



There is a common misconception that the CAP is about helping small struggling farmers and looking after the European rural environment. But in reality the bulk of these funds end up in the pockets of the wealthiest farmers and processors while also doing enormous harm to developing countries.

Luis Morago, Head of Oxfam International in Brussels

In Europe the CAP has been so successful in achieving food security that consumers have come to take it for granted. But the EU has now dismantled almost every instrument that created this stability.

Pekka Pesonen, Secretary General of COPA-COGECA (EU farm lobby)

The common agricultural policy

Chapter Contents

9.1	The old simple logic: price supports	219
9.2	Changed circumstances and CAP problems	224
9.3	The simple economic logic of the new CAP	231
9.4	CAP reform	234
9.5	Today's CAP	236
9.6	Remaining problems	237
9.7	Summary	238

Introduction

The Common Agricultural Policy (CAP) is a set of policies aimed at raising farm incomes in the EU. The CAP is problematic. It accounts for 40 per cent of the EU budget but farmers continue to leave the land. It accounts for many of the quarrels among EU members and between the EU and third nations, yet it is extremely difficult to reform. Given all these problems and its dominant role in the budget, a good understanding of the CAP is essential to the study of European integration. This chapter presents the essential elements and economics of the CAP.

The best way to understand today's CAP is to realize that it is in transition between two rather simple systems. The CAP started life in 1962 as a straightforward policy of keeping agricultural prices high and stable. Technological progress in agriculture, however, undermined this simple logic by turning Europe into a net exporter of food. For reasons described below, this created huge problems and triggered a reform process that has been going on since the 1980s. The latest are the CAP 2014–20 reforms currently being implemented.

The reform is leading towards a system whose logic is almost as simple, namely, payments that are unrelated to food production but tied to socially desirable goals such as the environment, animal welfare and rural development. The need and general direction of this reform has been obvious from the beginning, but because farming is so politically sensitive for so many members, reform has been piecemeal and very, very slow. That is why the CAP is so complex. What we see today is not a well-designed policy aimed at achieving well-thought-out objectives. It is a snapshot of an ongoing adjustment process.

The radical transformation of European agriculture goes a long way to explaining why this process is so politically painful and slow. The left and right panels of Figure 9.1 show what French farming with the CAP looked like when it was first formulated and how it looks now. When farming involved three-horse ploughing teams, European agriculture required a great deal more farm workers than today's world of tractors and high-tech production methods. This technological progress – combined with the fact that Europeans do not really eat much more food than they used to – means that numbers in the farm sector have been falling steadily for decades.

Figure 9.1 French farming in the 1950s and 2010s



Source: Fox Photos/Getty

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Table 9.1 shows how important agriculture was in western Europe in the mid-1950s and how unimportant it is now in terms of employment and GDP. In 1955, agriculture accounted for double-digit shares of employment in all the original Six members. In France the share was more than a quarter and in Italy it was a shocking 40 per cent. The shares in GDP were much lower, reflecting the low level of productivity in the sector. In the twenty-first century, agriculture has shrunk to a minor share of employment in all western European nations. The special situation in Britain is also shown in the table. Owing to its long history of free trade, the British agricultural sector had already completed a great deal of its downsizing

Table 9.1 Importance of agriculture, 1955 vs. 2009

	Agriculture's share of GDP (%)		Agriculture's share of employment (%)	
	1955	2009	1955	2009
Belgium	7.9	0.6	9.3	1.5
Luxembourg	9.3	0.2	19.4	1.4
Netherlands	11.4	1.3	13.2	2.8
Germany	8.0	0.5	18.5	1.7
France	11.4	1.2	26.9	2.9
Italy	20.7	1.5	40.0	3.7
EEC6	11.5		21.2	
UK	4.8	0.5	4.6	1.1
Denmark	18.4	0.7	24.9	2.5

Sources: European Commission (2011) and Zobbe (2001)

by the 1950s. Comparing the numbers for 1955 and 2009 for Britain versus the other nations, it is clear that the downsizing of farming has been a much bigger headache on the Continent. This goes a long way to explaining why Britain has always had a problem with the EU's agricultural policy, which was basically designed for nations in very different situations.

To a large extent, the CAP has been a programme aimed at buffering the worst pain of this inevitable downsizing. As the agricultural sector changes, so too must the CAP.

The CAP is a policy that is in the politically painful process of moving from one simple economic logic to another simple economic logic. This suggests that the best way to understand the CAP is to study the CAP's original simple economic logic before discussing the unintended problems that are driving EU leaders to reform the CAP towards its new simple economic logic.

Once we have these analytic organizing frameworks in place, we consider the details of the CAP's policy instruments and commodity regimes.

9.1 The old simple logic: price supports

The early CAP was designed to ensure that farmers would get at least a minimum price for their output. In economics jargon, it established a price 'floor'. Such prices were set for many farm products, including grains, dairy products, beef, veal and sugar. For most of the CAP's existence, these prices were between 50 and 100 per cent higher than world prices; dairy and sugar prices were even higher.

How does a government enforce a price floor?

- One way is to impose an administrative price and make it a crime to sell for less.

This rarely works when there are millions of sellers and buyers as black markets and corruption tend to undermine the official price.

- The CAP, instead, chose a market-based system called 'market intervention'.

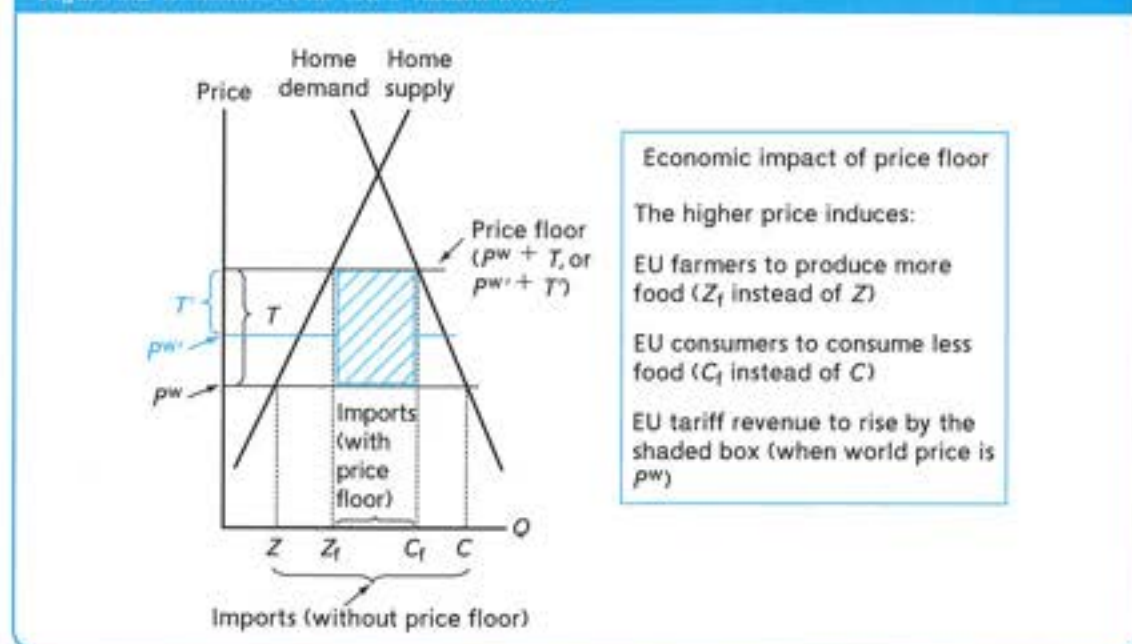
The CAP promised to buy unlimited amounts of food at the price floor, so the market price could never be lower. Such purchases, however, were only the last resort. Up until the 1970s, the EU imported most farm products, so it could raise their domestic price with tariffs – as we saw in Chapter 4. Given this, the best way

to understand the simple logic of the early CAP is to use the standard open-economy supply and demand diagram introduced in Chapter 4.

9.1.1 Basic price-floor diagram for a net importer

The economics of the tariffs used to raise EU food prices above the price floor are quite similar to the standard tariff analysis presented in Chapter 4. The CAP tariffs were called 'variable levies' since they changed daily with the world price, which itself fluctuated due to shifts in world supply and demand. The tariff was adjusted to ensure that imports never pushed EU prices below the price floor; for example, when the world price is P^w (see Figure 9.2), the tariff necessary to achieve the price floor is T . When the world is higher, say, P^w' , as shown in the diagram, the tariff only need to be T .

