Reforming the Common Agricultural Policy in the Shadow of the WTO

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The WTO farm trade regime, aiming at creating a liberal trading system, has had an important impact on the evolution of the Common Agricultural Policy (CAP) over the last two decades. The recent reform proposal for the post-2013 CAP seems less influenced by the WTO than the previous reforms.

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POLICY RECOMMENDATIONS

- **Ensure that the post-2013 CAP reform is compatible with expected Doha Round Agreement on Agriculture**
- **Avoid using the same policy instrument to support farm incomes and to deliver environmental services.**

Introduction

Agricultural trade became fully integrated into negotiations on trade liberalisation in the Uruguay Round commencing under the General Agreement on Tariffs and Trade (GATT) in 1986 and has been the cause of much discontent ever since – every major setback in the GATT and World Trade Organization (WTO) trade rounds has been caused by lack of progress in agricultural trade negotiations.

The EU's Common Agricultural Policy (CAP) has often been a source of conflict between the EU and its trade partners, first within the GATT, and then the WTO. In the Doha Round agriculture was again a sticking point, resulting in setbacks and delays. The position of the EU is pivotal because the CAP sets limits for agricultural trade liberalisation, blocking progress across the full compass of the WTO agenda. However, the CAP has not been static but has evolved considerably over the last two decades, responding to the developments in the WTO farm trade agenda as set out in the Agreement on Agriculture. This policy brief discusses how the integration of agricultural trade into the WTO trade regime has influenced the evolution of the CAP through a succession of reforms.

Agricultural exceptionalism

Since the early 1990s the major driving force behind CAP reforms has been developments in the WTO trade negotiations. Though the Uruguay Round Agreement on Agriculture itself did not have any significant influence on the level of agricultural support and protection, it did have an important impact on the way in which agricultural reformers in the EU shaped the CAP. The source of this impact is not to be found in the specific commitments on reductions in domestic agricultural support, export subsidies or tariffs. Rather, it is the ideational underpinning of the Agreement which has affected the shape of the CAP.

Throughout much of the 20th century most industrialised countries intervened extensively in the agricultural sector with the aim of supporting the incomes of their farmers. Government intervention was based on the belief that agriculture was a unique economic sector with special market and production conditions, which deserved special treatment because it contributed to national goals. Political scientists call this fundamental assumption about the nature of agriculture *agricultural exceptionalism*. Agricultural exceptionalism at national level was reinforced internationally when, in the founding years of the GATT, the US insisted on excluding agriculture from a number of the newly agreed disciplines on international trade (GATT Articles XI and XVI). Later on, the EU's use of variable import levies further legitimised agricultural exceptionalism.

Challenging agricultural exceptionalism in the global arena

In the 1970s agricultural economists began questioning the idea of agricultural exceptionalism, arguing that agriculture is an industry with market and production conditions which are not dissimilar to those of other economic sectors. The idea that agriculture is not fundamentally different from other economic sectors later became the basis of the US farm trade policy in the GATT Uruguay Round (1986–94) and underpinned its so-called 'zero-2000 option' which proposed the phasing out of all import barriers and agricultural subsidies directly or indirectly affecting trade.

Essentially, the farm trade negotiations in the Uruguay Round were a matter of finding a compromise between the EU and the US. Eventually the EU was able to secure considerable concessions in the specific commitments of the Agreement on Agriculture in 1994 in return for concessions to the US in forming the ideational framework of the Agreement to support the then preference of the US for market liberalism. In the initial preamble to the Agreement it is explicitly emphasised that the "long term objective … is to establish a fair and market-oriented trading system ..." and that the aim of "substantial progressive reductions in agricultural support and protection …" is to result in "correcting and preventing restrictions and distortions in world agricultural markets". Articles XI and XVI of GATT 1947, which were the legal expressions of agricultural exceptionalism, though formally still alive in GATT 1994 (identical to GATT 1947 but legally distinct), have been overridden by Article 21 of the Agreement. Most importantly, Article 20 states that farm trade liberalisation was "an ongoing process" and that "negotiations for continuing the process will be initiated one year before the end of the implementation process", i.e. before the end of 1999 (the continuation clause). The Doha Round negotiations on agricultural trade are structured on the basis of the three pillars of the Agreement: market access, domestic support and export competition (e.g. export subsidies). The direction set out for the Round corresponds well with the objectives of the Agreement by aiming at lowering agricultural protection and support.

