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RESEARCH PAPER

EU Agricultural Protection: Tariffs and the CAP

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EXECUTIVE SUMMARY

- The CAP now makes up roughly 40% of the EU budget, down from 60% in the 1990s and costs about €55 billion every year.
- The EU has moved the CAP away from subsidies linked to production, instead linking subsidies to farm land.
- The UK receives roughly €4 billion in direct support payments every year.
- The EU has been much more successful in its agricultural reforms than it is generally given credit for in the UK:
  - The CAP is significantly less trade distorting than it was. The proportion of EU agricultural subsidies which fall into the WTO green box measurement (non-trade distorting) has dramatically risen. Overall Trade Distorting Subsidies (OTDS) have fallen by two thirds, from roughly €60 billion in 2004 to roughly €20 billion in 2007.
  - The CAP is due to be reformed again in 2013, although there is significant disagreement between the UK and other member states as to the nature of these reforms.
  - EU agricultural tariffs have fallen from a bound trade weighted average rate (in Ad Valorem Equivalents) of 22.9% in 2004 compared to the applied trade weighted average figure of 11% now, according to the latest WTO figures.
- The EU is further committed to reducing its agricultural tariffs and subsidies in the Doha trade round, although Doha progress is currently stalled.
- The EU charges concessionary or zero rate tariffs on agricultural imports from many countries:
  - It has a growing number of bilateral trade agreements which reduce the levels of tariffs EU importers actually pay.
  - It unilaterally provides for significant reductions in its agricultural tariffs for 176 developing countries under its Generalised System of Preferences (GSP).
  - Its 'Everything But Arms' (EBA) initiative provides duty-free, quota-free access for all products for the 49 least developed of the 176 developing countries which benefit from the GSP.
- The EU's overall trade in agricultural goods is roughly in balance. It is a net importer of raw agricultural goods and a net exporter of processed agricultural goods. Its biggest agricultural importer is Brazil and its biggest agricultural export market is the USA.
- If the UK left the EU and negotiated to stay in bilateral customs union with it, it would have to retain EU tariffs for most categories of import. As regards subsidies it would be best to continue with the existing Pillar 1 (Single Farm Payment) and Pillar 2 schemes in the immediate future. But in the medium term the UK would be free to reform UK agricultural policy in the same way as it has unsuccessfully sought to do at EU level.

EU AGRICULTURAL POLICY AND TRADE:

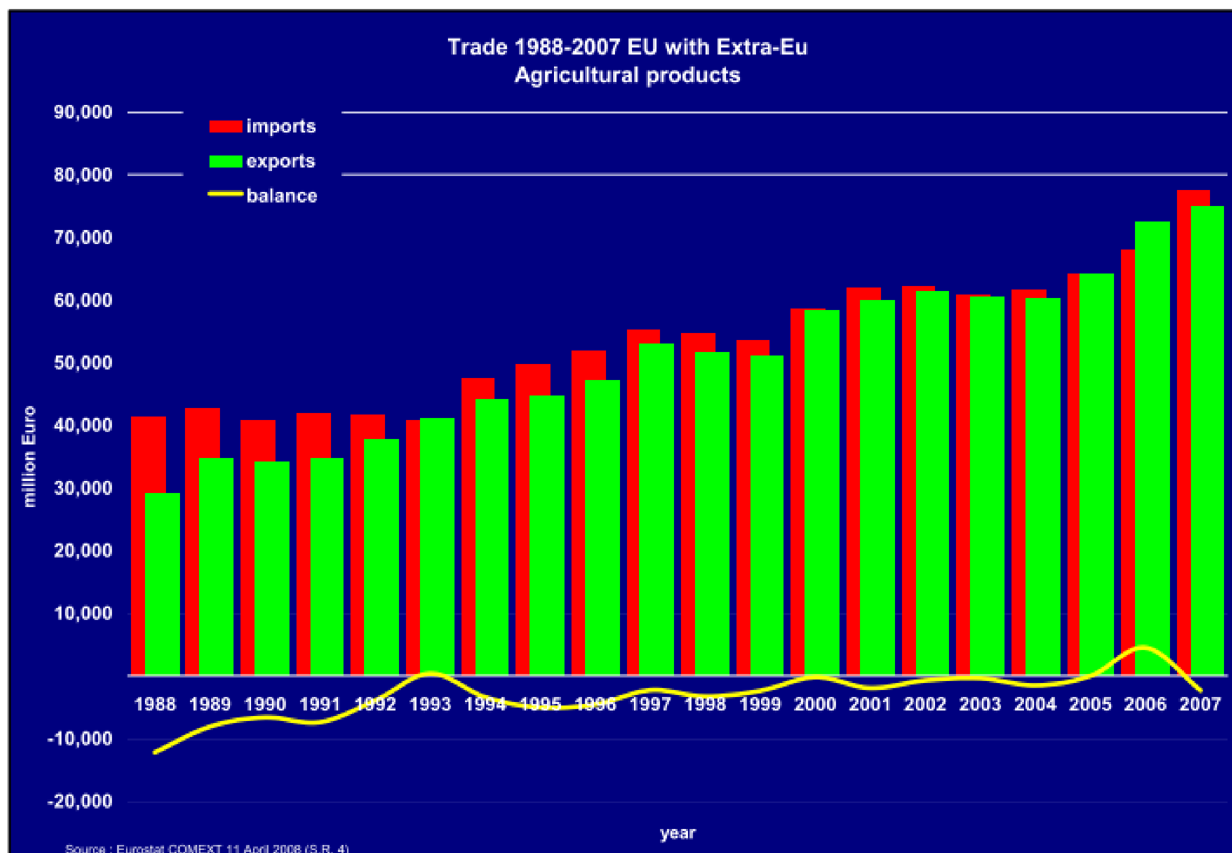
Imports and Exports

The European Commission provides the following information with regard to the EU's trade in agricultural goods. "In 2007, trade in both raw and processed agricultural products accounted for approximately 6% of total EU trade in goods with non-EU countries. This figure compares to a 9% share in 1995 and underlines the steady decline of its importance in total EU trade.

This development is primarily due to the dynamic increase (almost 150%) in trade in industrial products during the last twelve years, compared to a relatively modest 60% increase for agricultural products over the same period. Trade in fish and fish products lies somewhere in between.

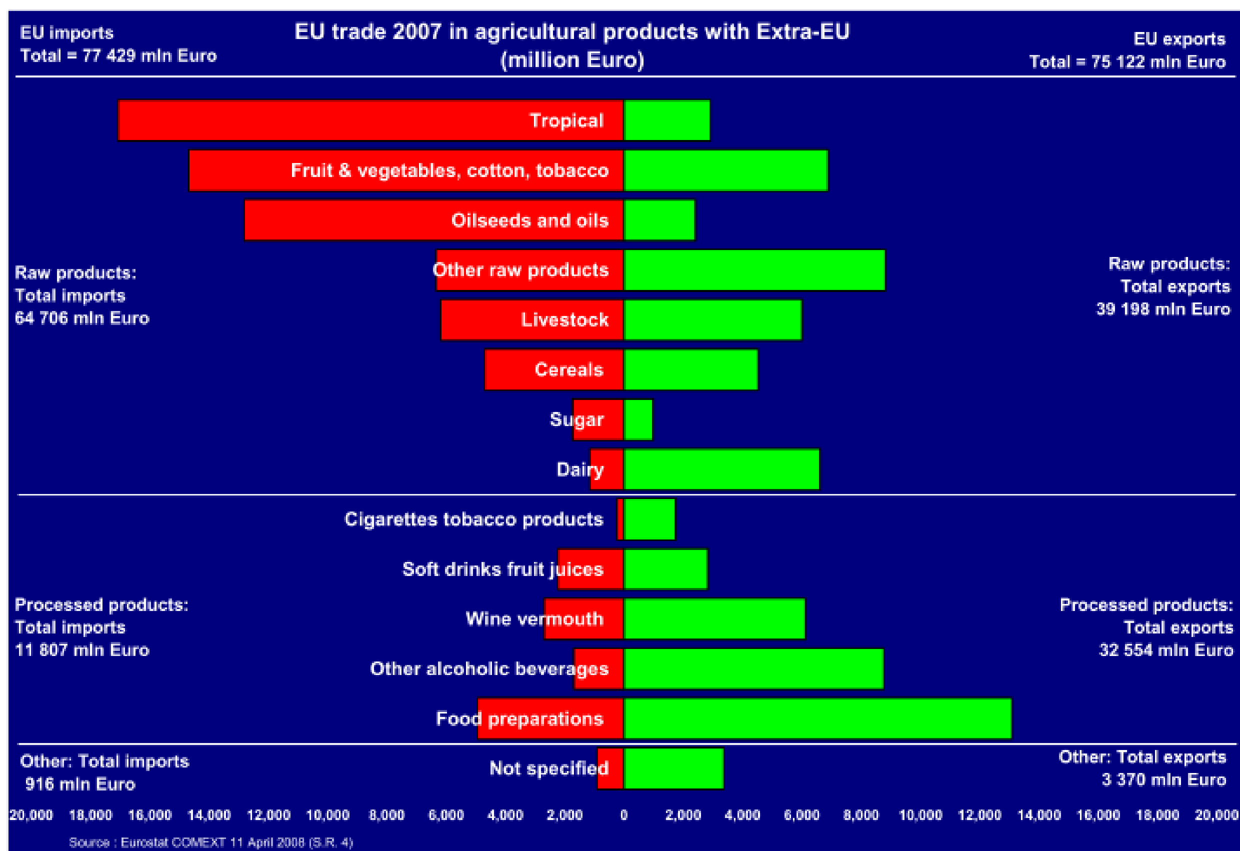
In absolute terms, total trade in agricultural products amounted to almost €153 billion in 2007, split between EU imports from third countries of €77.4 billion and exports of €75.1 billion. Since the enlargement to EU15, imports have increased by 55% and exports by 68%."[1]