Figure 9.2 Economics of the CAP's 'variable levies'



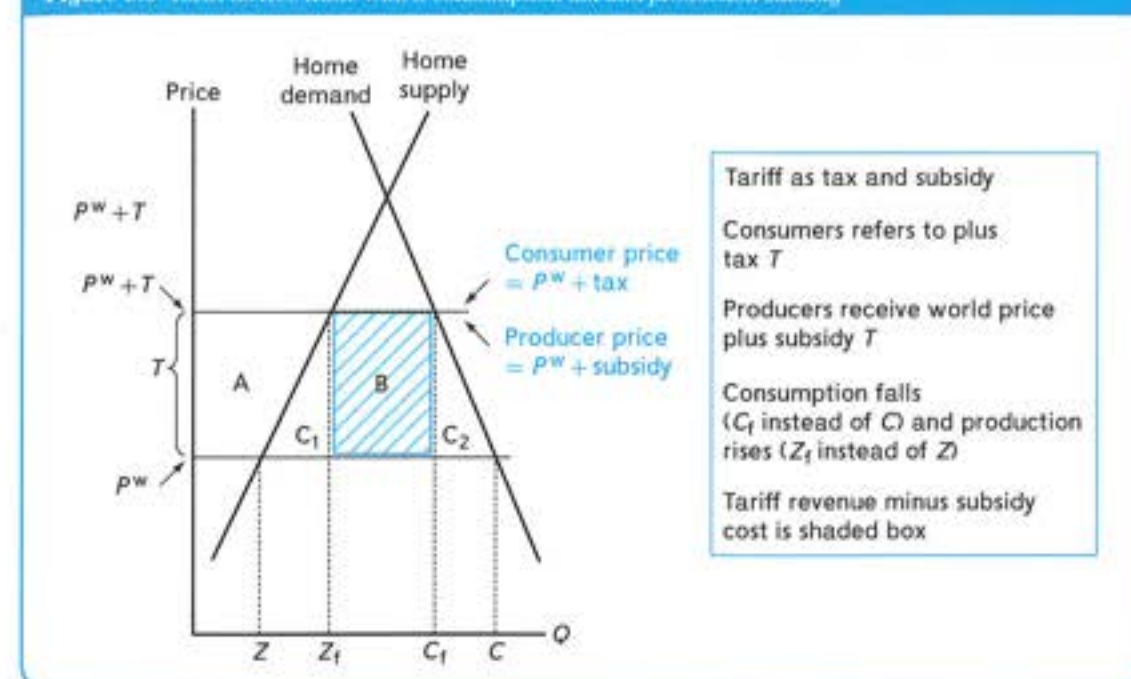
As we saw in Chapter 4, the domestic price ends up as the world price plus the tariff, for example, $P_w + T$. At this price, all domestic production (equal to Z_1) is sold at the price floor, where the subscript '1' indicates 'floor'. Domestic consumption is C_1 and the difference between consumption and production equals the level of imports. In words, the variable levy raises the EU price by taxing imports.

The food tax and subsidy interpretation

Readers will gain great insight into all the complicated politics of the CAP and the problems that arise from different thinking on tariffs. As it turns out, any tariff can be thought of as an all-in-one package consisting of (1) free trade in the presence of (2) a consumption tax equal to T and (3) a production subsidy equal to T . Figure 9.3 facilitates the analysis.

With free trade (i.e. no tariff), the domestic price would be P^w but consumers would see this price plus the tax T (so they'd actually pay $P^w + T$). A production subsidy means that the government pays farmers T euros per kilo of food they sell at the market price P^w , so farmers would produce as they would when the price was $P^w + T$. Since consumers and producers see the same price as with the tariff, they consume and produce exactly the same amounts (C_1 and Z_1). This implies that imports are also the same, namely, C_1 minus Z_1 .

Figure 9.3 Tariff as free trade with a consumption tax and production subsidy



What about the tariff revenue? There is no tariff and thus no tariff revenue, but there is revenue from the consumption tax. The revenue from the consumption tax is the level of consumption C_1 times the tax T (equal to areas $A + C_1 + B$ in the diagram). The consumption tax revenue, however, is offset by subsidy expenditure. The cost of the production subsidy payment to farmers is production Z_1 times T (equal to areas $A + C_1$ in the diagram). The difference between the new revenue and the new expenditure is exactly B – the amount of the tariff revenue. Or to put it differently, the government's receipt net of its payments for its tax-and-subsidy policy equals $(C_1 - Z_1) \times T$, just as with the tariff.

The insight payoff

This way of looking at the price floor is insightful since it makes quite plain that EU consumers were the ones paying the CAP's price floor. Part of what they pay goes to domestic farmers (area A) and part to the EU budget (areas B and C_1). It also helps us understand the political difficulties encountered as the EU tried to reform the system.

As we shall see, most of the reform involved lowering the price floor – which is equivalent to lowering the subsidy to farmers. Plainly, they would resist such a cut unless it was compensated somehow. Providing such compensation is the source of many sticky issues in CAP reform. Moreover, it is clear that such reforms are not going to save much money. In 2014, farmers were paid directly by the EU with something called 'direct payments' instead of being paid indirectly via artificially high prices. Despite this, the shift from price supports to direct payments can still be win-win. EU consumer surplus rises by $A + C_1 + B + C_2$ while the direct payments necessary to fully compensate the farmers is just $A + C_1 + B$.

Aggregate welfare effects

The overall welfare effects of the tariff are familiar from Chapter 4. Figure 9.2 provides a recap of the analysis. The higher price ($P_w + T$ instead of P_w) means that consumer surplus falls by $A + C_1 + B + C_2$. The first part, $A + C_1 + B$, reflects the higher cost that consumers pay for the food they continue to consume. The second part, C_2 , is what they lose from the tariff-induced drop in consumption. For producers, the gain

in producer surplus is equal to area A. We can think of this impact on producers as consisting of the impact resulting from getting a higher price for the amount they would have produced without the tariff plus the gain in producer surplus from the higher sales.

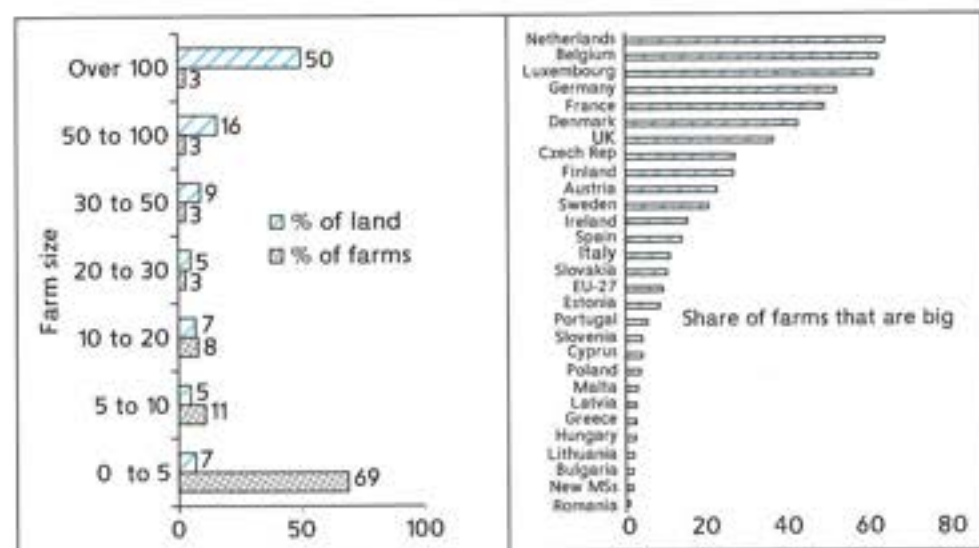
9.1.2 Farm size, efficiency and distribution of farmer benefits

The overall welfare analysis that lumps all EU farms together is useful for some things, but it hides a very important effect of price floors – the distribution of benefits among farms. This fact is at the heart of one of the problems that continues to plague today's CAP, so it is worth studying its basic economic logic in a simple setting.

Anyone who has done much travelling in Europe realizes that a 'farm' means very different things in different places. A wheat farm in the Paris Basin and a farm on a small Greek island, for example, are very dissimilar. On the Parisian plain, farms tend to be very large and very, very high tech. They use expensive, high-yield, disease-resistant seeds to boost their 'yield' (food produced per hectare), they apply large quantities of pesticides to control bugs, large quantities of chemical fertilizers to maintain the soil's fertility, and they use massive, labour-saving machines to plant, tend and harvest. In the Greek islands, farms are smaller and less efficient. As we shall see, these differences have important implications for the distribution of gains from price floors.

The basic facts are shown in the left-hand panel of Figure 9.4. The chart shows seven classes of farm size, from small (less than 5 hectares) to very large (more than 100 hectares). The top bars show what share of all EU27 farmland is held by farms of each class size. The bottom bars show what share of all EU27 farms are of the listed size.

Figure 9.4 Distribution of farm size by number of farms and share of land, EU27



Note: Big farms are defined as those producing sales of more than 50,000 euros per year.

Source: Authors' manipulation of European Commission data (2013), Table 3.5.4

The stand-out features of the chart are how the biggest farms own most of the land, but most farms are small. The biggest 'farms' own half the land, but account for only 3 per cent of all EU27 farms. At the other end of the size spectrum, 69 per cent of all EU27 farms own less than 5 hectares apiece (a standard football

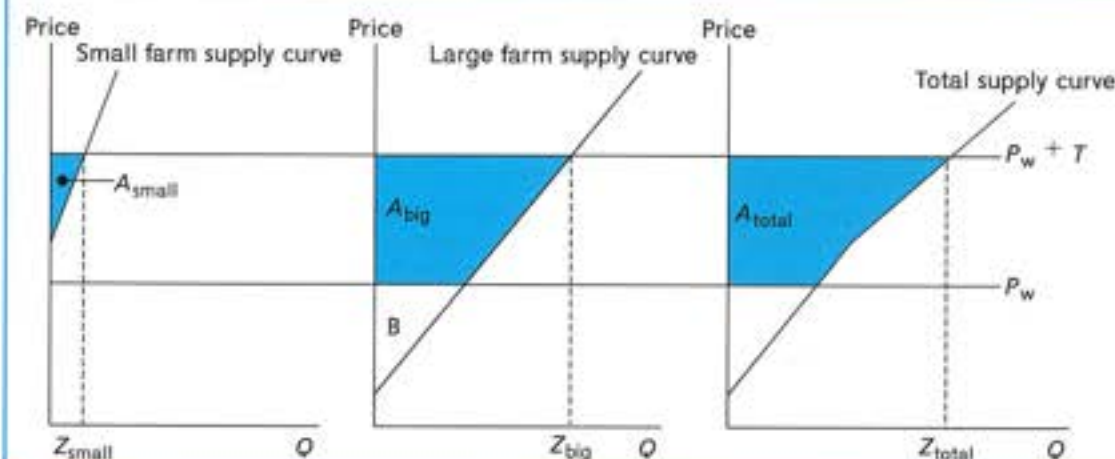
pitch is about 0.7 hectares). Thus more than two-thirds of farms are small in this sense, but together they own only 7 per cent of the land. This shows why farm size analysis is so important. If we worked only with averages, we would miss the fact that 3 per cent of 'farmers' own half the land, and thus get about half the CAP money. Here, we put farmer in quotation marks because many of these land-holdings are owned by corporations with revenues of hundreds of millions of euros.

