

# Applied Welfare Economics and Agricultural Policy

MSc Course, Humboldt-Universität zu Berlin

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# Applied Welfare Economics and Agricultural Policy

## Introduction

- 1 Principles of applied welfare economics
- 2 Price policy I
- 3 Price policy II
- 4 EU agricultural policy and international framework**

# Applied Welfare Economics and Agricultural Policy

- 5 Agricultural policy in transition countries (Wilkin)
- 6 EU enlargement and accession (Wilkin)
- 7 Rural finance in development (Heidhues)
- 8 Structural adjustment policies (Heidhues)
  
- 9 Structural policy
- 10 Multiobjective policy analysis

# Applied Welfare Economics and Agricultural Policy

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## Chapter 4

### EU Agricultural Policy and International Framework

# Origins of the CAP

- **Post-war Period**
- **Structural change**
  - High supply growth due to technical progress
  - Low demand growth caused by low population growth and low income elasticity of demand
- **Cheap imports from the world market**
  - ⇒ Downward pressure on farm prices and income
  - ⇒ EU agricultural policy

# Objectives of the CAP

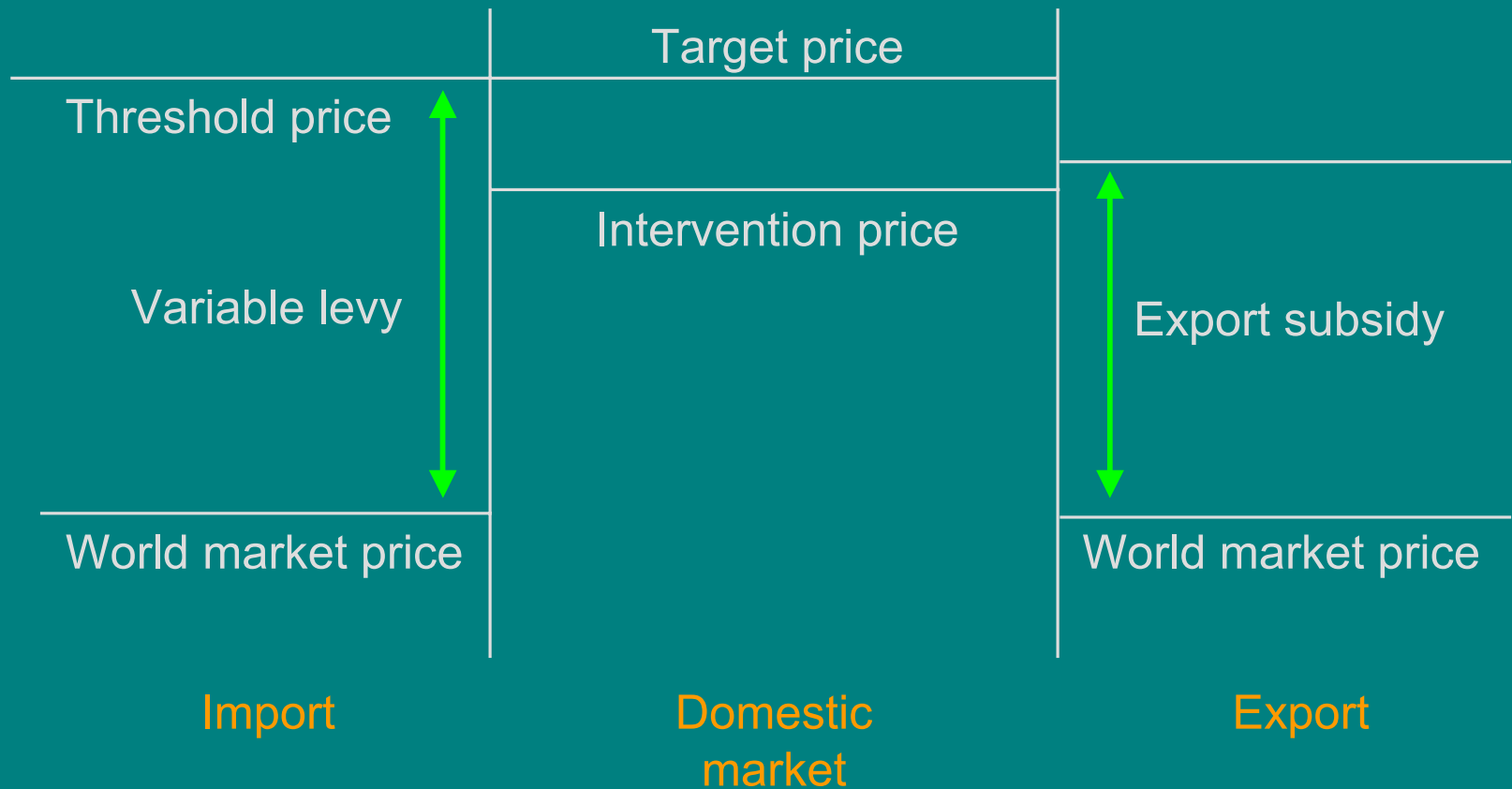
## Treaty of Rome Article 39 objectives:

- To increase agricultural productivity
- To ensure a fair standard of living for farmers
- To stabilise markets
- To ensure the availability of food
- To ensure reasonable food prices

## Principles of the Common Agricultural Policy (CAP):

- Common market
- Community preference
- Financial solidarity

# Implementing Protectionism

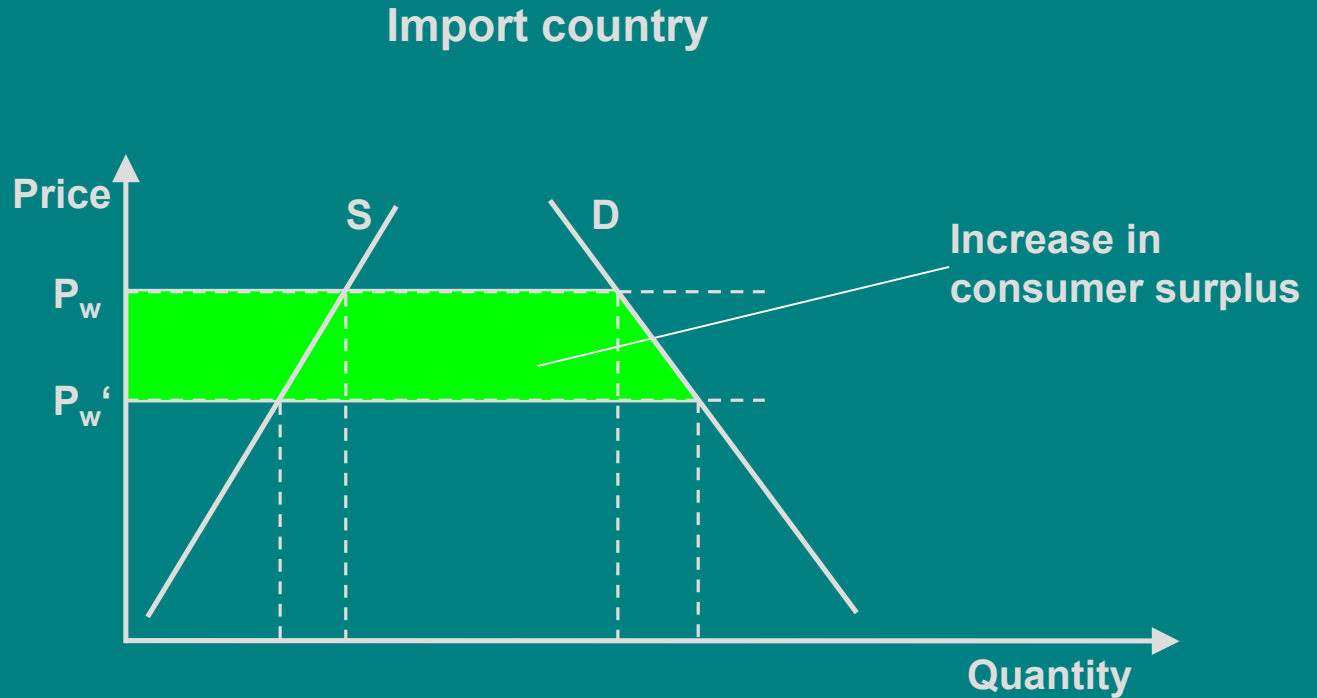


# Criticism of the CAP

- Welfare losses
- Low income support for farmers
- Taxation of consumers
- High government expenditure in an export situation
- Environmental costs due to intensification and specialisation
- Transfers between member states
- Lowering of world market prices and conflicts with trade partners
- High bureaucratic costs