The following bar chart shows the growth in EU agricultural trade from 1988 to 2007, the red bars represent imports and the green bars exports, with the yellow line showing the balance between exports and imports:



[1] European Commission, 'EU Trade in Agriculture', downloadable from: http://ec.europa.eu/trade/creating-opportunities/economic-sectors/agriculture/

The second chart shows EU imports and exports of agricultural goods broken down by types of product. The red bars account for imports and the green bars exports. Raw products fall into the top half of the chart and processed products the bottom half:



The European Commission provide an analysis of the chart; "With some exceptions in specific categories, the EU is a net importer of raw products, with a global trade deficit of about €25 billion. Tropical products are the most significant contributors to this deficit (around €14 billion) with oilseeds and oils (€10.4 billion deficit) and fruit & vegetables (€7.8 billion) ranking second and third. On the other hand, the EU trade in both livestock and cereals turns out to be quite balanced, while the dairy sector registers a trade surplus.

The EU is a net exporter of processed products, with a total surplus of €20.7 billion in 2007 that almost offsets the net deficit in raw products. Food preparations and other alcoholic beverages (mainly spirits) are the sectors showing the highest balance (more than €7 billion in both cases)."[2]

Looking at the EU's agricultural trading partners; Brazil (16%), the USA (9%) and Argentina (8%), together account for nearly a third of the EU's agricultural imports. Together the EU's top 10 Agricultural suppliers accounted for 55% of total agricultural imports.

In terms of exports, the USA (19%) was the EU's largest agricultural export market with Russia (10%) and Switzerland (7%) being the second and third largest markets respectively. Together the EU's top 10 agricultural export markets accounted for 56% of total exports. This is a very similar figure to the EU's top 10 agricultural suppliers (55%), although it should be noted the countries that comprise the two lists are quite different.