The CAP in the Uruguay Round

During the early 1960s the Common Agricultural Policy was gradually implemented. The CAP basically became a high-price policy whereby consumers paid a significant share of the cost of subsidising farmers through artificially high consumer prices. The CAP stabilised markets and farm incomes by providing floor prices in the markets for various commodities. Variable import levies ensured that imports from the world market could not be sold below minimum import prices (threshold prices) that were set well above the floor prices. Schemes for stockpiling, destruction and/or export subsidies ensured that when EU internal supplies increased, EU prices would not fall below politically determined floor prices which were usually substantially higher than world market prices. This type of agricultural support was highly trade-distorting as it drove up production as a result of the artificially high farmgate prices. In the EU this resulted in substantial surplus production which was sold on the world market by making use of export subsidies, outcompeting otherwise competitive exports from other countries.

During the Uruguay Round the EU was under pressure to reduce the trade-distorting impact of the CAP by lowering its level of support and border protection. The tensions peaked when the GATT negotiations in Brussels broke down dramatically in 1990. Eventually the EU farm ministers realised that their unwillingness to undertake substantial CAP reform was blocking a deal on farm trade as well as agreement on the whole package of agreements of the Round. The reform they adopted in May 1992 transformed the architecture of the CAP through a partial shift from price support to direct payments to farmers. The policy changes mainly took place in the arable sector. Guaranteed minimum prices for cereals were reduced by 29%. These price cuts enabled the EU to lower the tariffs and export subsidies. Farmers were compensated for the lost income by direct payments established on the basis of the area of eligible land upon which the so-called 'reform crops' (cereals, oilseed, and protein crops) were grown, provided that they set aside 15% of their arable land. This production-limiting measure meant that the CAP became less trade-distorting than previously, as it limited surplus production. Under the Agreement on Agriculture, direct farm subsidies linked to production limiting measures – so-called blue box support – are exempt from reduction commitments. The reform of the CAP enabled a compromise to be reached with the US, which the other members of the GATT accepted as a *fait accompli*.

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Further evolution of the CAP in the shadow of the Doha Round

The inclusion of farm trade as an integral part of first the GATT, and then of the WTO, trade rounds introduced a strong and lasting exogenous influence on the CAP. Thus EU agricultural policy could no longer be decided in isolation as it had become linked to the global arena and increasingly had to take WTO trade rules into consideration. This globalisation of the agricultural policy shifted some decision making power to a different, supra-EU, policy venue where new actors and ideas could come into play. The Agreement on Agriculture set the scene for continued negotiations on farm trade liberalisation. This meant that the EU had to consider how to respond to the agenda of the forthcoming trade round. The Agenda 2000 reform adopted in 1999 attempted to do so. It is generally understood as 'a deepening' of the 1992 reform as it further lowered the guaranteed minimum prices and raised direct payments but, at the end of the day, the reform did not create much leeway for the EU in the WTO.