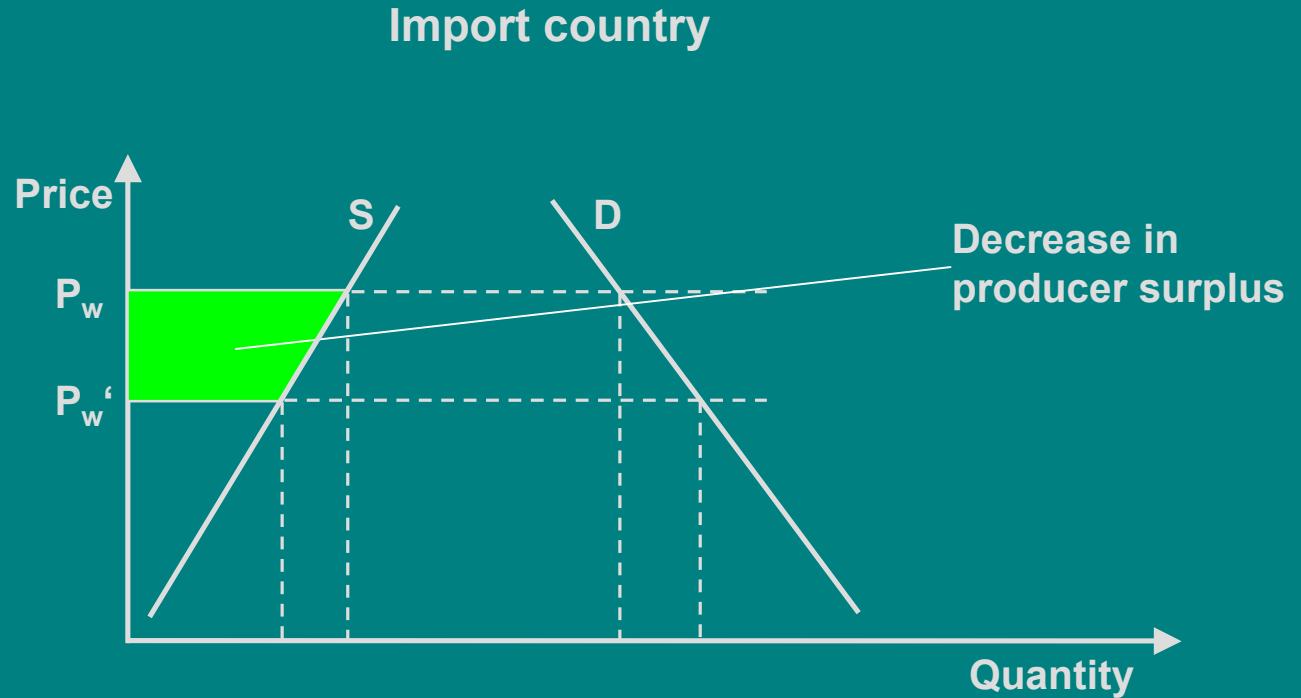
# Welfare Effects of the CAP Price Policy for Third Countries



S - Domestic supply curve

D - Domestic demand curve

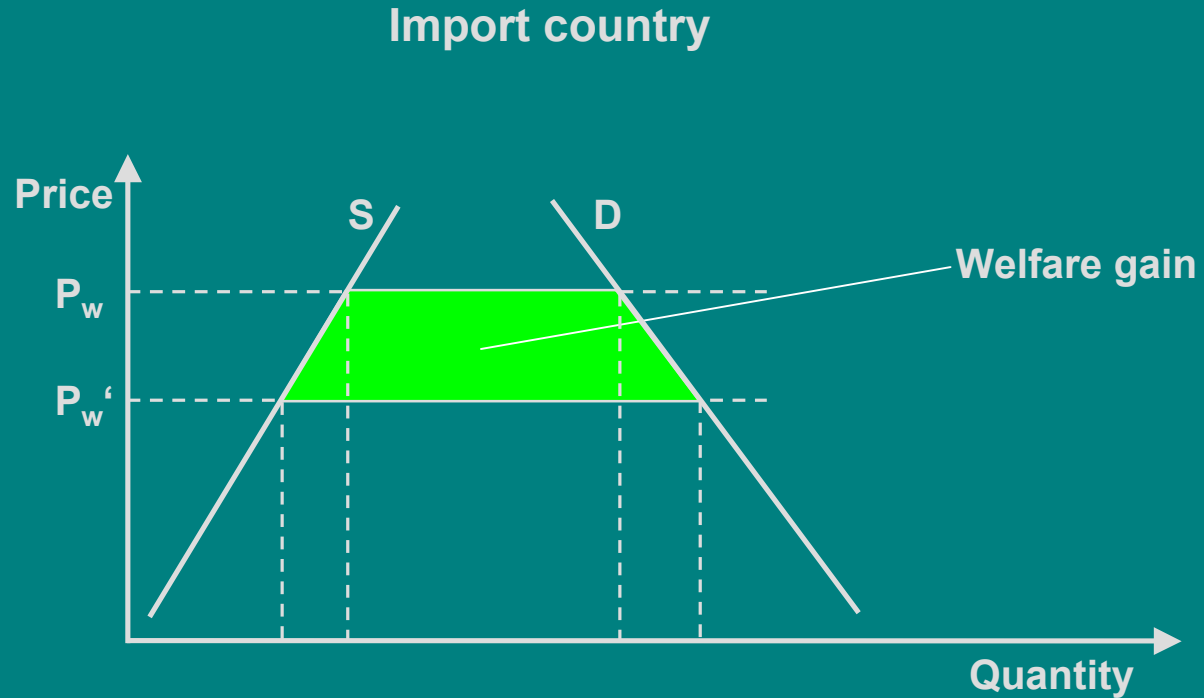
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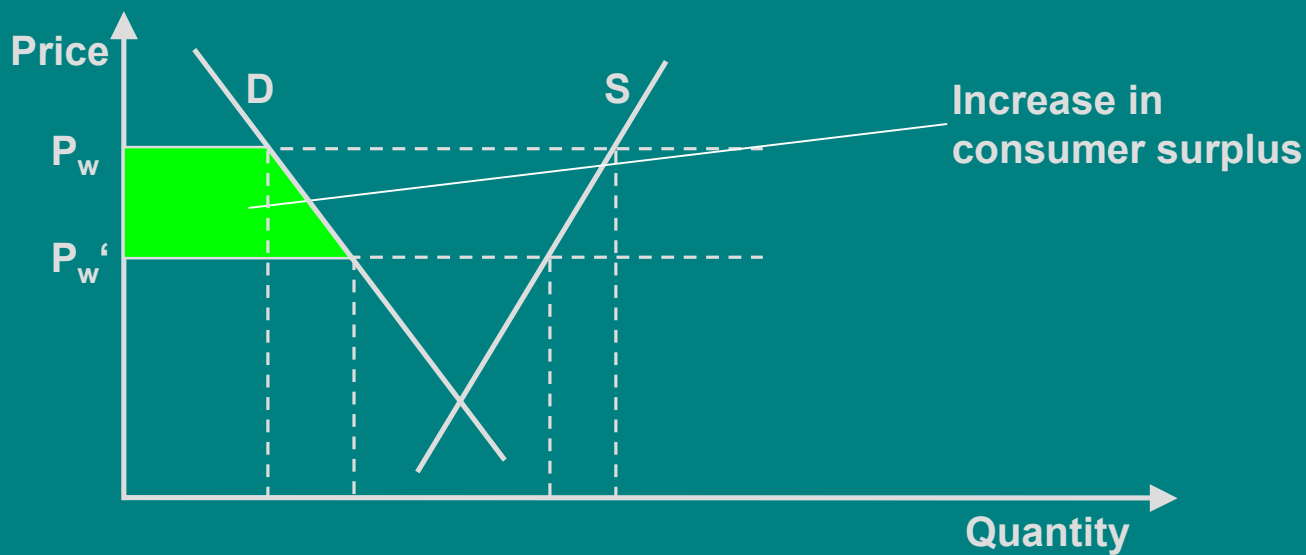