Another striking fact, seen in the right-hand panel of Figure 9.4, is that the size distribution varies enormously across Member States. In particular, only a small share of the farms in the central and eastern nations that joined in the 2000s are big. This fact means that discussions about the distribution of CAP money across farm sizes quickly becomes a discussion about distribution of money across nations.

Why price support schemes favour large farms

The small-versus-large logic is best illustrated with the help of Figure 9.5. To keep things simple, suppose there are only two farms in the EU, one large and one small. The small-farm supply curve is shown in the left-hand panel, that of the large farm in the middle panel, and the total supply curve in the right-hand panel. Note that the small farm's supply curve is above the large farm's supply curve, reflecting the large farm's greater efficiency. (Remember from Chapter 4 that the supply curve shows marginal cost, so a higher supply curve means that the small farm has higher marginal cost at any level of output.)

Figure 9.5 Distribution of gains, big and small farms



The world price is marked P_w . Note that at this price only the large farm would produce anything. The small farm would stop farming with free trade since the price would be below its marginal cost of producing even a small amount. With the price floor at $P_w + T$, however, both farms produce. Specifically, the small farm produces Z_{small} and the large farm produces Z_{big} . Total output is just the sum of the two.

From Figure 9.5 we see that the producer surplus generated by the price floor is quite unevenly distributed. The small, low-technology, high-cost family farm earns only A_{small} , while the large, modern industrial farm earns A_{big} . This should be intuitively obvious. Since a price floor helps producers in proportion to their production, big producers will benefit more from the policy.

How is this connected with income levels? The benefit from owning a farm is the producer surplus it yields, so the income generated by the small farm is A_{small} and the income for owners of the large farm is $A_{big} + B$, since B measures the producer surplus that the large farm would have without the price floor. Plainly, the owners of big farms tend to be richer than the owners of small farms. This is the main point. Price floors help all farmers but most of the gains go to large farmers who tend to be richer; after all, they own larger farms.

This uneven-distribution point is critical – the key to many of the CAP's paradoxes – so it is worth presenting it from another angle. Few readers will be familiar with modern farming, but everyone has been to a food store. Box 9.1 presents an analogy by considering what would happen if CAP-like policies were used to support the owners of European food stores.

Box 9.1 An analogy with hypothetical support for food stores

In most European nations, there are many, many food stores, but food sales are dominated by huge supermarket chains. Simplifying to make the point, we can think of there being two types of store: small, family-run stores and hypermarkets. The small stores are much more numerous, but since many people do their main food shopping at hypermarkets, the total sales of the many small stores is only a fraction of the hypermarkets' sales. To be concrete, suppose that the hypermarkets account for only 20 per cent of the total number of stores, but account for 80 per cent of sales. Now suppose that small, family-owned stores experienced severe problems and the EU decided to support them. However, instead of subsidizing only the small stores, the EU decides to subsidize the sales of *all* food stores. Plainly, 80 per cent of the subsidies would go to the hypermarkets that did not need them. Once the hypermarkets got used to the billions, you can bet that they would engage in some pretty fierce politicking to hold on to the money. Moreover, the public might support the policy in the belief that the funds are helping the millions of small, family-owned stores.

In summary, the distributional consequences of using price floors to support the EU farm sector are quite regressive:

- The benefits of price supports go mainly to the largest EU farms because large farms produce a lot (and the support is tied to level of production) and because large farms tend to be more efficient (so their costs are lower). Since the owners of large farms tend to be rich, the benefits of a price floor are systematically biased in favour of large, rich farmers.
- Since price floors are paid for by consumers (they are the ones that have to pay the higher price), and food tends to be more important in the budget of poor families than it is in the budget of rich families, price floors are in essence paid for by a regressive consumption tax.

9.2 Changed circumstances and CAP problems

When the CAP was first implemented in 1962, its price-support based design was a politician's dream. Producers were happy, consumers were happy, and the programme paid for itself (indeed, it produced a profit). Specifically:

- The price floors provided higher and more stable prices to farmers, so they were happy.
- The booming growth of the 1960s (see Chapter 7) was biased towards industry and cities, so raising farm incomes fostered 'social cohesion'.
- Food production rose and stabilized, which was viewed as an important achievement at the time because many remembered food shortages and hunger.
- The variable tariffs even generated revenue for the EU budget.

Because average incomes were rising so rapidly – much faster than food prices – the share of people's income spent on food actually fell. Readers should also note that many Europeans felt and still feel a great deal of empathy with farmers. They view agriculture as a form of economic activity unlike others.

The CAP's 'honeymoon', however, was soon to end.

9.2.1 The 'green' revolution

The post-war period saw revolutionary advances in the application of science to agriculture. Crops and farm animals were selectively bred to boost yields. A whole agrochemical industry sprang up, producing

pesticides to control insects, herbicides to control weeds and chemical fertilizers to boost soil fertility. Huge planting and harvesting machines were developed to save labour. Strange as it may seem today, this chemical-, energy- and machine-intensive technology was known as the 'green revolution'.

Since the CAP rewarded output, EU farmers – especially those with large farms – switched to these new, more intensive farming methods. The result was impressive. EU farm production rose rapidly – so much so that the EU switched from being a net importer to a net exporter in most farm products.

In most sectors, this sort of rapid productivity growth would be a cause for celebration. In European agriculture, it was called the 'supply problem'. Other European sectors that have experienced rapid technological progress – e.g. telecoms – saw rapid price falls as the efficiency gains were passed on to consumers. The political power of the EU farm lobby, however, was strong enough to prevent this. EU food prices continued to be fixed far above the world price.

9.2.2 Negative consequences of the 'supply problem'

This combination of high, fixed prices and rapid technological progress created a whole cascade of problems that triggered a series of CAP reforms – the latest of which was implemented in 2014. To understand these, we study the impact of a price floor in the presence of a positive supply shock. Figure 9.6 shows the situation. Technological improvements shifted the supply curve down (recall that the supply curve is marginal cost, so cost-lowering technology shifts the whole curve downwards; see Chapter 4).

Figure 9.6 The green revolution and price floors: the EU becomes an exporter



Green revolution impact

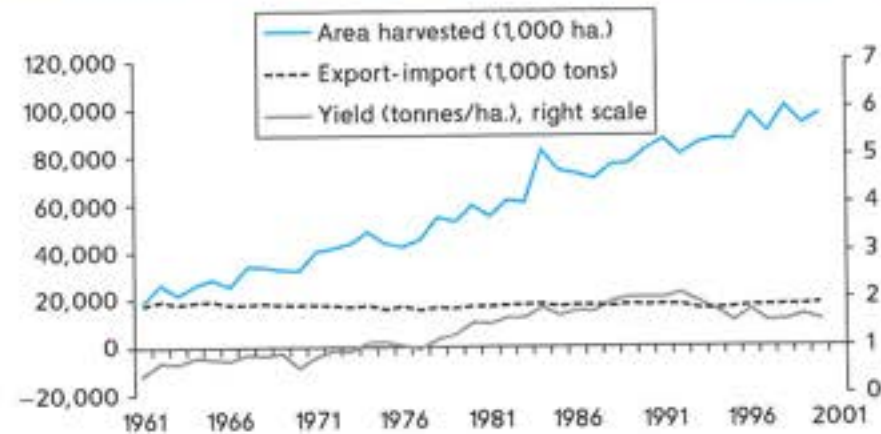
- Technological improvements lower marginal cost.
- This shifts down supply curve from S_1 to S_2 .
- EU switches from importing food to producing surplus food (production exceeds consumption at price floor).
- Tariff revenue switches from positive ($abcd$) to negative ($dcef$).

Before the supply shift, the EU was a food importer and the price floor worked as in Figure 9.2. After the shift, the EU supply curve is S_2 with the price floor in place, so the EU has surplus food production; production level Z' exceeds the consumption level, C .

Some facts showing the impact on the EU food trade balance are shown in Figure 9.7, using wheat to illustrate the points. The rapidly rising line shows how the green revolution boosted yields (i.e. output per hectare) on a sustained basis. As area harvested changed little, output rose along with the rising yields. As consumption rose more slowly than production, the EU switched from importing wheat to exporting it around the late 1970s.

This simple switch trigger a cascade of problems.