[2] European Commission, 'EU Trade in Agriculture', downloadable from: http://ec.europa.eu/trade/creating-opportunities/economic-sectors/agriculture/

The two following tables give a more detailed picture of the EU's main agricultural trading partners in terms of imports and exports:[3]

EU Imports - Main Trade Partners	Agricultural products:	
Top 10 2007	Billions Euro	% of Total
Total	**77.43**	**100**
Brazil	12.15	16
USA	7.07	9
Argentina	6.04	8
China	3.43	4
Turkey	3.13	4
Switzerland	2.79	4
New Zealand	2.17	3
Indonesia	1.97	3
South Africa	1.96	3
Australia	1.78	2
Rest	34.94	45

EU Exports - Main Trade Partners	Agricultural products:	
Top 10 2007	Billions Euro	% of Total
Total	**75.12**	**100**
USA	14.11	19
Russia	7.68	10
Switzerland	4.97	7
Japan	4.01	5
Norway	2.43	3
Canada	2.13	3
Saudi Arabia	1.91	3
St, P .Extra	1.77	2
Turkey	1.75	2
China	1.64	2
Rest	32.71	44

The Common Agricultural Policy

The EU Commission's website says that "During the first years of the EU's existence the CAP represented a significant proportion of budget expenditure, over two-thirds on occasions." However, this has changed: "The CAP [now] costs about EUR 55 billion per year. This represents 40 % of the total EU budget, less than 0.5 % of GDP in the EU. Not only is the share of CAP in EU GDP declining, but this share is also declining much faster than EU public expenditure."[4]

Major changes were undertaken to the CAP in 2003 following Agriculture Commissioner Franz Fischler's reforms. Fischler's reforms have significantly altered how the CAP operates. Subsidies which were linked to production of goods were 'decoupled' and farmers instead received payments based on the size of their farms, under what are known as 'Single Farm Payments'. "Farmers in some member-states get considerably higher payments per hectare than farmers in other member-states. The EU average is €200 per hectare, but a Greek farmer gets €500 per hectare and a Latvian farmer only €100. (Some direct interventions still apply when there is a crisis, but on a much reduced scale than was the case before.)"[5]

Fischler's reforms also diverted money away from supporting farmers' incomes and towards environmental goals and rural development. Christopher Haskins, a member of the Centre for European Reform advisory board concludes that "the CAP is much better than it was. It is less protectionist. It aspires to promote environmental sustainability. And it takes up a smaller share of the EU's budget (40 per cent of the total, down from over 60 per cent in 1990)."[6]

[3] European Commission, 'EU Trade in Agriculture', downloadable from: http://ec.europa.eu/trade/creating-opportunities/economic-sectors/agriculture/
[4] European Commission, Agriculture and Rural Development, http://ec.europa.eu/agriculture/capexplained/cost/index_en.htm
[5] Christopher Haskins, 'A chance for further CAP Reform', Centre for European Reform, February 2011, p1-2
[6] Christopher Haskins, 'A chance for further CAP Reform', Centre for European Reform, February 2011, p2

The EU is committed to reviewing the CAP again in 2013, and as part of the Doha round is committed to significantly reducing its agricultural tariffs and subsidies on a multilateral basis. However, at present the Doha round is stalled and it is unclear when or even if it will be completed.

How is the CAP structured?

Subsidies under the Common Agricultural Policy are categorised under two different pillars, Pillar 1 and Pillar 2 as shown in the tables below.

Pillar 1 subsidies aggregated € 41.1 billion in 2009, as shown in the 'CAP 1st Pillar' table. This represented 83% of total CAP spending in 2009. Decoupled Direct Subsidies amounted to € 31.3 billion, representing 76% of all Pillar 1 subsidies. They consist of Single Farm Payments for the 15 countries that were EU members before 2004 (the EU15) and their equivalent for the 12 countries that joined the EU since 2004 (the EU12), which are known as Single Area Payments. The remainder of Pillar 1 consists mainly of Market Interventions and Coupled Direct Subsides.

CAP 1st Pillar - European Agricultural Guarantee Fund – 2009 Overall Budget

Policy	**Objective**	**Main Instruments**	**2009 Expenditure (€ Billions)**
Market Interventions	Raise and stabilise market prices	Intervention Buying, Export Subsidies	3.4
Decoupled Direct Subsidies	Support farmers income	Single Farm Payments, Single Area Payments	31.3
Coupled Direct Subsidies	Increase production of select goods	Production premia, area payments	5.9
Other	Various	-	0.5
Total	-	-	41.1

[7]

Pillar 2 of the CAP comprises three different 'Axes', with the objectives of improving competitiveness (Axis 1), improving the environment and countryside (Axis 2) and improving the quality of life in rural areas (Axis 3).