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# Welfare Effects of the CAP Price Policy for Third Countries

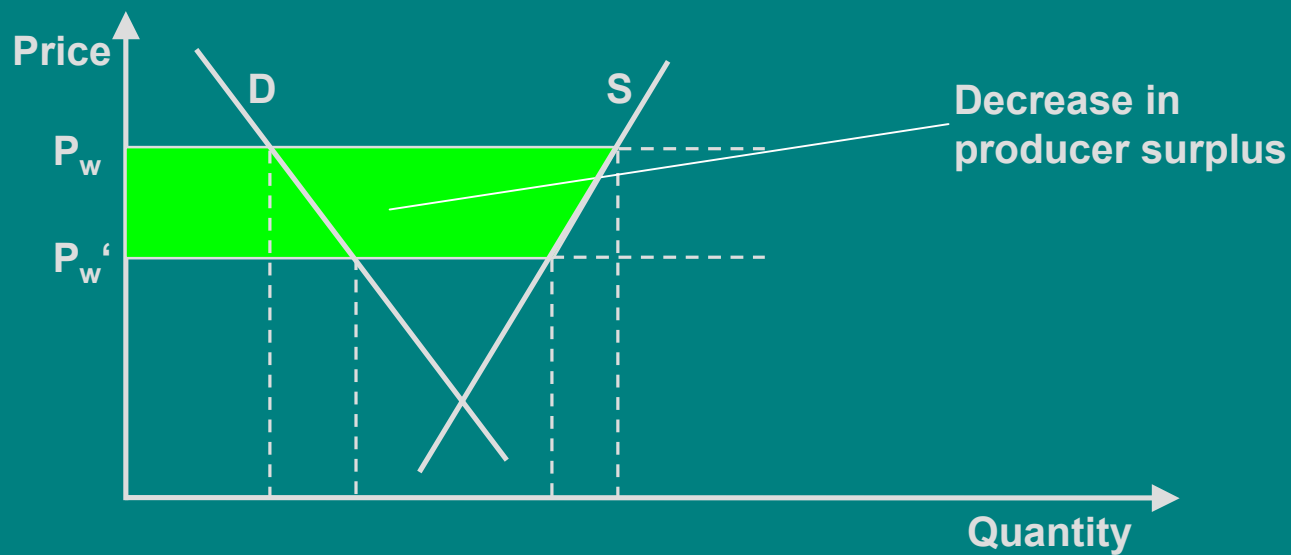
Export country



- S - Domestic supply curve
- D - Domestic demand curve

# Welfare Effects of the CAP Price Policy for Third Countries

Export country

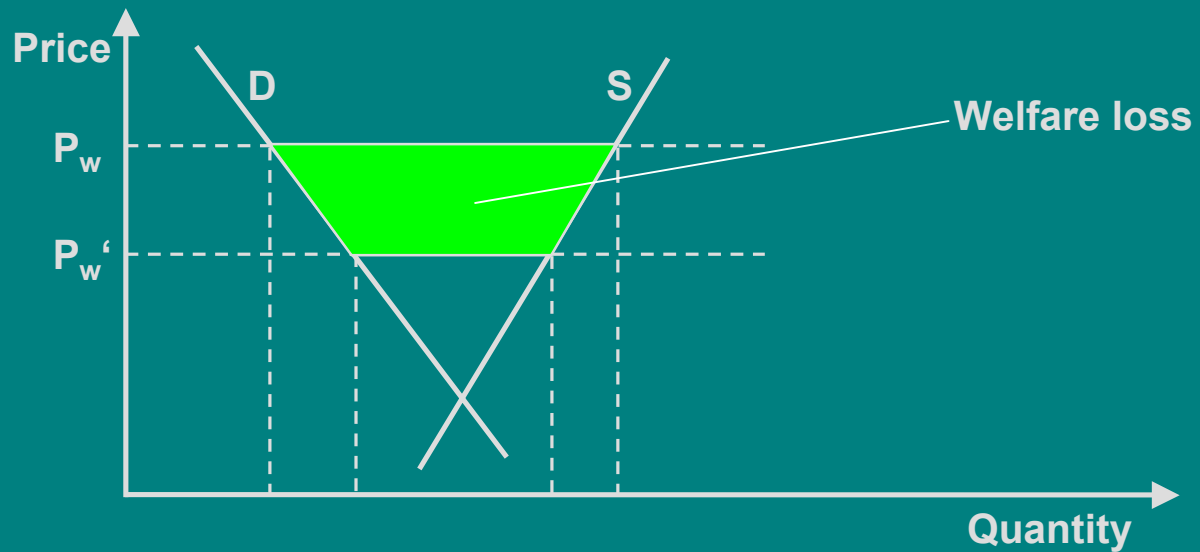


S - Domestic supply curve

D - Domestic demand curve

# Welfare Effects of the CAP Price Policy for Third Countries

Export country



S - Domestic supply curve

D - Domestic demand curve

# Consequences of the EU's Agricultural Price Policy for Developing Countries

- **Lowering of world market prices**
  - Changes in foreign exchange balance
  - Welfare loss in export countries
  - Welfare gain in import countries
  - Unfair competition for agriculture

# Consequences of the EU's Agricultural Price Policy for Developing Countries

- **Instability of world market prices**
  - Reduced market stabilisation
  - Policy uncertainty



# Consequences of the EU's Agricultural Price Policy for Developing Countries

- **Indirect advantages and disadvantages**
  - Sugar agreement

# CAP Reform Steps

- Since 1975 reduction of protectionist price policy
- 1984 installation of milk quotas
- 1987 installation of set-aside system
- 1992 McSharry Reform
- 1999 Agenda 2000
- 2003 Luxembourg decisions

# The McSharry CAP Reform 1992

**Principle: Implementation of price cuts compensated by area and headage payments**

<b>Arable crops</b>	<b>Price support</b>	<b>Reduction in intervention prices</b>
	<b>Area payments</b>	<b>Product specific on a per hectar basis.</b>
<b>Beef</b>	<b>Price support</b>	<b>Reduction in intervention prices</b>
	<b>Headage payment</b>	<b>Installation on a per head basis</b>
<b>Regional policy / Environmental measures</b>		<b>Extensification, afforestation</b>

# The Uruguay Round Agreement on Agriculture

- **Market access**
  - Conversion of border protection instruments other than tariffs into tariff equivalents (TE)
  - Reduction of tariffs and TEs by average 36%
  - Minimum access opportunities increasing from 3% to 5% of domestic consumption