Figure 9.7 EU trade balance in food, 1961–2001



Source: DG Agri online database

The budget problem

The immediate difficulty was budgetary. Since the EU was no longer a food importer, the price floor could not be maintained with a variable tariff. The CAP had to directly buy food at the price floor; specifically it had to purchase at the price floor (i.e. Z' minus C in Figure 9.6) all the food that EU consumers didn't want. In short, the CAP rapidly turned from a money-maker to a money drain as the EU had to dole out large sums to buy the 'excess' food.

Although the CAP came into operation in 1962, it did not incur a positive expenditure until 1965. After this, however, its cost and share of the budget started to grow exponentially, rising from 8 per cent in 1965 to 80 per cent in 1969 (Figure 9.8). Fights over how to pay for these hindered EU cooperation throughout the 1970s and early 1980s.

Figure 9.8 The CAP's early budget problem



The disposal problem: wheat, beef and butter mountains

Initially, the surplus production was viewed as a temporary problem. The food was stored in the hope that next season the consumption would exceed production. The stored food was viewed as a buffer stock. This was not to be.

High and stable prices teamed with steady technological progress made investment in agriculture very attractive. The supply curve continued to shift outwards, so the EU were forced to continue buying food. The EU found itself the owner of what the media called 'wheat, beef and butter mountains'. In 1985, the EU had 18.5 million tonnes of cereals stored, about 70 kilos for each of its citizens. Much of this food rotted, causing a major public relations problem (paying high prices for food and then allowing it to rot certainly looks bad).

Apart from the cost of buying all this food, the EU also faced the problem of what to do with it. When the food 'surpluses' first appeared, the EU viewed them as temporary. To reduce the budget and disposal problems, the EU sold the food at subsidized prices. Some was sold to non-standard consumers within the EU. For example, a sixth of the wheat crop in 1969 was rendered unfit for human consumption and sold as animal feed at a subsidized price. The major destinations for the subsidized sales were foreign markets. This practice of buying high domestically and selling cheap abroad is called 'dumping', although the EU jargon for it is 'export restitution' or 'export subsidies'.

The cost of such export subsidies can be thought of as 'negative tariffs'. That is, instead of buying at the low world price and selling at the high support price, the EU was buying high at the support price and selling low at the world price. The cost is shown in Figure 9.6 as area *dcfe*. Technically, this was done by paying large corporations to undertake the buy-high-sell-low business. This is why companies like Tate & Lyle routinely received billions of euros from the CAP. The payments are called export subsidies.

Readers will realize that the EU needed high tariffs and border controls to make the price floor work even when it was exporting. Although no imports come into the EU with the tariff set such that the support price equals the world price plus the tariff, they would if the tariff were removed. Every farmer in the world would like to sell at the EU's price floor instead of the world price; thus to reserve the higher price only for EU producers, the world price plus the EU tariff must exceed the price floor. For an example of the sort of smuggling that can result, see Box 9.2.

Box 9.2 Swiss border guards catch meat smugglers

'Buy low and sell high' is a sure way to make money. Unfortunately, two men were arrested in December 2012 as they sought to put this theory into practice. Under pressure from Switzerland's powerful 'cow lobby', the nation keeps beef prices very high – even higher than those in the EU. The men were caught smuggling 151 kilos of sausages, 110 kilos of chicken, 57 kilos of lamb and large quantities of poultry-burgers from Germany.

The plan was to deliver the meat to a family farm, which would then resell it in the Swiss market. This is hardly a unique occurrence. In the same year, Swiss customs guards caught a man smuggling in vans 1.4 tonnes of Dutch beef and 1.5 tonnes of ham and cheese.

Source: Based on an online news story by Malcolm Curtis, 18 December 2012. <http://www.thelocal.ch/20121218/basel-border-guards-nab-meat-smugglers>

Dumping and international objections

Disposing of EU 'surplus' food abroad created the next problem – a foreign trade problem. Under WTO rules for manufactured goods, dumping is normally not permitted, especially when the practice is driven by government export subsidies. However, before the 1994 Uruguay Round agreement, the WTO placed no restrictions on the dumping of agricultural goods.

The EU's food dumping drove down world food prices. As we saw in Chapters 4 and 5, a drop in the world price is a gain for net importers but a loss for net exporters. While the world's net food importers did not complain, EU dumping infuriated the world's large food exporters: Argentina, Australia, Bolivia, Brazil, Chile, Colombia, Costa Rica, Guatemala, New Zealand, Paraguay, the Philippines, South Africa, Thailand, Uruguay, Canada and – most importantly – the USA.

By shutting off EU markets to the exports of non-members, the CAP reduced the world price of food as well as reduced the volume of non-members' exports. As the EU's food surplus grew, and the EU started to subsidize its exports, non-members were further harmed.

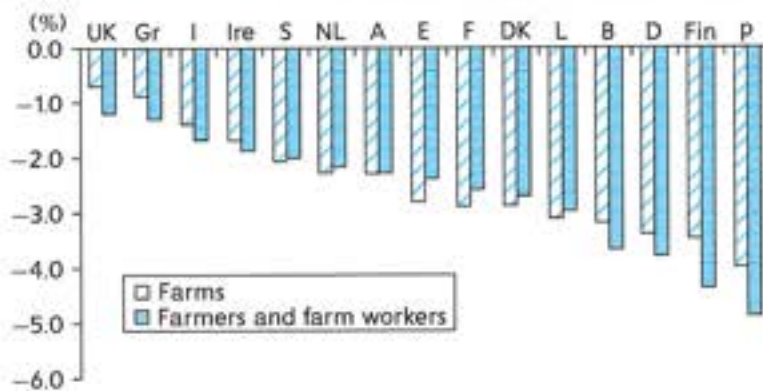
Many countries impose some form of import protection on food, so while the CAP's tariffs were harmful to the world market, they were not viewed as particularly out of line with the rest of the world's practice. The subsidized export of food, however, was more unusual. Additionally, the USA and the EU were, at the time, the only major subsidizers and often engaged in subsidy wars. We shall return to the international impact of the CAP several times in the rest of this chapter.

The farm income problem

A somewhat paradoxical effect of this rapid technological progress was a shrinking of employment in the farm sector – the 'farm income problem'. Despite its massive budgetary cost and high implicit tax on European food consumers, the CAP failed to bring the reward to farming in line with the incomes of average EU citizens. In 1990, the income from farming per agricultural worker averaged less than 40 per cent of the income per worker in the EU12 economy as a whole (European Commission, 1994). While most farm family income was augmented by some non-farm earnings, farming was not a very attractive activity.

Farmers showed their discontent with the CAP by 'voting with their feet', i.e. quitting the sector. The number of farms and farmers has declined steadily since the CAP's inception (Figure 9.9). This is the truest indication that the average EU farmer found that, even with CAP support, farm incomes were not keeping up with those in the rest of the economy.

Figure 9.9 Declining number of farms and farmers



Note: Average from 1975 to 2005 depending upon data availability.

Sources: DG-Ag (2010); http://ec.europa.eu/agriculture/publi/situation-and-prospects2010_en.pdf

Inequality across farm size

The big-versus-small logic illustrated in Figure 9.5 was magnified by green revolution technology. Much of the new innovations worked best for large-scale farms, so the output of large farms increased more than that of small farms. This exacerbated the unequal distribution of CAP support.

Table 9.2 shows just how uneven the payments were in 2011. The payment size categories are on the left; they range from less than 0 euros (i.e. these farmers actually owed the CAP money!) to over half

Table 9.2 Extremely uneven distribution of CAP payments, EU27, 2011

Size of payment (euros)	1000 recipients	Average payment (euros)	Cumulative share of recipients (%)	Cumulative share of payments (%)
< 0	13.7	824	0.2	0.0
> 0 and < 500	2,847.7	250	37.6	1.7
> 500 and < 1,250	1,582.3	807	58.4	4.9
> 1,250 and < 2,000	671.7	1,585	67.2	7.6
> 2,000 and < 5,000	996.5	3,187	80.3	15.5
> 5,000 and < 10,000	577.9	7,082	87.9	25.7
> 10,000 and < 20,000	433.2	14,212	93.6	41.0
> 20,000 and < 50,000	364.6	30,736	98.4	68.9
> 50,000 and < 100,000	93.0	66,954	99.6	84.4
> 100,000 and < 200,000	16.7	119,528	99.8	89.3
> 200,000 and < 300,000	5.7	171,460	99.9	91.8
> 300,000 and < 500,000	2.9	221,665	99.9	93.4
> 500,000 and < 1,000,000	1.7	276,555	99.9	94.5
> 1,000,000 and < 2,000,000	2.6	380,738	100.0	97.0
> 2,000,000 and < 5,000,000	1.5	806,719	100.0	100.0

Source: http://ec.europa.eu/agriculture/statistics/agricultural2013/index_en.htm, Table 3.6.1.14

a million euros. What the figures show is that 58 per cent of farmers got less than 1250 euros. While that will sound like a nice amount of money to most readers, it is peanuts when it comes to running a business, or farm. For these farms, the CAP is not really helping. At the other extreme, 1500 recipients got, on average, 806,719 euros. As these are large farms, these are almost sure to be run as modern industrial agricultural corporations. For them, the CAP is probably not really necessary – although, as the old saying goes, 'rich or poor, it's always nice to have money'.

Table 9.2 also shows the share of CAP that goes to big and small recipients. Notice that 80 per cent of the farms get only 15 per cent of the money. That means that the 85 per cent of the money remaining goes to just 20 per cent of the farms. To put it starkly, big farms find the CAP hugely profitable, but for the vast majority of farmers the CAP payments are just enough to keep them on the edge of bankruptcy.