Pillar 2 subsidies aggregated €8.2 billion in 2009, as shown in the 'CAP 2nd Pillar' table, accounting for 17% of total CAP spending in 2009. This amount represents only 60% of the €13.7 billion budgeted through committed appropriations[8] for 2009, with the remaining 40% accounting for money to be spent in later years.

[7] European Commission, '3rd Financial Report from the Commission to the European Parliament and the Council on the European Agricultural Guarantee Fund 2009 Financial Year', p14

[8] Commitment appropriations cover the total cost, in the current financial year, of the legal obligations entered into for operations to be carried out over more than one financial year. This type of appropriation constitutes the upper limit of expenditure which can be committed during the financial year

CAP 2nd Pillar - European Agricultural Fund for Rural Development – 2009 Overall Budget[9]

Policy	Objective	Main Instruments	2009 Expenditure (€ Billions)
Axis 1	Improving Agricultural competitiveness	Modernisation of agricultural holdings, infrastructure	2.6
Axis 2	Improving the environment and countryside	Agri-enviromental payments, payments to farmers in areas with handicaps	4.7
Axis 3	Improving the quality of rural life and diversifying the rural economy	Village renewal and development, business creation and development	0.4
Other	Various	-	0.5
Total	-	-	8.2

While € 8.2 billion was paid out in 2009, total Committed Appropriations (funds assigned in 2009 but some spent in later years) were € 13.7 billion.

In terms of how much funding the UK receives, UK farmers received €3.98 billion in direct subsidy payments in 2010 (the combined totals of Decoupled and Coupled payments subsidies from the Pillar 1 table), while the total amount paid in direct payments across the EU 27 was €41.95 billion. This compares to figure of €37.2 billion for the previous year's 2009 budget as shown in the 'CAP 1st Pillar' table. This means that in 2010 the UK received a 9.48% share of direct payment CAP funds.[10] All of the Pillar 1 funds assigned to the UK fall into the category of Single Farm Payments.

The CAP and the WTO

The WTO sorts subsidies into four categories. "Amber Box is the most trade distorting category of support, assessed by using the total aggregate measurement of support ('AMS') calculation set out in the WTO Agreement on Agriculture. Another category of Amber Box support is known as '*de minimis'* which falls outside the main AMS calculation and is at present limited to 5 per cent of agricultural production for developed countries. The 'Blue Box' covers direct payments to farmers to limit production such as the former Set-Aside scheme which are deemed to be less trade distorting. The 'Green Box' covers support measures deemed to have no more than minimal impact on trade. Only Amber Box and *de minimis* support were limited under the Agreement on Agriculture."[11]

As a result of the Fischler reforms and the direct payments system replacing the old system of payments based around production, the EU's trade distorting farm subsidies have gradually fallen. Amber Box subsidies

[9] European Commission, '3rd Financial Report from the Commission to the European Parliament and the Council on the European Agricultural Fund for Rural Development (EAFRD) 2009 Financial Year', p12

