price but certainly (up to 1992) much higher than the world price level (**import prices**). Hence, in order to avoid the saturation of the internal market with imports at lower prices, a **threshold price** is also fixed which almost corresponds to the indicative price. The threshold price, setting the lowest price at which imports could enter the Community markets, constituted the level of protection at the frontiers. It was calculated by deducting the transport cost (from the frontiers to a representative internal market) from the indicative price.

The set of the above three institutional prices is accompanied by a system of *variable levies and refunds.*

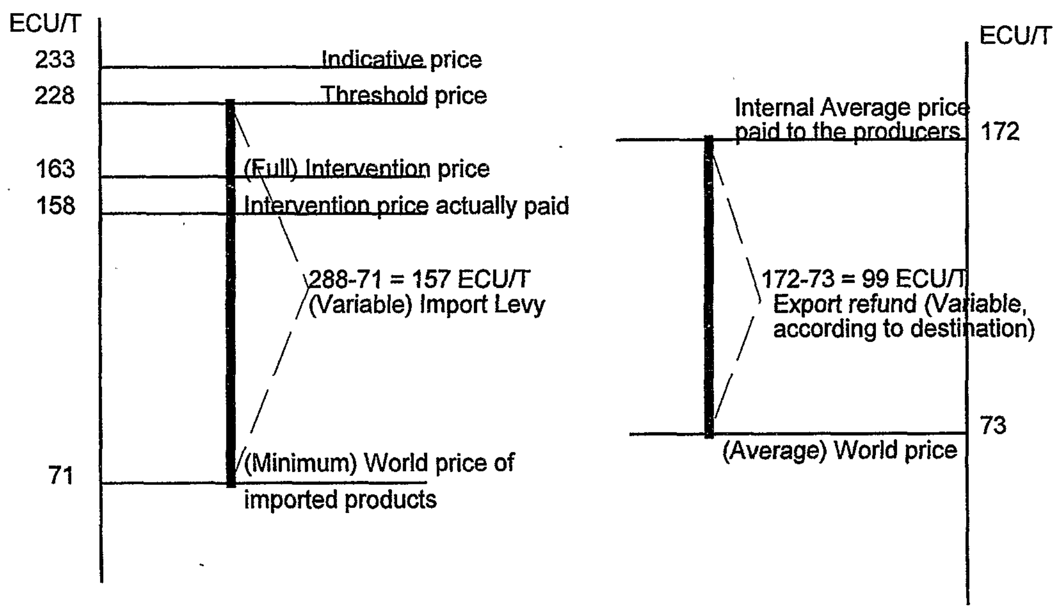
Up to 1993, agricultural imports were subject to **import levies**, calculated as the difference between the threshold and the world prices. They were collected at the frontiers and constituted a financial inflow to the Community Budget (FEOGA). They were imposed independently of the tariff which existed and differed from the usual customs duty in the sense that it was not fixed but **variable**, depending on the upwards and downwards movement of the import prices.

(It should be noted that the concept of "**variability**" became one of the key issues during the Uruguay Round negotiations, when the major trading partners of the EU demanded (and successfully obtained) the tariffication of all variable levies applied at the frontiers.)

At the same time, to enable EU products to be competitive in world markets, agricultural exports were subsidised, at the expense of the Community Budget. This subsidy is better known as an **export refund** and covers the difference between the average internal price obtained by the Community producers and the world price of the product.

All the above-mentioned agricultural prices constitute the so-called "packet" of EU Institutional Prices which is regulated each year, at the beginning of the marketing period of each product, by the Council of Ministers (for Agriculture), following a Commission proposal. An illustrative example is given below, describing the various prices applied to cereals in 1991 (one year before the drastic reform of CAP).

EU Institutional Prices for Cereals - 1991



Under the above system and for a long period of time, the Community farmer enjoyed high prices (when compared with the world market prices), the cost of which was upheld by the consumers (since they were "obliged" to buy even the imported products at least at the price paid to the Community's producers), while the difference between the Community and the world market prices was covered by the level either of the import levies or the export refunds.

It is true that the system of variable levies and export refunds isolated domestic agricultural prices from world levels. From another point of view, however, it should be mentioned that at the time when the EC was a net importer of almost all the major products, this system was the strongest incentive towards a rapid increase in the productivity of the sector, while the budgetary revenue resulted from variable levies largely outweighted the costs incurred by subsidising agricultural exports.