Industrialization of farming: pollution and animal welfare

The 'industrialization of farming' that came with green-revolution technology had a negative impact on the environment and animal welfare. As the public's concerns over both reawakened in the 1980s and 1990s, these harmful effects of the CAP eroded public support for it.

The CAP harmed the environment in many ways. It induced farmers to apply more fertilizers and pesticides, and put more cows to graze on each hectare of land. The resulting decline in semi-natural habitats harmed wildlife numbers and diversity. Land under cultivation expanded in ways that had damaging effects on soil structure. The CAP's subsidization of particular crops (e.g. cereals, oilseeds, peas and beans) and livestock enterprises (e.g. dairy) encouraged 'monocultures', which further reduced biodiversity. Water quality suffered from the nitrates and phosphates in chemical fertilizers, which over-stimulated water

plants and led to the clogging up of lakes and so on. Where pork and beef production are particularly intensive, such as in the Netherlands, animal manure is the problem.

Animal welfare and 'factory farming'

Just as science improved crop yields, science has also been applied to boost the efficiency of animal products – meat, eggs, milk, etc. Efficiency in this sense typically means producing the most meat at the least cost. Doing so has involved studying the most efficient density of animals, the use of antibiotics to control disease and promote growth, the scientific design of animal feed and the breeding of higher-yielding, disease-resistant animals. While raising farm productivity, these practices have moved modern farming a very long way from the pastoral scenes still in the minds of many Europeans.

Some aspects of industrial farming became known to the wider public as the result of two animal diseases. BSE, known as 'mad cow' disease, was spread by the practice of processing the carcasses of dead cows (some of which had the disease) into feed that was then given to healthy cows. Outbreaks of 'foot and mouth' disease also occasionally occur and, to contain them, large numbers of animals are destroyed to mitigate the economic consequences. The disease does not kill the animals but renders them uneconomical.

Some Europeans reacted strongly against this 'factory farming' as inhumane treatment of animals. While there are some extremists, the concern has become quite mainstream. For instance, a million EU citizens signed a 1991 petition to the European Parliament calling for animals to be given a new status in the Treaty of Rome as sentient beings. The petition worked. The Lisbon Treaty includes animal protections: 'Member States shall, since animals are sentient beings, pay full regard to the welfare requirements of animals' (Article 13 of EFUE).

Concern for developing nations

The last problem facing the CAP was the growing realization that the dumping of food on the world market was harming the prospects of developing nations. The dumping of sugar and protection of cotton were particularly harmful to some of the world's poorest nations. As EU citizens started to realize this, attitudes began to change.

See Box 9.3 for a discussion of the impact of the EU sugar policy on Mozambique.

Box 9.3 EU sugar policy and Mozambique

The CAP's sugar policy is one of the oldest and most complex EU policies. EU sugar prices are maintained at about three times the world price, but not for all production. At the high price, many EU farmers would find it profitable to switch to growing sugar beet. EU leaders recognized this impending 'supply problem' from the beginning, so the amount of sugar for which farmers receive the high price is capped. Since the EU produces more sugar than it consumes at the high prices, the EU has to subsidize the export of the excess, but again, not for all production. The EU sets a quota for the maximum amount of exports it will subsidize; anything beyond this must be sold at world prices. One strange thing about EU sugar policy is that it actually taxes EU farmers in order to raise the money for the export subsidies. High EU tariffs shut off almost all imports, but again with an exception. The EU allows entry for some imported sugar from its former colonies, the so-called ACP (African, Caribbean and Pacific) nations, but the EU must re-export it, with subsidies, since it already produces more sugar than it consumes. Note that more than half of the EU's sugar is grown in Germany and France.

All this manipulation has made the EU the world's largest exporter (accounting for approximately two-fifths) of white sugar. EU subsidies depress the world price and its tariffs deny other nations the opportunity to sell in the EU market. Taken together, the CAP's sugar policy has a powerfully negative impact on poor countries, especially on poor nation farmers – a group that tends to be the poorest people in poor countries.

By way of illustration, the non-governmental organization Oxfam has highlighted the impact of EU sugar policies on Mozambique (2002, www.oxfam.org.uk). It points out that per-capita income in Mozambique is under 250 euros per year and two-thirds of the population live below the poverty line. The 80 per cent of the population that lives in rural areas relies mainly on agriculture for their living, with sugar production being the single largest source of jobs in the country. Oxfam estimates that Mozambique is one of the lowest-cost producers of sugar in the world, with a production cost under 300 euros per tonne. Removal of EU sugar tariffs would help Mozambique directly, but even a cessation of export subsidies would be welcome. For example, the EU exports almost a million tonnes of sugar to Algeria and Nigeria, nations that would otherwise be natural markets for Mozambique's sugar.

Since 2006, the system has been becoming less distortionary, with support prices falling by about 40 per cent. The reform increased EU imports to the benefit of developing country sugar exporters. However, the developing nation exporters that get limited preferential access to the EU market are harmed by it (the ACP nations; see Chapter 12 for details). These exporters face the same price reduction.

9.3 The simple economic logic of the new CAP

The EU is moving to a new simple CAP logic. Below we discuss some of the milestones in the transition between the old and new simple logic, but first we explain the economics and politics of the new logic. This involves three steps, each corresponding to one of the three elements of the new system: (1) support prices lowered to the world price level, (2) farmers compensated for the lower prices with 'decoupled direct payments', and (3) a new linking of the payments to social concerns, particularly the environment, animal welfare and rural development.

9.3.1 The logic of price cuts

Adam Smith's book *The Wealth of Nations*, published in 1776, contains a simple solution to all the CAP's problems, which all stem from the fact that the EU was producing too much food given world market conditions. Overproduction, in turn, was due to the fact that EU prices were above the world price. The obvious solution was to let Smith's 'invisible hand' guide production and consumption instead of politically-set support prices. This simple solution – lowering the support price to the world price, or eliminating the price floor all together and allowing the free-market price in food – is the first part of the new CAP logic.

The welfare gain from this cut-the-price reform is positive, as can be seen in Figure 9.10. The lower price would raise consumer surplus by the area $a + b$, while lowering producer surplus by $a + b + c$. Additionally, the cost of the 'negative tariff' (i.e. export subsidy) would be eliminated, adding an area of gain equal to $b + c + d$. In total, EU welfare would rise by $(a + b) - (a + b + c) + (b + c + d)$, which equals area $b + d$.

While eliminating or lowering the price floor would have solved the problem and raised EU welfare on aggregate, this 'Adam Smith reform' was not politically feasible. The EU farm lobby was, and is, just too powerful.¹ Although there are few EU farmers – less than 5 per cent of the population even back in the 1970s – their political power was, and still is, enormous. To EU farmers who have earned millions from the EU since the 1960s, the CAP resembled a personal gold mine. Just as real gold-mine owners hire armed guards to protect their investment, EU farmers were willing to spend millions on the politicking necessary to guard their 'gold mine', i.e. prevent prices from being lowered without compensation.²

¹ It is important to note that the EU's special treatment of farmers was not unusual. In the early 1990s, the EU's generosity was only in the middle of the OECD pack. OECD (2004) reports that the subsidy equivalent per EU farmer was \$13,000, less than half the amount for EFTA members (Sweden, Switzerland, Norway, Finland and Austria) and about equal that of the USA and Japan.

² See http://ec.europa.eu/agriculture/fin/directaid/2006/annex1_en.pdf for details.

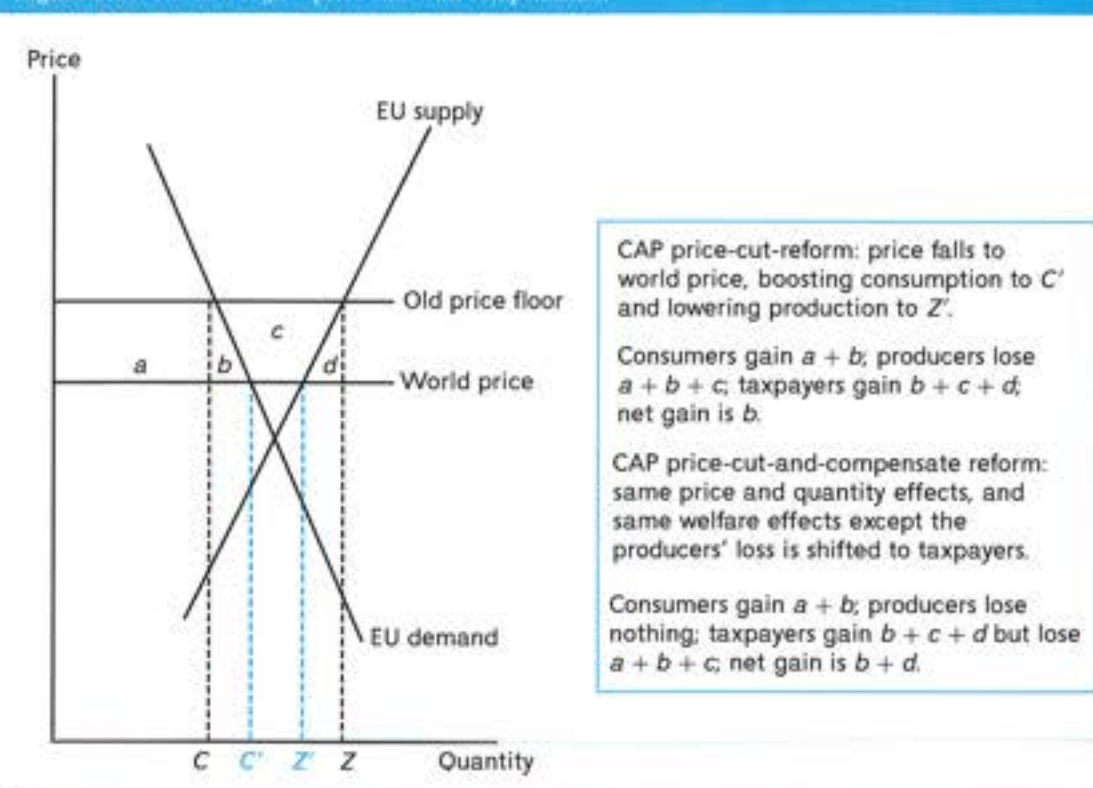
9.3.2 Price cuts compensated by 'decoupled direct payments'

The political solution was to provide compensation that would, in essence, 'bribe' farmers into allowing CAP reform to proceed. This added the second element to the new CAP logic. In EU jargon, this compensation is termed 'decoupled direct payments'. The 'direct payment' part is self-explanatory; the 'decoupled' part indicates that payment of the money is not linked to food production levels.