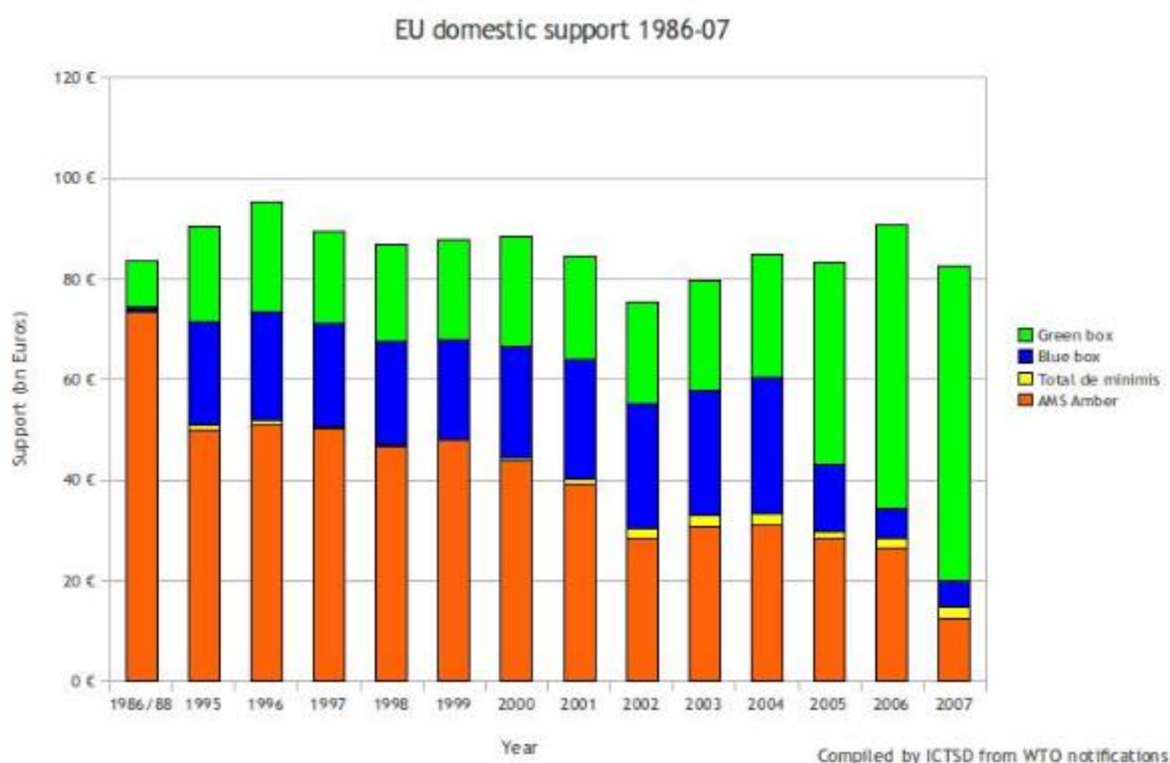
[10] Valentin Zahrnt, 'Financing the Common Agricultural Policy: Which member states pay for the waste of public money?', ECIPE, 2011, p3

[11] Ronald Stewart Brown, 'Doha Round in the balance after Hong Kong', The European Journal, February 2006, p8-9

reached a record low of €12.4 billion for the year 2007/8, down from €26.6 billion in 2006/07 according to the EU's notification of subsidies to the WTO[12].

Looking at which part of the CAP would fall into which boxes, clearly the Single Farm (EU 15) and Single Area Payments (EU 12) are firmly in the Green Box category. Second Pillar schemes are likely to fall into Blue and Green boxes given their largely environmental and development orientated goals. Market Interventions and Coupled Direct Subsides which fall into Pillar 1 are certain to be Amber Box subsidies. The Axis 1 component of Pillar 2 is also likely to fall into the Amber Box category.

The International Centre for Trade and Sustainable Development (ICTSD) have produced the following bar chart showing how the EU's trade distorting agricultural subsidies have fallen over the past decades, with blue and amber box subsidies decreasing dramatically, while green box subsidies have risen[13]:



Alan Matthews, Professor Emeritus of European Agricultural Policy at Trinity College Dublin, explained this dramatic change as follows:

> Part of "the reason for the more than halving of the reported EU AMS in 2007/08 compared to 2006/07 is that the EU no longer calculates an 'equivalent measure of support' for fresh fruit and vegetables. Until 2007/08, it calculated an AMS for 16 fresh fruits and vegetables plus separate AMS's for a number of processed fruit and vegetables (notably tomatoes and peaches) and bananas. This AMS was calculated as the support provided through the entry price system, which sets the minimum import price for imported fruits and vegetables.
>
> But in 2007/08, without comment, the EU has dropped this calculation and now reports virtually zero trade-distorting support in the fruits and vegetables sector. While some non-exempt direct payments

[12] Alan Matthews, 'The mystery of the EU's disappearing AMS', capreform.eu, September 22nd 2011, http://capreform.eu/the-mystery-of-the-eus-disappearing-ams/