# The Uruguay Round Agreement on Agriculture

- **Export subsidies**
  - Ban on new export subsidies
  - Reduction of existing subsidies by 36% in value

# The Uruguay Round Agreement on Agriculture

- **Domestic support**
  - Creation of a “Green Box” of permitted support
  - Summing-up of other subsidies into the non-permitted Aggregate Measure of Support (AMS) (“Amber Box”) to be diminished by 20%
  - Decoupled direct payments (EU) neither included in “Green Box” nor in the total AMS
    - “Blue Box” exemption

# The Uruguay Round Agreement on Agriculture

- **Additional provisions**
  - Sanitary and phytosanitary measures
  - Peace clause (2003)
  - Special treatment for developing countries

# Background to Agenda 2000

- To further adjust to the WTO framework
- To meet the challenge of the European Union's eastward enlargement
- To integrate environmental concerns and consumer interests in food safety, quality and animal welfare



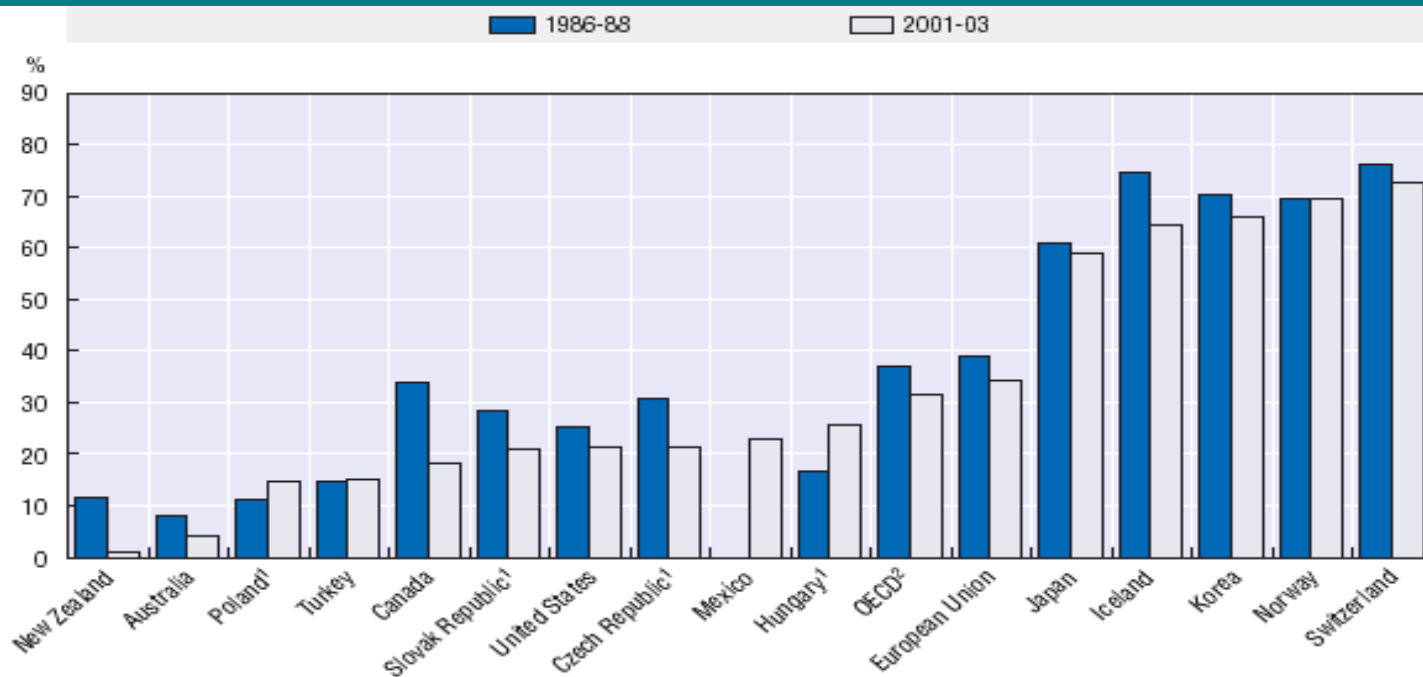
# Agenda 2000

**Principle: Further price cuts compensated by increased area and headage payments**

<b>Arable crops</b>	<b>Price support</b>	<b>Further reduction in intervention prices</b>
	<b>Area payments</b>	<b>Increase, standardization</b>
<b>Beef</b>	<b>Price support</b>	<b>Further reduction in intervention prices</b>
	<b>Headage payment</b>	<b>Increase</b>
<b>Dairy</b>	<b>Price support</b>	<b>Reduction in intervention prices of milk products starting 2005/6</b>
	<b>Dairy cow premium</b>	<b>Installation</b>
<b>Regional policy / Environmental policy</b>		<b>Continuation of extensification and afforestation</b>

# Current Situation / Support

PSE by Country (% of value of gross farm receipts)



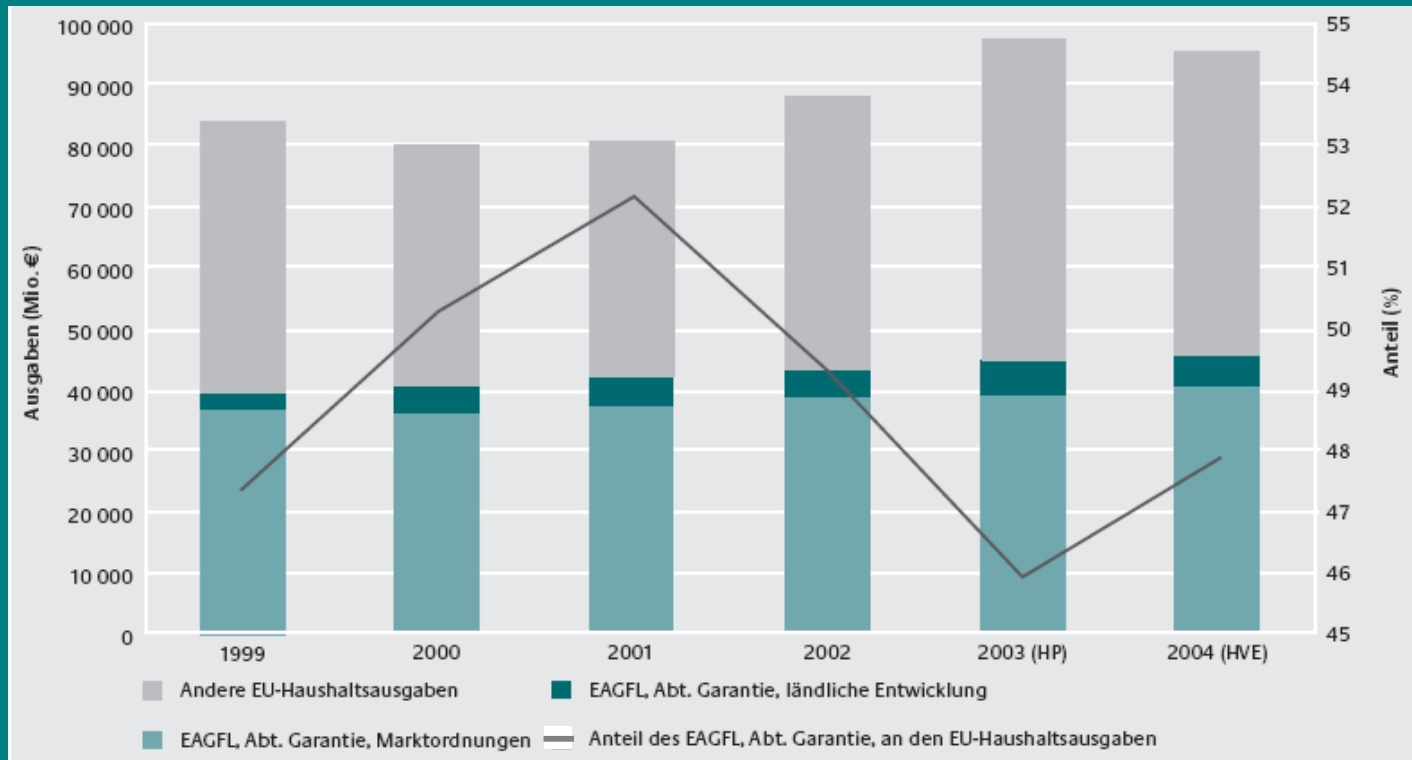
Notes: Countries are ranked according to 2001-2003 levels. For more detail, see Table I.3.