The aforementioned system of price support was selected for the COMs of products with a relatively high sufficiency (*cereals, sugar, dairy, beef, etc.*). However, where products with a large deficit were concerned, a different system was adopted, the so-called system of **"deficiency payments"**.

The system was first applied in the mid-1960s when the COM for *oilseeds* was designed. Later, more or less the same system was applied to other non-food products like *tobacco, flax, hemp, cotton* etc. used in the industry as raw materials.

Under this system, the protective mechanism at the frontiers was eliminated by the application of a zero import duty. Through the guarantee of low prices to importers, the Community consumer buys the products mentioned at relatively low prices, since the domestic price of those products is comparable with the world price levels.

However, to enable EC producers of those products to function in a fashion similar to that of producers under a price support system, direct (or indirect) aid was granted, at the expense again of the Community Budget. This aid supplemented the farmers' income, which otherwise would be determined solely by the low market prices. It is considered to offset the insufficiency or even entire lack of external protection, ensuring a relatively satisfactory level of agricultural income.

The difference between the two systems above is evident. The "deficiency payment" is supposed to be a system **decoupling** support from production. The whole issue played a decisive role in the course of the GATT multilateral negotiations, as well as in the context of the internal discussions held on the orientations of 1992 reform, when the "price-support system" was accused of causing surpluses and trade distortion since it is directly linked to the volume of production and trade.

So far, it should be pointed out that both systems described above constitute simplified versions, adjusted according to the market situation of each production. In practice, in many cases, a combination of these two systems was often applied (as in the case of olive oil, durum wheat, sheep and goat meat).

It could be argued, therefore, that at the heart of the CAP was the system of guaranteed prices for unlimited production. Farmers were enjoying a minimum price for their commodities even if they were selling them as surpluses to be stockpiled by the EU intervention authorities for later resale on the world market at subsidised prices. Moreover, the common characteristic of both systems ("price support" and "deficiency payments"), was that the EU farmer enjoyed a total income which was higher than that of the world level.

4. THE DEVELOPMENT OF THE CAP - THE FIRST PROCESSES

In the course of the first 10-15 years of its operation, CAP developed spectacularly, given that the principal objectives set out in the Article 39 of the Treaty of Rome had to a great extent, been fulfilled, that is, the full supply of the market had been ensured by increasing considerably the volume of production and productivity as well as the relative market stability, in combination with a satisfactory standard of living for the farmers as a whole in relation to that of the rest of the world.

Since the beginning of the 1980s, however, new problems appeared, due to the fact that certain imbalances were created. They centered especially on the high budgetary expenditure needed to meet the necessities of CAP and on the vast increase in the sizeable production surpluses of most basic products. At the same time, criticism was raised internally, focused on the fact that the CAP mechanisms had not taken into serious consideration the structural and social parameters of EU Agriculture. Out of the total budget expenditure for agriculture, only 5% was allotted to some structural action (FEOGA-Guidance Section), while intra-agricultural income disparities, as well as the disparities among the various regions, not only remained unaffected but also, in most cases, broadened.

In the mid 80s, the need for a radical reform met with criticism from the main trade partners of the EU, focused on the concept that the adoption of the CAP was opposed to the GATT principles, alleging that the "double price system" distorted the rules of international competition and calling for measures towards the liberalisation of agricultural trade.

It is true that, from 1979, the Community started responding to warning signs that the rigidities of the CAP mechanisms were causing growing surpluses. To avoid the latter, the first measures were introduced towards changing the system of unlimited price guarantees, and gradually expanded to cover most of the COMs. The measures adopted and imposed took (either separately or in combination) the following forms:

- Co-responsibility levies on farmers (dairy, cereals) forcing them to share the cost of storing the surpluses
- Production quotas (sugar, dairy) allocated to the Member States (over which penalties were imposed), to force production more into line with demand
- Intervention or withdrawal limitations (dairy, beef, fruits & vegetables)
- Total thresholds in EC production (cotton)
- Eradication of, or restrictions on, new plantings (vineyards, olive-trees)
- Restrictions on the application of the intervention mechanism, through:

- decreasing purchase price
- lowering monthly increases
- limiting the intervention period
- delaying payment to the producer

However, the measures imposed proved to be inadequate to curb overproduction and increased spending on agriculture.