As it turns out, such price-cuts-with-compensation are win-win. To see this, recall how the price support was like a combination of a consumption tax and a production subsidy. In this light, the simple cut-the-price reform would have removed both the tax and the subsidy. The cut-prices-and-compensate reform removes the consumption tax and replaces the production-linked subsidy with a decoupled subsidy.

In terms of Figure 9.10, the cut-prices-and-compensate reform lowers the price that both consumers and producers see in terms of the old price floor and the world price. This reduces EU output to Z' , raises EU consumption to C' , thus eliminating the need for the EU to buy unwanted food and dump it on the world market. Full compensation of farmers would cost $a + b + c$ (equal to their loss in producer surplus), but this would still make the whole reform a net winner for EU consumers and the EU as a whole. Consumer surplus would rise by $a + b$ and the producer surplus reduction would be exactly offset by the compensation, leaving tax revenue implications. EU taxpayers would save $(b + c + d)$ from eliminating the export subsidy, but have to pay $(a + b + c)$ in compensation. EU welfare would thus rise by $(a + b) + (0) - (a + b + c) + (b + c + d)$, where the (0) shows the impact on EU producers. The sum of this is the same as the cut-the-price reform, namely, a gain equal to the area $b + d$.

Figure 9.10 The new logic – price cuts with compensation



This result should not surprise readers who fully understand the logic in Chapter 4. Since the compensation is – from the EU-wide perspective – just one group of EU citizens transferring money to another set of EU citizens, it has no impact on EU-level welfare. From an aggregate welfare point of view, cut-the-price and cut-the-price reform-with-compensation are identical.

9.3.3 Linking direct payments to environmental and animal welfare goals

This cut-and-compensate reform made sense in the short run. Most Europeans would agree that some sort of transitional compensation was owed to farmers. After many years, however, the moral case for compensation began to fade. The first steps towards the new logic happened in 1992 – before most readers of this book were born. By the 2000s, the payments started to look more like unjustified transfers. Two developments extenuated this impression. First, since the direct payments were made to named farms and farmers, the inequality documented in Table 9.2 became very transparent. One could even see how much the Queen of England received in CAP payments (see Box 9.5). Second, the money started going to millions of farmers in central and eastern Europe, who had never experienced the price cuts in the first place. They were being compensated for losses they had never incurred.

One reaction would have been to shift EU spending from farms to other areas, say, R&D schemes to deal with youth unemployment, or development aid to Africa. The political power of the farmers, however, prevented this. The political solution was to justify the payments on social grounds, such as protecting the environment, promoting animal welfare, encouraging rural development, etc. In essence, the 'decoupled' direct payments were recoupled to something other than farm output.

Box 9.4 Money and the extraordinary political power of EU farmers

To understand how much big EU farmers would spend to resist simple price cuts, consider the numbers involved, taking the EU 2007–13 budget package as an example. This package allocated 330 billion euros to payments to farmers and the cost of keeping farm prices high. There are only 12.6 million people working in the farm sector. If the money were divided evenly, that would be about 26,000 euros per person – certainly something worth fighting for.

The money, however, is not distributed evenly, as Table 9.2 showed. Most of the money goes to the largest farm owners. For example, in 2006, the EU25 paid 33.1 billion euros to 7.3 million farmland owners, with about 70 per cent of the money going to just 10 per cent of these (the ones with the largest landholdings). Small farmers earned much less from the CAP but, without the higher prices, many would be driven out of farming altogether.

In a nutshell, the CAP meant loads of cash for the happy few (large farms) but it was a matter of survival for the 80 per cent of EU farmers with small operations. In addition to the cold-hearted political logic of cash, part of the farmers' disproportionate power stems from the warm-hearted feeling that the average European has towards the sector; opinion polls show that most EU citizens approve of CAP spending in general.

Box 9.5 Queen Elizabeth's CAP receipts

The list of English CAP recipients (the Scottish and Welsh governments refuse to release the information) includes some of the richest people in the realm. The Duke of Westminster, whose net worth is about €7 billion, received about €1 million over two years, the Duke of Marlborough got €1.5 million over the same period, and the Queen and Prince Charles received more than €1.5 million each, according to the data. The royal family is also a major landowner in Scotland (for which the data is still secret), so this is probably a serious underestimate. Multinational corporations, however, received even more. At the head of the subsidy list is the multinational corporation Tate & Lyle. It received more than 10 times the payments received by Queen and Prince Charles, some €180 million (most of this was spent on dumping sugar on the world market). Nestlé got €30 million. Overall, there were 24,525 names on the list, but half of the money went to the top 2000 recipients. Or, to put it differently, half the money was divided among the 22,500 smallest farms. See *The Guardian* newspaper's website (<http://image.guardian.co.uk/sys-files/Guardian/documents/2005/03/23/CAP.pdf>) for a full list. A similar list can be downloaded for Denmark from www.dicar.dk.

9.4 CAP reform

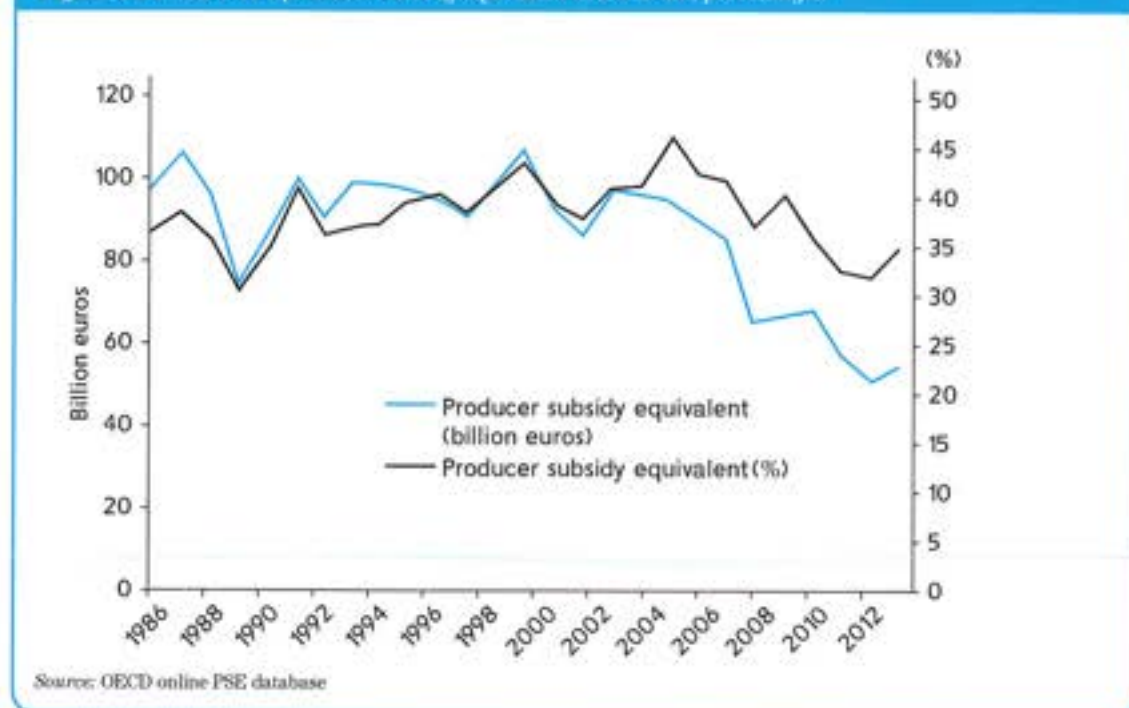
Up to the mid-1980s, the primary way of dealing with higher CAP costs was to increase contributions from Member States. This was understandable. The CAP was not very expensive from the aggregate viewpoint (less than half a per cent of EU GDP) and it was essentially European governments paying each other's farmers. The Germans paid more than they received while the reverse was true for the French and Italians. The British negotiated a 'rebate' in 1984 to reduce their net payment.