1. For the Czech Republic, Hungary, Poland and the Slovak Republic, 1986-88 is replaced by 1991-93.
2. For 1986-88, the Czech Republic, Hungary, Poland and the Slovak Republic are excluded.

Source: OECD, PSE/CSE database, 2004.

# Current Situation / Budget

## Anteil des EAGFL, Abt. Garantie, an den EU-Haushaltsausgaben im Zeitraum 1999 - 2004 (EU-15)

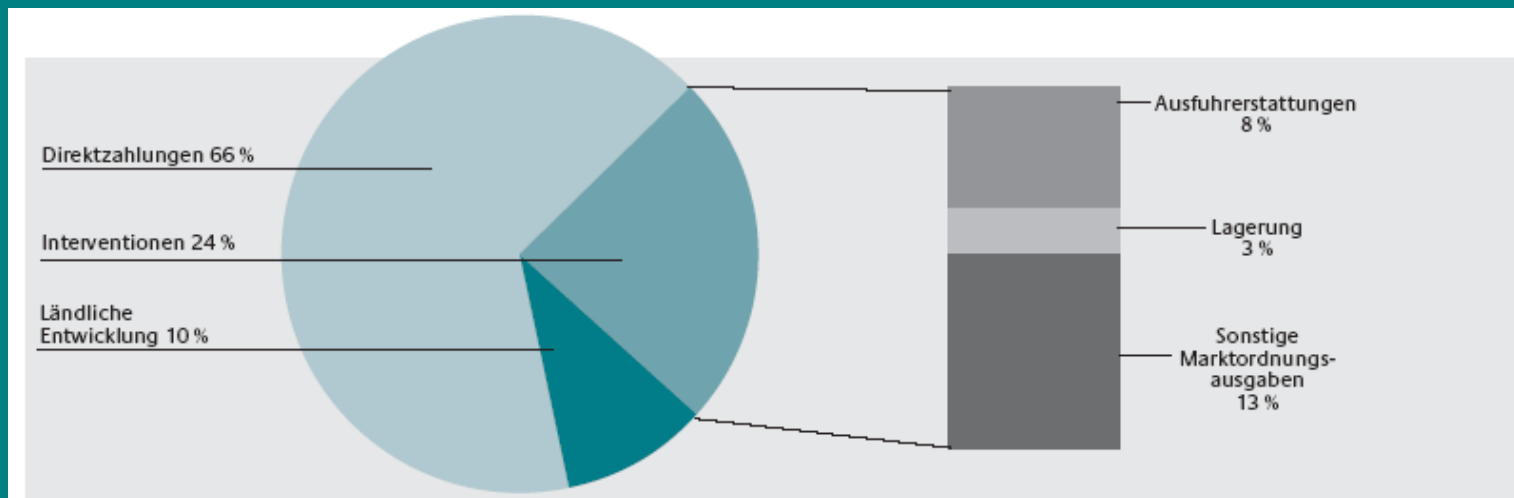


HP: Haushaltsplan, HVE: Haushaltsvorentwurf

Quelle: Eigene Darstellung mit Daten aus Europäischer Kommission (2003), Gesamthaushaltsplan der Europäischen Union für das Haushaltsjahr 2003, Europäische Union (2003), Finanzbericht 2002, Kommission der Europäischen Gemeinschaften (2003), 32. Finanzbericht über den Europäischen Ausrichtungs- und Garantiefonds für die Landwirtschaft EAGFL, Abteilung Garantie - Haushaltsjahr 2002

# Current Situation / Budget

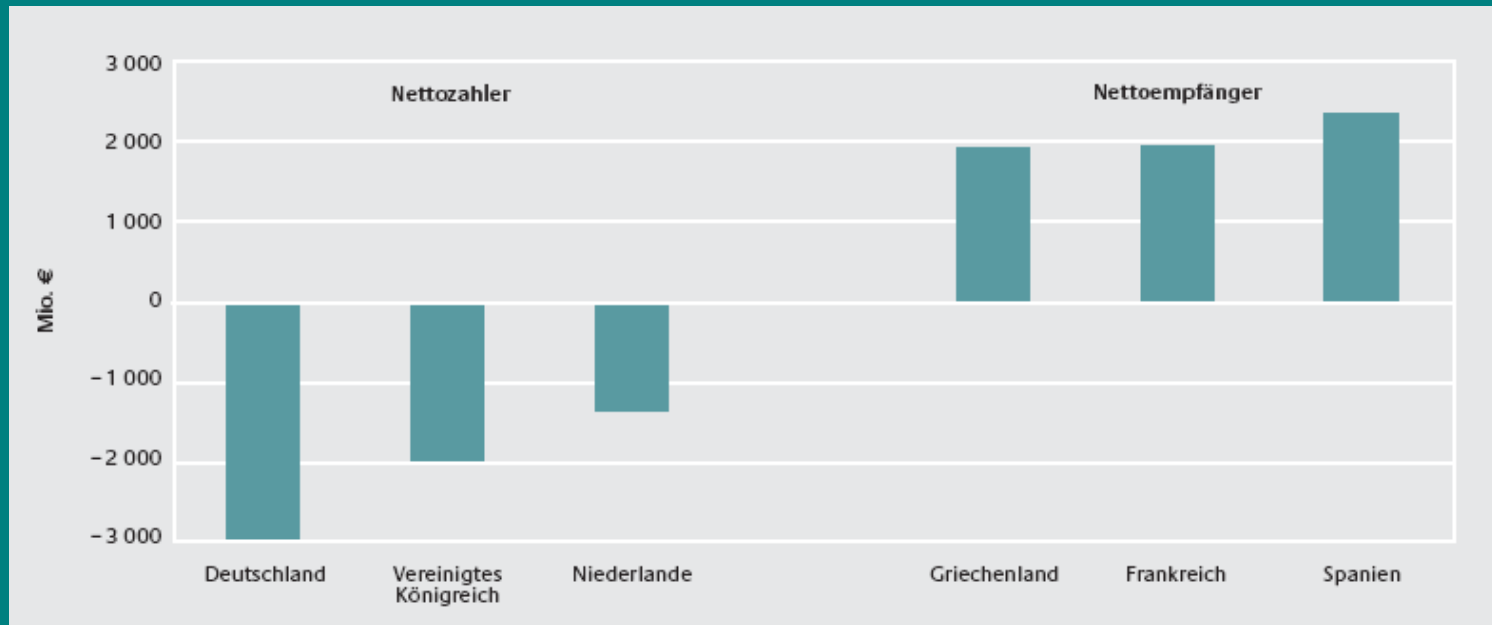
## Ausgaben des EAGFL, Abt. Garantie, nach einzelnen Maßnahmen im Haushaltsjahr 2002



Quelle: Eigene Darstellung mit Daten aus Kommission der Europäischen Gemeinschaften (2003), 32. Finanzbericht über den Europäischen Ausrichtungs- und Garantiefonds für die Landwirtschaft EAGFL, Abteilung Garantie - Haushaltsjahr 2002

# Current Situation / Budget

Die größten Nettoempfänger und Nettozahler in Bezug auf den EAGFL, Abt. Garantie, im Haushaltsjahr 2002



Quelle: Eigene Darstellung und Berechnung mit Daten aus Europäischer Kommission (2003), Gesamthaushaltsplan der Europäischen Union für das Haushaltsjahr 2003, Europäische Union (2003), Finanzbericht 2002, Kommission der Europäischen Gemeinschaften (2003), 32. Finanzbericht über den Europäischen Ausrichtungs- und Garantiefonds für die Landwirtschaft EAGFL, Abteilung Garantie - Haushaltsjahr 2002

# Harbinson (18.3.2003) and July-Package (1.8.2004)



## Market access (bounded tariff rates)

### – Harbinson

> 90 %      →    – 60 % Ø, – 45 % min.