A more integrated approach towards changing the total CAP system was made in the mid 1980s. In 1985, as soon as the USA pushed for a new round of negotiations in the framework of the GATT (Uruguay Round) with the target, inter alia, of liberalising agricultural trade, the Commission submitted the "Green Paper" dealing with the perspectives of CAP. From then on, in order to achieve a restoration of the market equilibrium, a freezing and/or a reduction of the institutional EC prices was decided upon while supplementary measures were adopted to improve agricultural structures, strengthen research, and promote non-food uses of agricultural products.

In this context, the main effort was focused on **applying measures for the improvement of the agricultural structures**, the most important of which were:

- The Integrated Mediterranean Programmes (IMP) and other measures which addressed the disadvantaged and less developed regions of the South
- Measures to improve the effectiveness of agricultural holdings
- Incentives to develop marketing and processing of agricultural products
- Encouragement of crop restructuring
- Incentives to institute and promote collective producers' groups
- Encouragement of extensification.

In 1988, following the "Single European Act" (which came into force in July 1987, with the purpose of preparing the Community for the establishment a Single European Market in 1993), a more wide-reaching change had to be made of under the so-called "Delors Package".

In this context, the decisions finally adopted are summarised as follows:

1. **Introduction of guarantee limits on all the main EC products**

Given that in the dairy sector milk quotas existed had since 1984 and the sugar regime had always operated under a quota system, the guarantee limits altogether constituted the **generalised system of "stabilisers".** The stabilisers were activated automatically, as soon as production and cost of the COMs exceeded certain maximum levels.

More precisely, a **Maximum Guaranteed Quantity (MGQ)** of production per product was introduced (*production thresholds*), related to the total EC production as well as to the individual quotas of each Member State. If production in one period exceeded the MGQ, penalties were imposed in the form of automatic reduction of support payments (prices and/or aid). This cut in payments was applied to the total production and not only to the portion beyond MGQ

In the case of cereals, for instance, the MGQ was set at 160 million tons per year. If production exceeded this level, a price cut of 3% was automatically imposed in the following year after that particular harvest. Price cuts were cumulative. Production beyond the M.G.Q. for a second time would bring about another 3% price cut.

As a response to the restrictions imposed, certain compensation measures were also adopted, as follows:

- Compensation in cases of withdrawal of the land from cultivation (set-aside),
- An early retirement scheme applied under certain conditions to farmers over 55 years of years who wished to cease their agricultural activity
- Direct income aid, for a limited number of years (3 or 5), to farmers who were hit by the restrictions imposed on production, so that they could adjust in order to meet the new conditions.

2. **Strict application of the "Financial Discipline"**

A ceiling was imposed on future agricultural spending. The growth in farm spending had to be kept well below the level of growth in the GNP of the EU. By using as a base year the farm spending of 1988 (26,000 million ECUs), an **obligatory "guideline"** was set to determine, henceforth, that the annual growth of FEOGA Guarantee spending should not exceed (in real terms) 80% of the annual growth of the Community GNP.

In addition, a-two-and-a-half-month **delay** in payment was granted to the Member States, in return for the immediate refund to the farmers which resulted from guarantee expenditure accruing from CAP mechanisms.

Furthermore, a special *monetary reserve fund* was established (1 billion ECUs), independently of FEOGA appropriations, in order to face any excessive fluctuations in the ECU/dollar parity. This was justified by the fact that, in principle, every dollar devaluation augmented the difference between the Community and world market prices, bringing about increased support spending.

3. **Joint action of the "Structural Funds"**

The Guidance Section of the FEOGA was mobilised in conjunction with the **European Regional Development Fund** and the **European Social Fund,** into a joint instrument at the service of **rural development.**

The joint action was pursued to fulfil the following **five objectives,** by diversifying the rural areas according to their main problem:

(1) Encouragement of the development and structural adjustment of backward areas, through a concerted action taken by *all three Funds.*

(2) Economic restructuring of the regions hit by industrial decline, through actions of the *Regional Development* and *Social Funds.*

(3) Measures to fight against long-term unemployment. The principal action was to be taken by the *Social Fund.*

(4) The facilitation of vocational training and participation of the young people, through actions of the *Social Fund.*

(5) Development of the European agricultural sector, in view of the CAP reform, through:

(a) Adjustment of production, processing and marketing structures

(b) Encouraging the development of those rural areas in which agricultural activity is of principal importance for total employment, while agricultural income level and per capita GNP remain quite low. Actions were taken by the *Guidance Section* of FEOGA and the *European Social Fund*

Both the first and the last objectives are directly related to the agricultural sector.