This political balance changed when Spain and Portugal joined in 1986. As discussed in Chapter 3, this altered the politics in the Council in critical ways. The CAP did little to help Spanish and Portuguese farmers since their climates prevented them from producing the goods that the CAP supported most, i.e. dairy, sugar, wheat, rice and beef. The newcomers, who were reluctant to see their national contributions to the budget rise year after year in order to subsidize the production of rich northern European farmers, teamed up with the two incumbent poor nations (Ireland and Greece) to shift EU spending priorities towards 'structural spending' in poor nations (see Chapter 3 for further details). One option would have been to expand the EU budget to pay for the extra structural spending, but the EU net contributors (especially Germany, Denmark and the UK) opposed this. EU leaders decided instead to find ways of capping CAP costs, so to speak.

From 1986 to the present, the CAP has been repeatedly reformed. Although the details are complex, the basic trend is simple. EU leaders were gradually guiding the CAP from the old simple logic of prices explained in Section 9.1 to the new simple logic explained in Section 9.3.

For most of this period, the overall level of support to farm incomes did not fall, as Figure 9.11 shows. The producer subsidy equivalent (PSE), which is calculated by the OECD, shows the sum of all supports to EU farmers from the CAP and national sources. The chart shows both the level (billions of euros) and the PSE as a share of total farm output. Up until the mid-2000s, the total cost of the CAP was steady and it has fallen only moderately since. The PSE percentage, by contrast, has been on a clear downward trajectory since 1998. The difference indicates that EU agricultural output is falling more slowly than total PSE payments.

Figure 9.11 The CAP's producer subsidy equivalent in levels and percentages



9.4.1 Ad hoc supply control attempts

This situation posed a reform dilemma. Lowering farm prices dealt with the political roadblock discussed in the previous section, but buying all the excess food was too expensive. The EU's first reaction was to try to work around the problem, dealing with the surplus situation without fundamentally changing the price-floor system. As the European Commission (1994) puts it, the 1983 to 1991 period involved 'years of experimentation' with supply controls.

The CAP during this period became fantastically complex. Fortunately, most of these experiments have been dropped, so most students of European integration have no need to study their details. What is important is the outcome of these new policies. The CAP's share of the budget began to fall to meet the new political imperative of spending more of the EU budget on poor members and regions.

These ad hoc supply control policies, however, failed to address the supply problem. The wheat and butter mountains continued to grow along with subsidized exports, and, despite this, average farm incomes continued to fall relative to the EU-wide average.

9.4.2 The MacSharry reforms

The first really big reform was driven by pressure from the EU's trade partners who were fed up with seeing the market for their exports ruined by export subsidies (the USA also subsidized its exports). The issue came into sharp relief when the global trade talks, known as the Uruguay Round, failed in December 1991 when the EU refused to commit to phasing out its export subsidies and open its agriculture markets. Since these global trade talks were viewed as vital to European exporters of goods, services and intellectual property, Europe's highest-powered exporters started to push for CAP reform. The political power of poor regions who wanted to use the money and European exporters who wanted the Uruguay Round to succeed were sufficient to get a major reform accepted by the Council of Ministers. The resulting reform package (the MacSharry reforms) put the CAP on the road to the economic logic of Figure 9.9. All subsequent reforms to date have followed its main outlines.

There have been three major CAP reforms since the MacSharry package, which pushed the basic MacSharry logic even further. All involved further price cuts that were compensated by direct payments to landowners. The first resulted from the March 1999 meeting of the European Council in Berlin. The prime driver of this reform was the need to get the CAP ready for eastern enlargement and to prepare it for a falling budget share in the 2000–06 Financial Perspective. The second came in 2003. The third was embodied in the new 2014–20 Multiannual Financial Framework.

9.4.3 The 2003 CAP reform and 2008 Health Check

The driving force was the current WTO trade talks (the so-called Doha Development Agenda). Developing countries were reluctant to start new WTO talks and were only convinced when the EU members and other rich nations promised in November 2001 to liberalize agricultural markets as part of the Doha Round. With the crucial mid-term meeting of ministers scheduled for September 2003 in Cancun, Mexico, the EU had to come up with a reform of the CAP that would allow it to fulfil its liberalization pledge. The Cancun meeting ended in failure. Although there is plenty of blame to go round, many observers believe that the meagre liberalization contained in the CAP reform was at least one major reason for the failure. The 2003 reform has been followed up by a series of sector-specific reforms in recent years.

In 2008, the EU undertook a reform with a peculiar name, the 'Health Check'. This agreement pushed the market orientation of the CAP even further and took a big step towards liberalizing one of the most resistant sectors – dairy. The reform abolished arable set-aside (i.e. paying farmers to not grow food). It is also relaxing the restrictiveness of milk quotas gradually, with the goal of eliminating them in 2015. Moreover, the unfairness of the direct payments was mitigated under the name of 'modulation'. This means that some direct payments to farmers are reduced and the money transferred to the Rural Development Fund. Lastly, the direct payments are no longer linked to the production of a specific product.

9.5 Today's CAP

Today's CAP has two pillars. The first concerns direct payments and the cost of the remaining price supports. The second is called 'Rural Development'. The precise implementation of both pillars is delegated to Member States' Ministries of Agriculture – the idea being that the national ministries would have better knowledge of local conditions and constraints. Substantial reforms to this basic system are being phased in between 2014 and 2020.

We address the first pillar first.

9.5.1 CAP's first pillar: direct payments and market intervention

A key goal of the 2014–20 reforms is to achieve 'convergence', i.e. a more equal distribution of support. Previous CAP reforms had adjusted the level of direct payments according to a farm's historical production as a means of calibrating the amount of 'compensation' paid to each farmer for the price cut. The new system aims to achieve a more equal allocation across Member States and across farmers within each Member State. This will mean a clear and genuine convergence of payments not only between Member States, but also within Member States. As part of this, Member States will use a uniform payment per hectare by the start of 2019.

Another innovation is to tie the direct payments more clearly to environmental goals by insisting that 30 per cent of each member's budget allocation ('national envelope' in CAP jargon) be conditional on the adoption of sustainable farming practices. This is a step beyond the existing milder requirement that all recipients respect minimum environmental and animal welfare standards. These requirements are known as 'cross-compliance' rules. These are complex and vary somewhat from nation to nation. There are two basic categories: 'Good agricultural and environmental conditions' (soil protection, avoidance of overgrazing, etc.), and 'Statutory management requirements' (wildlife protection, avoidance of ground water pollution, etc.).

Basic Payment Scheme

The main vehicle for giving money directly to EU farms is called the 'Basic Payment Scheme' and it accounts for 70 per cent of each member's direct payments. Within this, there is flexibility for Member States to grant certain farmers more money according to a series of criteria such as young farmers, small farmers, and farmers who have land with natural constraints.

The new CAP takes one step back towards the old pre-reform system by allowing members to tie a limited amount of aid to the production of a specific product. The total amount, however, should be less than about one-tenth of the national envelope. It takes a step forward, in contrast, in that it seeks to prevent abuses of the system that occurred in the past, such as golf courses claiming CAP subsidies. While this was a positive move, the Commission had proposed a much stronger 'active farmer' condition to prevent payments to 'sofa farmers' and absentee landlords and the like. The farm lobby overruled them, however, arguing that it would be too burdensome administratively to prove eligibility if the criteria included things like being actively engaged in farming activities or farming forming a significant share of the farmer's income.

Market interventions: eliminating left over price support and supply control measures

While most CAP expenditures had long ago moved away from manipulating market outcomes via price floors and production quotas, two of the most politically powerful lobbies – dairy farmers and sugar beet growers – had managed to hold on to production quotas and high prices. The new CAP eliminates the quotas for milk in 2015 and for sugar in 2017.

The CAP's protection scheme for EU sugar producers has long been derided as one of the most obvious cases of the CAP harming the interests of some of the world's poorest people (see Box 9.3), so this is a welcome step.

9.5.2 CAP's second pillar: rural development

For many years, successive CAP reforms have moved money away from directly paying farmers and towards paying for rural development schemes. Member States design their own multi-year programmes but these

must be drawn from a menu of measures specified at EU level. The CAP 2014–20 requires Member States to spend about a third of this money on land management projects and schemes linked to climate change.

The multi-year programmes are to target six priorities areas: (1) improving innovation and knowledge transfer, (2) boosting agricultural competitiveness, (3) promoting food-chain integration, including processing and marketing, (4) helping ecosystems, (5) encouraging the transition to a low-carbon economy, and (6) promoting social inclusion, poverty reduction and economic development in rural areas.

9.6 Remaining problems

Today's CAP shares some of the problems discussed above. For example, not all of the payments are fully decoupled, so production distortions persist in some sectors. Moreover, with or without the CAP, the most productive farming is industrial farming and this almost inevitably involves chemical and energy usage that harms the environment.

9.6.1 Social inequality and CAP payments

The complete decoupling of the single payments is good economics, as we saw in Figure 9.10, but it poses what might be called a public relations problem for the CAP as a whole. Full decoupling turns the single payment into a subsidy to farmland ownership. Since many of the EU's landowners are not those who actually farm it, the CAP is increasingly looking like an excuse for paying very large sums of money to rich landowners. Paying millions of euros to wealthy landowners is not what most Europeans view as a good idea. For a long time the allocation of the payments remained a secret; however, using new 'freedom of information' laws, journalists forced some governments to reveal who was getting the cash. Such recipients included Queen Elizabeth II and other royalty (Box 9.5).

The Commission is set against this iniquitous allocation of CAP money and has tried many times to trim payments to the largest landowners. As part of its campaign, it has begun to publish annual data on the size distribution of payments in each Member State. Moreover, as part of the EU's new transparency goals, the Commission adopted a rule in March 2008 that requires the full name, municipality and postal code of every recipient. The first full list came out in April 2009. A good deal of information is already available on the Commission's web page on the CAP (ec.europa.eu/agriculture/funding/index_en.htm).