15 – 90 %   →    – 50 % Ø, – 35 % min.

< 15 %      →    – 40 % Ø, – 25 % min.

### – To be negotiated

### – Sensitive products



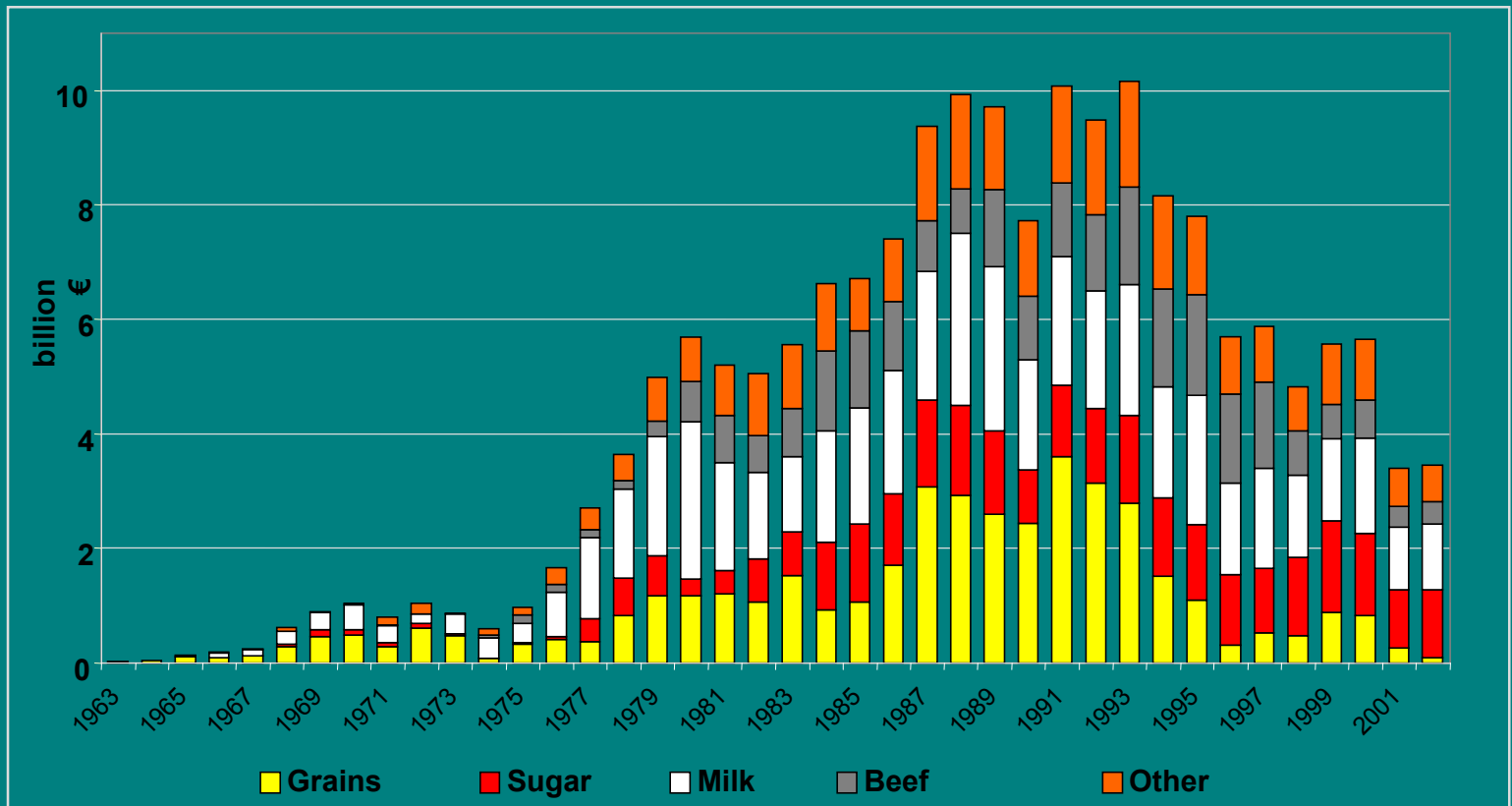
## Export subsidies

### – Abolition: export subsidies, export credits and insurance (refund > 180 days)

### – 5-9 years?

### – Rules, regulations: export credits and insurance (refund < 180 days), state trading, food aid

# EU-Export subsidies by sector



Source: Schaps, J. (2003) : Nach dem Fehlschlag von Cancún - wie geht es weiter? CEC, DG Trade

# Harbinson and July-Package (continued)

## ● Domestic support

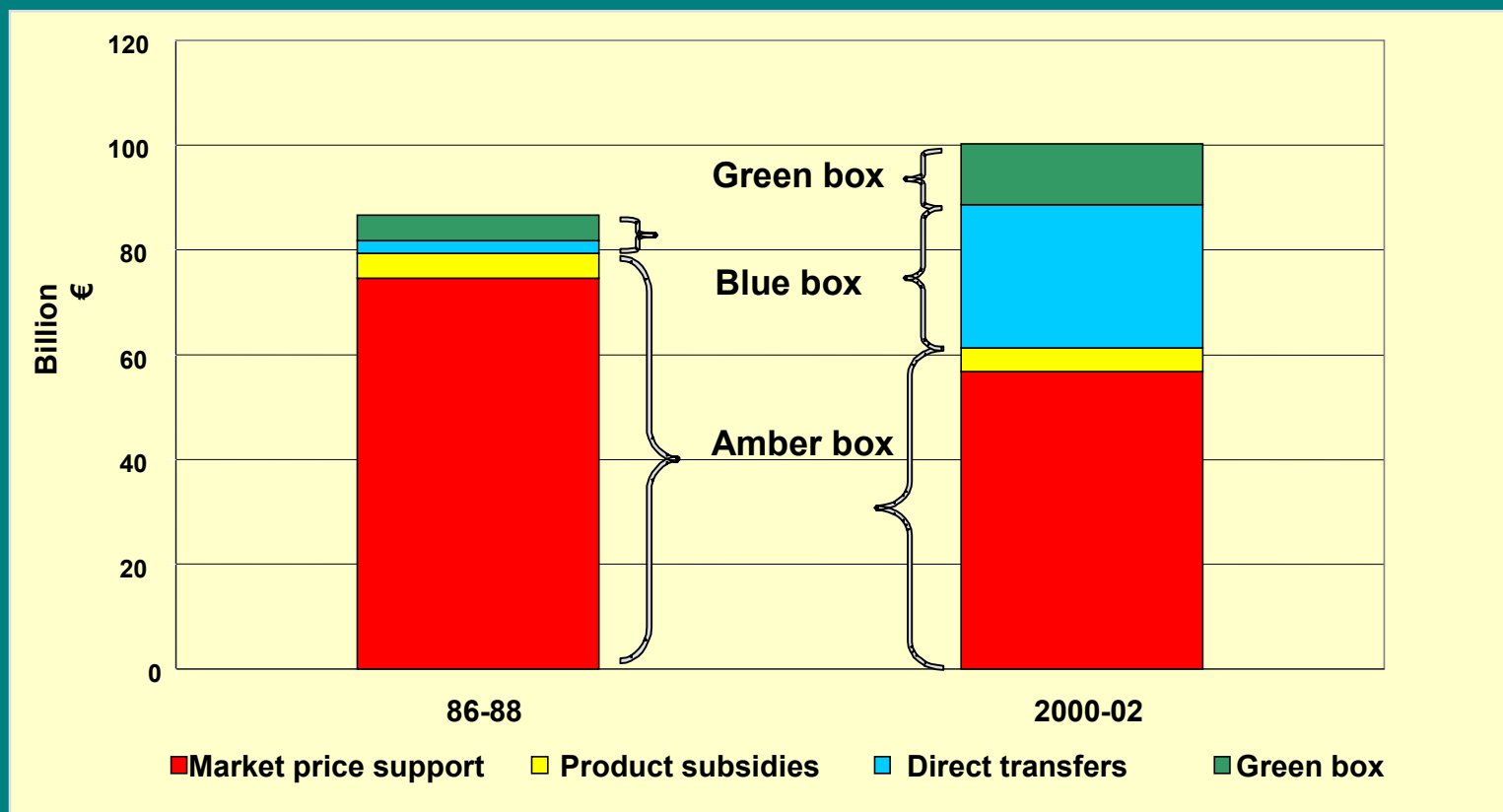
<b>Green box</b>	<b>remains</b>
<b>Blue box</b>	<b>&lt;= 5 % of production value</b> <b>– 20 % (1<sup>st</sup> year)</b> <b>further reduction, to be negotiated</b>
<b>Amber box (bounded values)</b>	<b>– 20 % (1<sup>st</sup> year)</b> <b>further reduction, to be negotiated</b>