In the case of the FEOGA Guidance Section, its actions had to support investments to improve the competitiveness of farms by covering jointly modernisation projects, the installation of young farmers, early retirement schemes and support payments for mountain farmers and those in less-favoured areas (where soil or weather conditions are less suited to farming).

The general target set was to diversify the economic activities of rural areas, and develop their infrastructure so as to reinforce the agricultural sector which was still vital and would remain the lifeblood of rural Europe.

The Single European Act also introduced the legal basis of the **Environmental Policy** of the EC. The increasing awareness of the need for an environmentally friendlier policy inspired the acknowledgement that «the protection of the environment is one of the major functions of agriculture» and that «measures have to be taken to prevent environmental degradation» (Green Paper - July 1985).

5. ORIENTATIONS OF THE 1992 REFORM

Despite all the efforts to stabilise production and limit the EC budgetary expenses, all the previous reforms of the CAP proved to be only partially successful, and only for a short period. Within three years, the 1988 reform was already inadequate, principally due to the continued accumulation of surpluses in main agricultural sectors (finally described as "structural surpluses"), especially in **beef** and **milk** products.

It was realised that the cumulative stocks of products, available at high prices, could be absorbed neither by increasing sufficiently the internal consumption, nor by the external markets. World prices (especially of cereals) continued to weaken, reflecting a fall in the dollar against the ECU. International competition became more and more acute, causing the cost of export subsidies to rise, due to the increase in the gap between EC and world prices. In turn, pressures on the EC Budget became more insistent.

These observations soon led to the conclusion that one more reform was absolutely necessary to ensure a **viable** long-term option for EC agriculture. The new reform had to be so radical as to tackle the **basic mechanism** of CAP itself, for two main reasons:

- Firstly, the mechanism ensuring high internal prices was no longer considered to be the appropriate tool to deal with the problems of surplus production, as it had been in the case of shortages 30 years earlier.

- Secondly, the failure of the Uruguay Round negotiations to reach a conclusion within the period initially scheduled (December 1990) provided the world competitors of the EC with the grounds to argue that the rigidities of the CAP mechanism, as they were applied, were directly related to the distortions of the rules of trade competition, and therefore responsible for obstructing the general tendency towards the liberalisation of international agricultural trade.

In February 1991 on the basis of the above developments, the EC Commission submitted a report about *the future role of the Common Agricultural Policy*, calling for the adoption of a reform package for European farming and taking into consideration certain facts, the most important of which were as follows:

1. The price support system is directly related to the volume of production and, therefore, it favours the increase of the quantities produced. Therefore, despite the production limits and restrictions applied, the system encourages the intensification of production, leading to the increase of surpluses and financial expenses.

2. In turn, intensification aggravates environmental problems (through over-use of fertilisers, water pollution, impoverishment of arable land, gradual desertification, etc.), and disturbs the ecological equilibrium.

3. The ensuring of agricultural income exclusively through guaranteed prices heightens the existing inter-sectoral disparities. It is impressively admitted that "*20% of farms enjoy 80% of the FEOGA expenditure*". This means the existing system favours big farms becoming larger, while the income of the great majority of European farmers (who own farms of under 5 hectares in size), is in practice not secured through the price support mechanism.

4. The sharp rise of agricultural expenses has not actually led to a decisive improvement of the per capita purchasing power of the farmers, although, during the 30 year period, there was a considerable decrease in the number of farmers. As a result, the inter-sectoral and inter-regional income disparities widened even further.

5. The European farmer traditionally plays a double role through his activity as a commodity producer and as a basic factor in the protection of the rural environment. This role, of great importance in the era of industrial and post-industrial society, is not favoured enough through the existing mechanism of CAP.

6. Some other source - structural features of the EC agriculture should be taken into consideration, in the framework of the new reform:

- Over 50% of EC farmers are over 55 years old

- High income disparities still exist among the Member States

- One third of farmers are engaged only part-time in agriculture

- There are big differences in the average farm size among the Member States ranging from 5 ha to 65 ha.