This sort of transparency puts a political bomb under the massive payments to rich landowners. Local media is likely to highlight the anomalies. For example, we have already seen that some of the ministers in charge of reforming the CAP are in fact receiving CAP payments (Box 9.6). Increasingly, CAP spending will be seen as welfare for the rich and support for first-pillar payments is likely to erode.

Box 9.6 Government ministers receiving CAP payments

In the Dutch and Danish cases, a scandal has emerged involving politicians charged with overseeing the CAP actually receiving some of the money personally. For example, 4 of the 18 Danish ministers or their spouses, including the Farm Minister, received CAP money. The biggest scandal to date, however, involved the Dutch Farm Minister Cees Veerman. He receives about €190,000 annually in CAP subsidies for the farms he owns.

The scandal was revealed when British Premier Tony Blair suggested a reform of the CAP in the summer of 2005. The Dutch Prime Minister Jan Peter Balkenende at first supported Blair, but Veerman threatened to resign in protest if Balkenende backed Blair. According to an *International Herald Tribune* article (19 August 2005), a spokesman for the Dutch Ministry of Agriculture claimed that there was no connection between Veerman's cash receipts and his opposition to CAP reform. One can question this assertion, since Veerman referred to his farms as 'my pension', according to a report in *The Guardian* newspaper.



This makes it easier to understand why governments have opposed the release of detailed information on who is getting the taxpayers' money. As more EU nations reveal the names of CAP recipients, the pressure to reform the welfare-for-rich-landowners aspect of the CAP is likely to grow. One proposal put forth several times by the European Commission (and rejected by the Council) would put an upper limit on the payment per farm.

The linking of these payments to environmental and animal welfare concerns is a popular conception, but the details matter and these will eventually be more widely publicized. The key point is that the payments are not linked to *new* environmental and animal welfare regulations; rather, they are linked to regulations that the farmers should already have been following. This is not done in other industries. For instance, the EU does not provide millions to the auto industry and threaten to take them away if they don't comply with environmental regulations.

9.6.2 Farmers only get about half of the CAP's support

Another problem with the CAP is that a great deal of the money ends up in the hands of people other than farmers. An OECD study in 2003 examining the actual beneficiaries of the reformed CAP found that much of the support actually ends up in the pockets of input suppliers such as non-farming landowners and agrochemical firms.

When it comes to direct payments based on hectares, one euro of payment ends up having a minimal impact on the earning of farm household labour. Since the payments are tied to the land, it is the land price that soaks up most of the subsidy. This is not a problem for farmers who owned their land before the area payments were instituted, but about 40 per cent of EU farmland is not owned by the people who farm it.

The OECD calculates that about 45 cents of every euro of direct payment benefits non-farming landowners instead of farmers. The other major CAP policy – market price support – does even worse. Farmers get only 48 cents in the euro, with 38 cents going to real resource costs and input supplies.

9.7 Summary

The CAP started in the 1960s as a way of guaranteeing EU farmers high and stable prices. Because agricultural technology advanced rapidly, and because the high prices encouraged farm investment, EU food production rose rapidly, much faster than EU food demand. As a consequence, the EU switched from being an importer of food to being an exporter of food. This change meant that supporting prices required much more than keeping cheaper foreign food out with high tariffs. The EU began to purchase massive amounts of food – an operation that became very expensive, consuming over 80 per cent of the EU's budget in the 1970s. Since the EU had no use for the food it bought, it disposed of the surplus by storing it or dumping it on the world market. The former was expensive and wasteful; the latter had serious international repercussions since it tended to ruin world markets for farmers outside the EU.

A combination of budget constraints and pressure from EU trade partners forced a major reform of the CAP in the 1990s, the so-called MacSharry reform. This reform lowered guaranteed prices, and thus reduced the amount of food the EU had to buy, but it compensated farmers for the price-cut by providing them with direct payments. This type of price-cut-and-compensate reform was developed further by the so-called Agenda 2000 reforms and the June 2003 reforms.

The economic impact of the CAP is quite unusual at first glance. Despite high prices and massive subsidies, the EU farming population continues to decline because CAP support is distributed in an extraordinarily unequal way. The largest farms, which are typically owned by rich citizens or corporations, receive most of the money, while the small farms get very little. In short, CAP payments to most EU farms are too small to prevent many farmers from quitting. Yet, despite the small size of most payments, the total cost of the CAP is huge because payments to big farms are big. The MacSharry and Agenda 2000 reforms did little to change this because the direct payments are related to farm size.

The CAP was seriously reformed in 2003, followed by a plethora of related reforms in 2005 and 2008. These moved the CAP a long way from a price-support system towards an income-support system with market-determined prices. This has solved many of the trade conflicts that arose from the EU's dumping and it has eliminated the food mountains.

The CAP reforms for 2014–20 complete most of the transition from the old simple system of price supports to the new simple system of direct payments that are decoupled from food production but linked to socially useful goals such as respect for the environment and animal welfare. Nevertheless, a very large share of the money is just given to people who own rural land. Since land ownership is quite concentrated, this ends up as a transfer from the average EU taxpayer to large landowners – even if the most recent reform made some modest progress on limiting large payments to large farms. This policy is increasingly difficult to justify when conditions of austerity are forcing governments to cut back spending on schools, innovation policies, pensions, etc.

The basic problem, to be tackled in future reforms, is the dilemma created by decoupling payments that were created to subsidize the production of food. Without the link to farm output, the CAP struggles to ensure that payments go only to 'farmers', as conventionally understood. This in itself raises the question of whether support for rural Europe should not be encompassed within more general social cohesion and development schemes, such as those discussed in Chapter 10.

Self-assessment questions

- 1 In 2003, the world wheat price is above the CAP's target price so the price floor has become a price ceiling. (i) Using a diagram like Figure 9.2, show how the EU could implement the price ceiling with an export tax. (ii) What are the effects of this in the EU and in the rest of the world (prices, quantities and welfare)?
- 2 Some developing nations accuse the EU of using technical standards for food (pesticide content, etc.) as a barrier to trade. Suppose they are correct. Use diagrams to show how you would analyse the impact of such protection on EU and RoW welfare. (Hint: See Chapter 4's analysis of 'frictional' barriers.)
- 3 Before the UK adopted the CAP, it supported its farmers with a system of 'deficiency payments', which is the agro-jargon for production subsidies. Using a diagram like Figure 9.2, analyse this policy assuming that the import of food was duty free, but the government directly paid farmers the difference between the market price and a target price for each unit of food they produced. Be sure to consider the implications for world prices, UK production and UK imports, as well as the welfare implications for UK farmers, consumers and taxpayers.
- 4 Suppose that the EU allowed free trade in food and subsidized production on small farms only. Analyse the price, quantity and welfare implications of this policy using a diagram.
- 5 The text mentions that since direct payments are tied to the land, it is the land price that soaks up most of the subsidy. Use a classic supply and demand diagram to demonstrate this result. (Hint: This is a standard exercise in what is known as the 'incidence of a tax' since a subsidy is just a negative tax.)
- 6 The European Commission has proposed putting an upper limit on the total direct payment per farm of approximately €300,000. What would be the impact of this on prices, output and the distribution of farm incomes?

Further reading: the aficionado's corner

A wide-ranging and accessible consideration of the CAP can be found in:
Hathaway, K. and D. Hathaway (eds) (1997) *Searching for Common Ground. European Union Enlargement and Agricultural Policy*, FAO, Rome.

An excellent account of why so few Europeans manage to capture such a large share of the budget is provided in:
Anderson, K. (2010) *The Political Economy of Agricultural Price Distortions*, Cambridge University Press, Cambridge.

Other useful works are:

- ERS** (1999) *The EU's CAP: Pressures for Change*, US Department of Agriculture Economic Research Service, International Agriculture and Trade Reports, WRS-09 - 2. Download from <http://www.ers.usda.gov/publications/wrs-international-agriculture-and-trade-outlook/wrs092.aspx>
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Useful websites

For a non-institutional view of the CAP, and a series of readable and informative essays, see <http://members.tripod.com/~WjnGrant/WjnGrantCAPpage.html>.

The Commission's website <http://europa.eu.int/comm/agriculture/> provides a wealth of data and analysis, although much of it is politically constrained to be fairly pro-CAP. The US government's Agricultural Department provides even more analysis and tends to be more openly critical of the CAP; the pages of the Economic Research Service are especially informative. See <http://www.ers.usda.gov/publications/wrs-international-agriculture-and-trade-outlook/wrs092.aspx#.VDvgvPmSy40>.

Every year, the OECD publishes an excellent report on the agricultural policy of all OECD members (this includes the CAP). For the latest figures and exhaustive analysis, see www.oecd.org.

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[T]he Community shall aim at reducing disparities between the levels of development of the various regions and the backwardness of the least favoured regions or islands, including rural areas.

Treaty on the European Union, Maastricht, 1992

Location effects, economic geography and regional policy

Chapter Contents

10.1	Europe's economic geography: the facts	242
10.2	Theory part I: comparative advantage	247
10.3	Theory part II: agglomeration and the new economic geography	249
10.4	Theory part III: putting it all together	256
10.5	EU regional policy	259
10.6	Empirical evidence	261
10.7	Summary	261