In November 2001 a new trade round in the WTO began in Doha, Qatar (the Doha Round). The EU quickly realised that the CAP would come under pressure from many of its trading partners. The US and the Cairns Group wanted the blue box domestic support category abolished and payments under this category included in the reduction commitments. This would force the EU to undertake substantial cuts in its domestic farm support unless its support system was changed. Decoupling the direct farm payments from production presented itself as a potential response to this pressure on the CAP. It was believed that by shifting the direct payments into the green box (a support category for minimally trade-distorting domestic support) they would be exempted from reduction commitments. This would relieve the pressure on the EU's domestic farm support scheme and, it was expected, improve the EU's negotiating position in the Doha Round. The reform, agreed to by the farm ministers in June 2003, decoupled direct payments from production requirements and transformed them into a flat rate, single farm payment. However, member states were allowed to tie up to 25% of the direct area payments to production and to choose from among various options for coupled payments in the beef cattle and sheep sectors. This effectively led to a considerable renationalisation of the CAP and, as a result, 31 different versions of the CAP emerged in EU-27.

While the 2003 reform was aimed at the large arable sectors (cereals, oil, and protein crops), a second phase of reforms brought cotton, tobacco, olive oil, hops (2004), sugar (2005), fruit and vegetables (2007) and wine (2008) into the decoupled framework. Whereas the 2003 reform entailed a considerable renationalisation of the CAP, the Health Check Reform adopted in November 2008 pushed the CAP back towards the Europeanised track by restricting the freedom of the member states to retain coupled direct farm payments. This created some extra leeway for the EU in the Doha Round negotiations, but had little impact on the negotiation which stalemated in December 2008 as a result of disagreements between India and the US.

A new direction for the CAP?

The sequence of CAP reforms beginning in 1992 has brought the CAP into more conformity with the WTO farm trade regime. This direction of the evolution of the CAP is clearly influenced by the WTO farm trade regime which aims at creating a liberal, trading system for agricultural produce. However, the EU did not adopt the liberal underpinning of the Agreement of Agriculture, but responded to it by shifting to less trade-distorting domestic farm support measures. Thus European farmers remain highly subsidised but in new ways; there has been no explicit decision to lower the level of support significantly.

The current Commission proposal for the post-2013 CAP does not respond to the WTO agenda to the same extent as the previous CAP reforms did. This may be explained by the lack of WTO pressure on the EU to reform the CAP. The Doha Round has been stalled since December 2008 with no sight of agreement. The reform proposal appears instead to be motivated in part by a desire to further green the CAP. If the greening component of the reform proposal, as outlined by Commission, is adopted, it may effectively backtrack the CAP in relation to the WTO negotiations. Since the proposal suggests that farm support is to an increasing extent to be linked to the compliance with specific environmental regulations for land use it may be difficult to sustain the argument that the payments are decoupled. Thus, it can be questioned whether the payments qualify as green box support under the WTO Agreement on Agriculture. However, as long as the Uruguay Round Agreement on Agriculture applies, the greening proposal poses no problem for the EU because if the direct payments do not qualify as green box support, there is plenty of room for them under the other support categories. In contrast, if the Doha Round is revived and an agricultural agreement is adopted, there would only be room for the direct payments under the green box and therefore the EU would be very vulnerable to legal challenges in the WTO's Dispute Settlement System questioning the green box status of its direct farm payments.

However, there are also forces pulling the CAP in the opposite direction, i.e towards further WTO compatibility. In the Uruguay Round the EU Farm Commissioner conducted the agricultural negotiations rather autonomously from the rest of the EU's negotiating agenda. There are some indications that the former Agricultural Commissioner, Mariann Fischer Boel, did not conduct the agricultural negotiations in the Doha Round as autonomously as her two predecessors. Her public announcements stressed to a much larger extent the linkage of the farm trade negotiations with the negotiations on trade in manufactured products and services. This may perhaps indicate that the CAP is becoming more integrated into EU trade policy. If so, there will be continued pressure on the CAP to liberalise further, in particular providing more market access, and the way in which trade and internal concerns are to be balanced in the future will remain a key issue in agricultural policymaking.

FURTHER READING

Carsten Daugbjerg and Alan Swinbank (2009), *Ideas, Institutions and Trade: The WTO and the Curious Role of EU Farm Policy in Trade Liberalization*, Oxford: Oxford University Press.

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