## ● Special treatment for developing countries

## ● Non-trade concerns not considered



# Protection of EU-Agrarian Sector (Ø 86-88, 2000-02)



Source: Schaps, J. (2003) : Nach dem Fehlschlag von Cancún - wie geht es weiter? CEC, DG Trade

# Luxembourg Decisions

- Decoupling (starting from 2005)
  - Single farm payments
  - Regional implementation option
    - Uniform area payment

# Luxembourg Decisions

## Evaluation of decoupling

- Welfare and distribution aspects
- Farm vs. regional model
- Political legitimation
- Supply and land use effects

# Luxembourg Decisions

- **Cross-Compliance**
  - Sanctions
  - Standards vs. 2<sup>nd</sup> pillar
- **Modulation**
- **Extension of 2<sup>nd</sup> pillar**

# Luxembourg Decisions



## Market and price policy

- Grains

  - Abolition of rye intervention

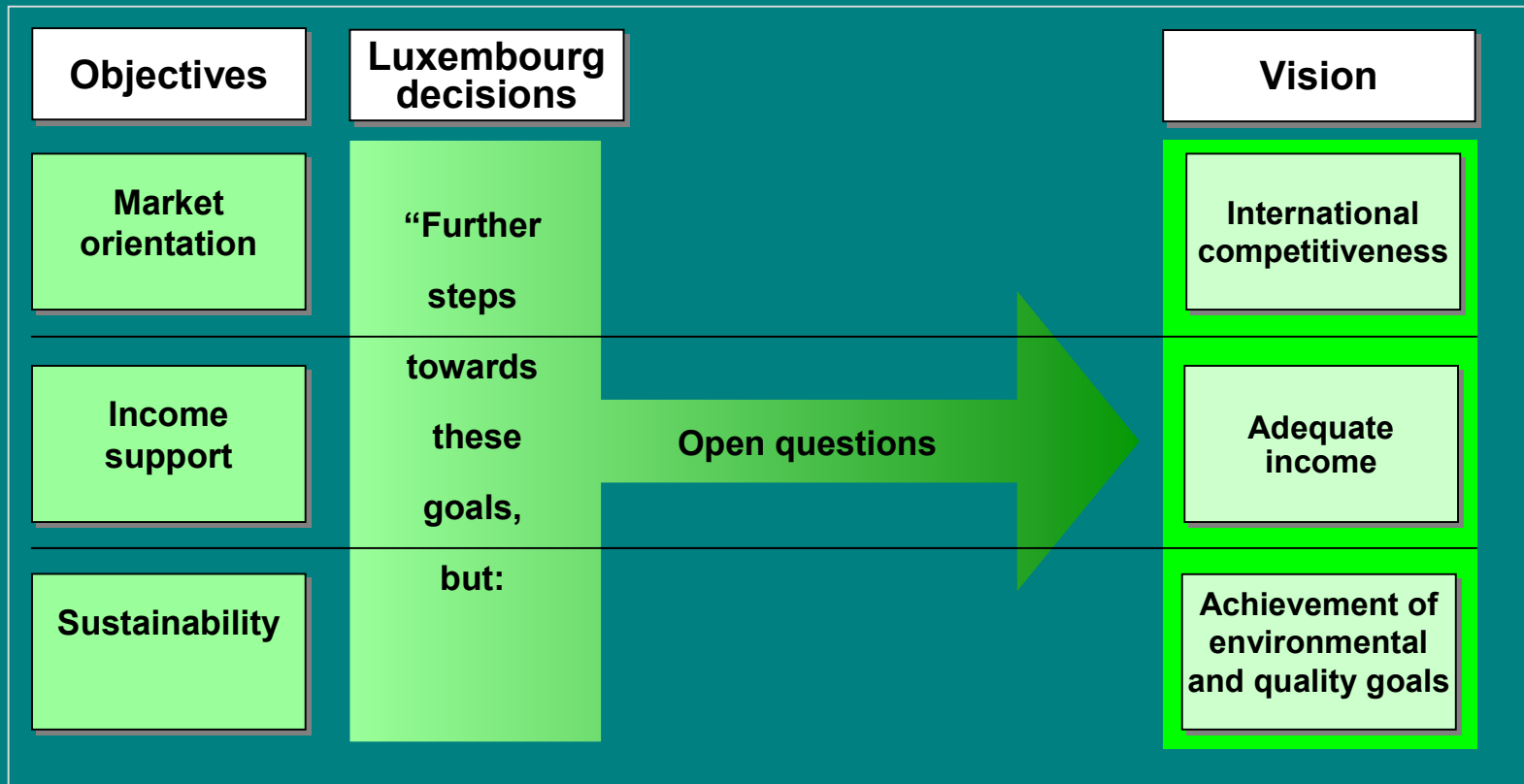
- Milk

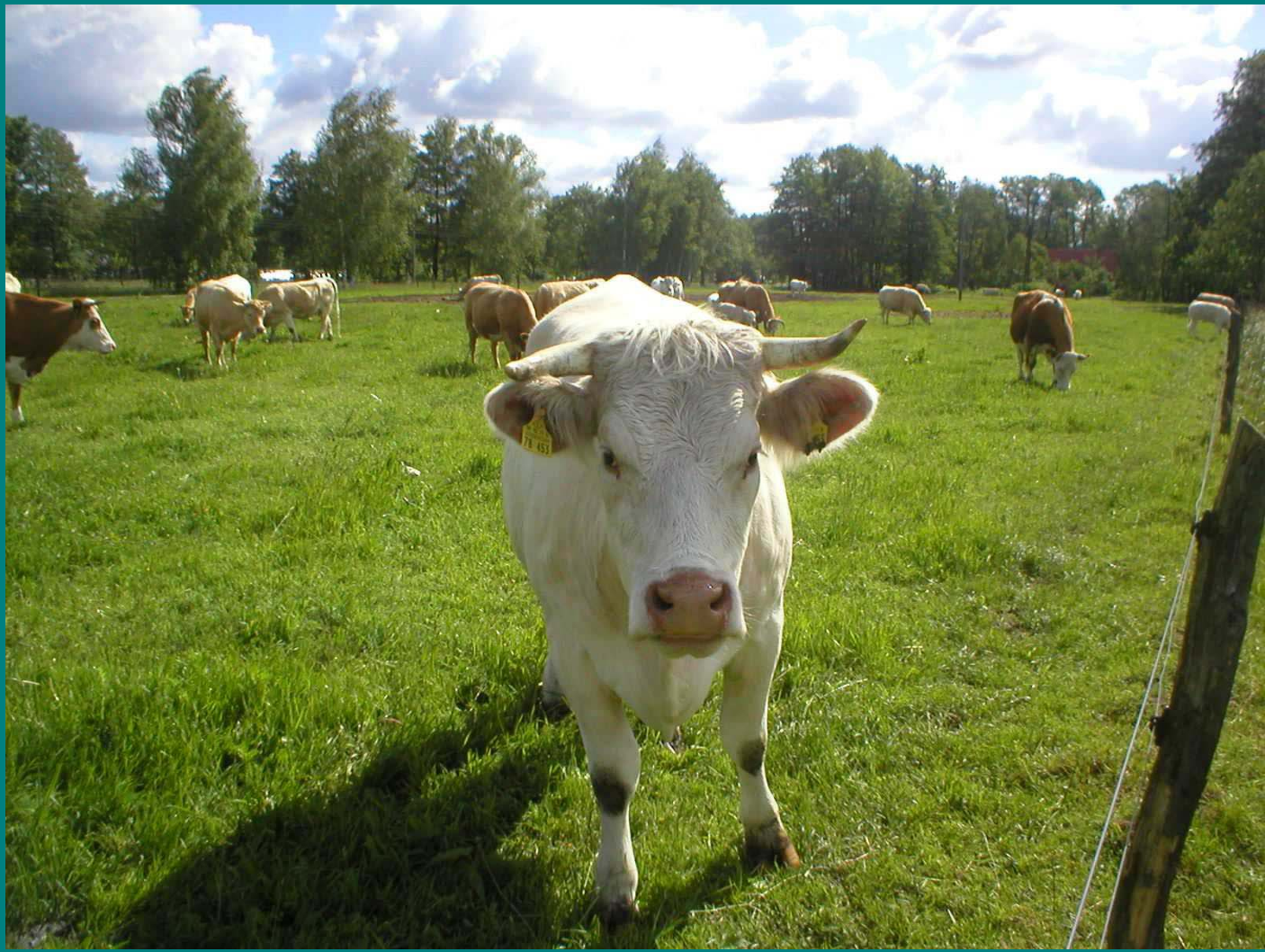
  - Quota system (prolongation from 2006, extension until 2014)

  - Reduction of intervention prices

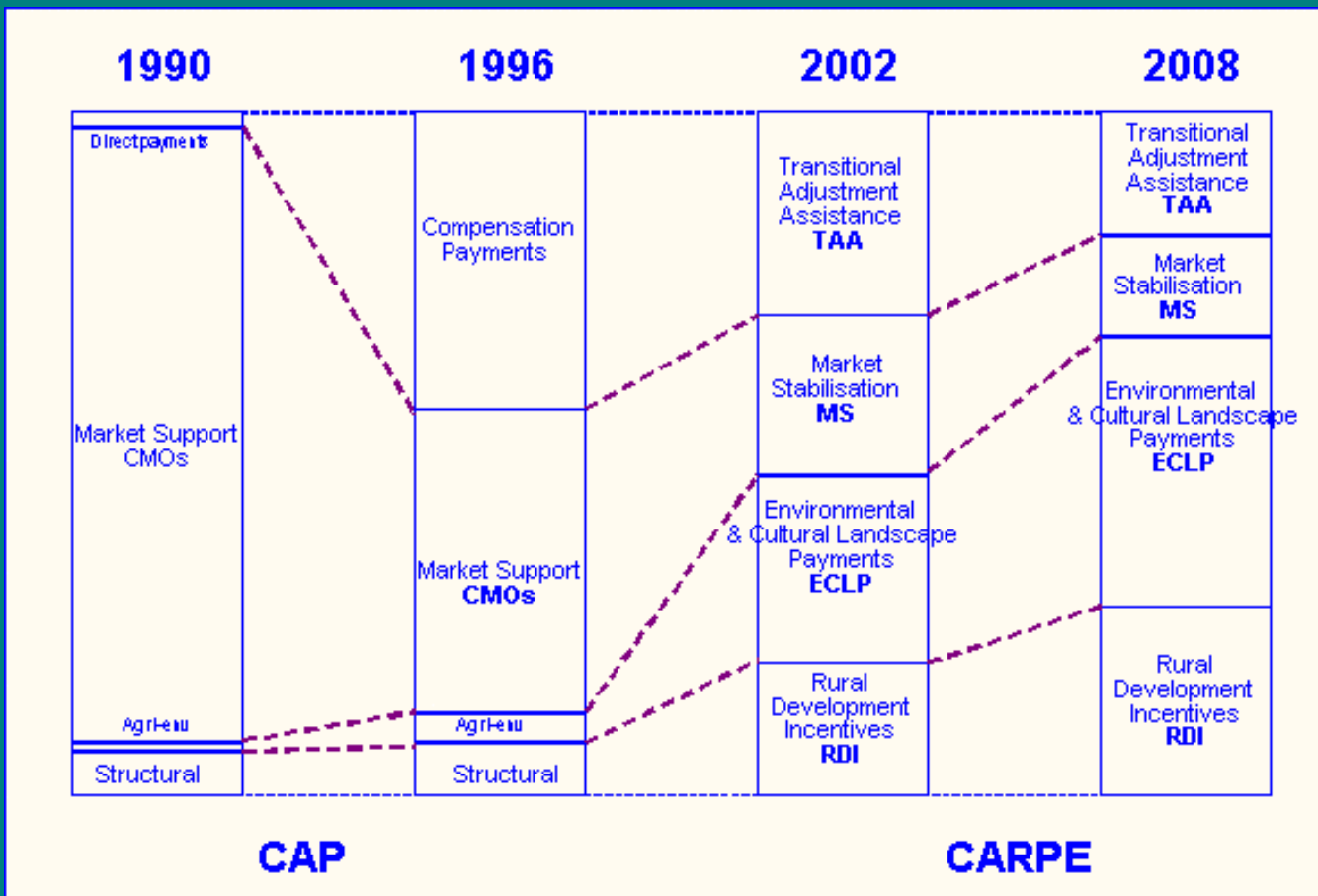
  - Direct payments

# Perspectives





# From Common Agriculture Policy to Common Rural Policy



Source: Buckwell: In: [http://europa.eu.int/comm/agriculture/publi/buck\\_en/figure2.htm](http://europa.eu.int/comm/agriculture/publi/buck_en/figure2.htm)



# Some Questions on the Future CAP

- How will the future production structure and land use look like?
- How will structural change in agriculture look like and how can it be supported?
- How should an effective 2<sup>nd</sup> pillar policy look like?
- How should income support policy be designed?
- How could price and structural policy be integrated?
- What will be the future framework of the CAP?

# Literature

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# Questions

1. Explain origins and evolution of the EU's agricultural policy!
2. Describe the price policy mechanism used in the EU's Common Agricultural Policy and explain the financial framework of the CAP!
3. Discuss the consequences of the EU's protectionist price policy!
4. Explain the impact of the EU's price policy on third countries!
5. What are the agricultural issues on the WTO agenda?
6. Discuss the Luxembourg decisions on the CAP reform!

# L' Agriculture Suisse