In July 1991, on the basis of the above undisputed facts, Mr McSharry, the Irish Commissioner at that time, submitted the Commission's proposals which aimed at breaking out of the vicious cycle created by high prices and excessive over- production.

To meet the inevitable competition in its own and world markets, the Commission argued that a policy of more competitive prices was needed, while, at the same time, CAP should be put at the heart of EC rural development strategy. In June 1992, after a year of debate and negotiations, the Council of Ministers adopted the latest and most radical reform package for European agriculture since the introduction of the CAP.

The decisions adopted referred initially to the following key products:

- Cereals
- Oilseeds and protein products
- Dairy products
- Beef sector
- Sheep and goat sector
- Tobacco

The intention, however, was clearly to institute a gradual reform, at a later stage and on similar grounds, of all the other sectors of production governed by a Common Organisation of Market (wine, fruit & vegetables, sugar, rice, cotton, etc.).

The central element of the package was **the change-over of the mechanism** from price support to direct income support, which would bring cereals and the other related sectors of production in line with the principle applied to other products such as oilseeds, olive-oil, tobacco, processed fruits & vegetables. Overall, the main objectives of the reform package are the following:

a. Improvement of the competitiveness of EC agricultural products on home and export markets

The target is to maintain the EC position in the world market as a major agricultural producer and exporter. The key issue in this objective was the drastic reduction of institutional prices for cereals by 29% over a 3-year period starting in 1993/94. This reduction would bring the intervention price close to world market prices. It was estimated that such a reduction would have further positive impacts:

- The reduction of the cost of inputs for livestock products, inasmuch as cereals are used as feeding stuffs. In turn, this would allow respective reductions in the institutional prices for **milk by 10%, butter by 15%, skimmed milk powder by 5%, beef meat by 15%.** Similarly, price reductions would be brought about for **pork, poultry and eggs** (considered as derivatives of cereals), thus allowing a drastic decrease in external protection of those products (through diminishing export refunds and import levies).

- The enabling of EU producers of cereals to win back a part of their share of the internal market for animal feed, which had been lost in recent years because of the much lower prices of the imported cereal substitutes. In turn, this would lead to an increase in the total demand for cereals, therefore stimulating production and prices.

- Benefits for EC consumers from the supply of final products in the internal market at prices cheaper than before. It should be mentioned that, previously, consumer prices (even of the imported products) were artificially high, due to the external protection implied by the high price support.

- Significant improvement in the competitiveness of the EC farmers and products in their own and in world markets.

- The making of the cost of the CAP more bearable to Member countries, by drastic reduction of the FEOGA expenditure required for stockpiling surpluses and subsidising exports on world markets.

Furthermore, the competitiveness of EC products is expected to be increased by the introduction of new rules and incentives to promote quality products for the consumer (labelling and certification of guaranteed quality, promotion of biological production methods, protection for geographical and other indications of product origin, standardisation, diversification of products according to regional specialties and traditional processes, etc.).

b. Supply control

The target is to bring production down to levels more in line with market demand. To meet this objective, the most important measure adopted is the obligation of the cereal farmers to take out of production **(set-aside)** a certain proportion of arable land each year, in line with forecasted market demands.

Using as a base year the average of the period 1989-91, it was decided initially that the proportion of compulsory set-aside in the first year of application would be **15%** of the arable land. In the following years, this proportion decreased to **12%** and to **10%.**

Additional incentives were also introduced for *voluntary*, as well as for "*permanent*" (for a 5-year period) set-aside. The set-aside land can be used for products of non-food purposes (i.e. cereals for bio-fuels). The goals of applying the set-aside system are:

- To decrease cereal production (and, therefore, surpluses) by approximately 10% in volume

- To reduce the FEOGA expenditure required for the financing of the export refunds of surpluses

- To increase world market prices, given that the EC, being one of the major producers and exporters of cereals, influences the situation of the cereal market world-wide

Apart from the set-aside system, quantitative restrictions have been generalised and expanded throughout all the sectors under reform, by adopting measures:

- Decreasing milk quotas per Member State by 4% (with the exception of Spain, Italy and Greece, for whom the previous quotas have been slightly increased for special reasons)

- Specifying a maximum number of head per farm of dairy cows qualified for premium

- Adopting a special premium to encourage the early removal of young calves from suckling cows

- Setting maximum premium limits for sheep and goats per farm

- Decreasing tobacco quotas per producer Member State and per variety.

c. Focus support for farmers' income where it is most needed

The loss of farmers' earnings from **cereals,** resulting from price cuts, is fully compensated by the payment of a direct aid per hectare under cultivation, calculated on the basis of the average yield in each region. At the same time, support for **oilseeds and protein crops** is integrated into the new scheme so that from now on, together with cereals, they constitute **arable crops.** A precondition for receiving compensation is that the farmer meets the requirements of the set-aside scheme, by taking out of production the certain proportion of land mentioned above.

Compensation is also paid for the set-aside land. However, the total area qualified for compensation cannot exceed a certain limit calculated on the basis of the historical data for each region. Therefore, future increases in areas under cultivation or in yields are not taken into consideration. In any case, **small farmers,** determined as those who do not produce more than 92 tons of cereals, **are not subject to set-aside requirements** and, therefore, they are qualified for full compensation.

For **beef farmers,** the price cuts are considered to be compensated by:

- Adopting extra premiums per head of beef cattle (up to a maximum number of heads) provided they raise cattle on open grazing land. This is to encourage "extensive" farming practices as agaunst intensive factory production. Therefore, premiums are not available for farmers raising beef cattle in stalls.
- Offsetting the drop in beef prices through the use of cheaper cereals as animal feed.

Given that financial support is now targeted particularly at the most vulnerable categories of farmers and at a more extensive form of agriculture, it is generally believed that the new system will encourage and enable more farmers to remain on the land than would have been possible under the former system.

d. Connection of the CAP with environmental protection

The disconnection of farmers' earnings from an exclusive price support and the incentives for extensification are expected to discourage the intensive use of fertilisers and pesticides and the development of higher yield products, all of which had a negative impact on the environment under the previous system of price support for unlimited production. At the same time, special legislation has been adopted to cover and encourage biological products. Therefore, the encouragement of farmers to use less intensive production methods became a central element of CAP reform. Measures such as, the set-aside scheme for cereals, oilseeds & protein crops, the permission to grow non-food products on set-aside land, the «extensification premium» granted to beef producers, the legislation on the use of pesticides and the encouragement of organic farming, are enforcing the connection between agriculture and environment.

Moreover, the 1992 reform provides for the active participation of farmers in the reinforcement of environmental protection by adopting a set of three main accompanying (supplementary) measures:

- Activities which introduce new farming practices compatible with environmental protection requirements (maintenance of fallow land, creation of nature parks or animal reserves, preservation of rural heritage, etc. are compensated in accordance with the loss of farmers' income (agro-environmental action)

- Specific programmes are financed with up to 20 years' compensation for income losses for the afforestation and management of forest areas

- A new early-retirement scheme has been introduced for the essential encouragement of elderly farmers to leave agricultural activities and thus make it possible for young farmers to acquire viable farming units. At the same time, the new scheme is expected to enable the retired farmers to remain in rural areas.

In departure, therefore, from an initial reactionary approach to environmental issues, present Community Policy has gradually adopted an approach towards sustainability, based on the integration of the environment into sectoral policies (including agriculture) and the reshaping of social and economic behaviour through the use of a broader range of instruments and the promotion of the principle of shared responsibility. In this respect, there is already a tendency for the direct or compensatory payments to the farmers to be made on the assumption that they achieve certain environmental and rural objectives.

6. CONCLUSION

The 1992 reform is considered to be an integral and coherent package, a response to internal and external pressure aimed at ensuring balanced rural development in the future. In general, as has been described above, the present CAP includes three aspects: the Common Organization of Markets, the Accompanying Measures and the Structural measures.

It could therefore be argued that, while the new CAP remained unchanged with respect to the basic principles, it added some new objectives and opened the way for further reforms in the future. In short, the 1992 reform introduced the following innovations:

- Income support is provided through the mechanism of direct income compensations rather than through the mechanism of market prices

- Income compensation is related to a policy of production control

- Set-aside becomes obligatory for large farmers as a means to control increases in production

- Income compensation is considered to be a means of counterbalancing losses from price cuts and is calculated on the grounds of a historically-determined base area, in order to discourage further increases in production

- The gap between the EU prices and the world price levels has been narrowed.

The whole package should be considered as a first step towards a further modification of European Agricultural Policy in the direction of more market orientation, combined with a greater emphasis on the development of alternative rural, regional and environmental policies as a means of facing the problems of rural areas as a whole.

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