[13] ICTSD, http://ictsd.org/i/agriculture/99554/

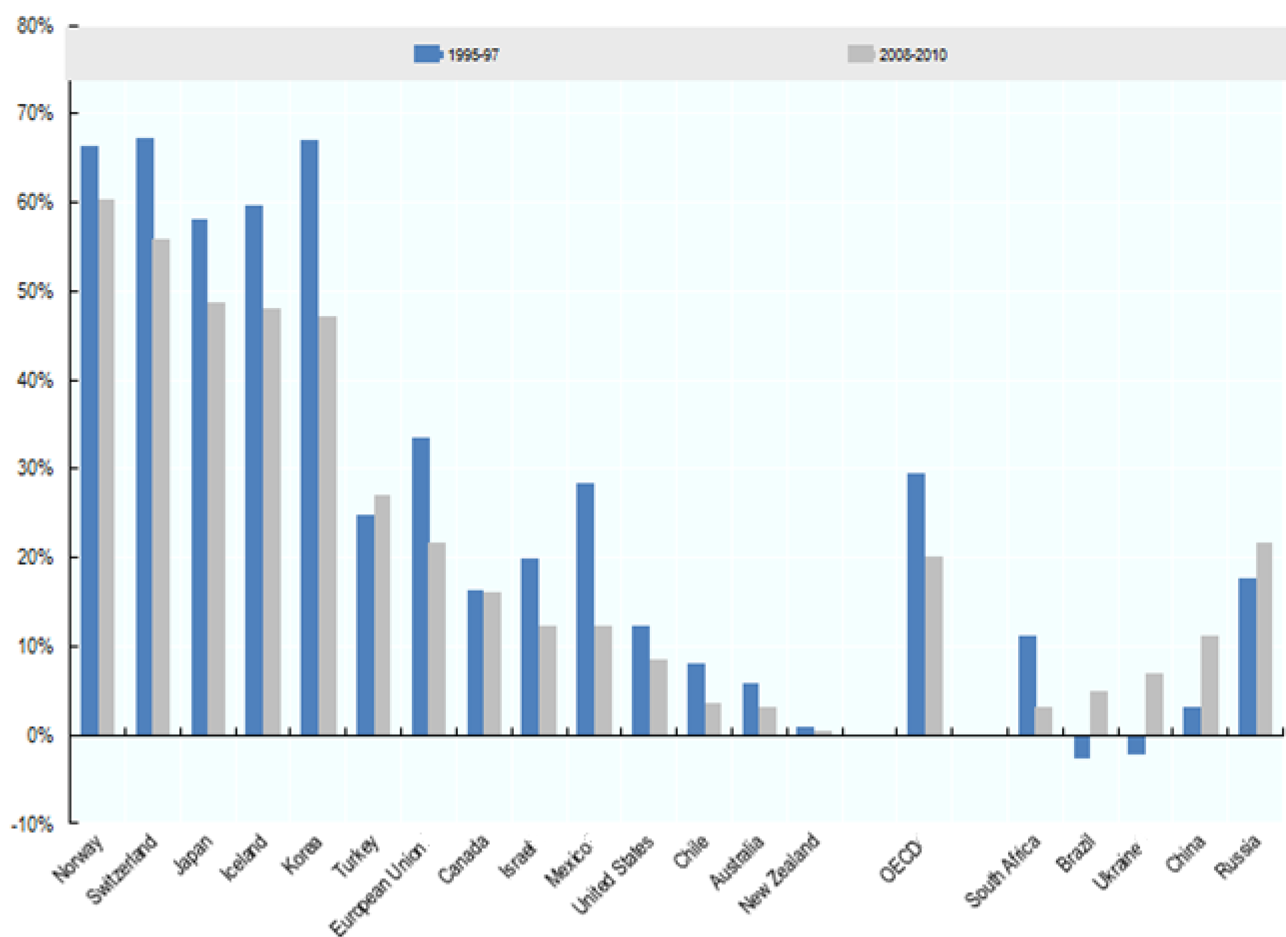
(e.g. production aids) are reported, these fall below the *de minimis* threshold and thus are not counted as part of current total AMS."[14]

This explanation does not account for the fall in Blue and AMS Amber support in previous years, (prior to 2007/8) with the substantial increase in Green box subsidies being explained by the switch from production to single farm payment subsidies. Correspondingly, green box support tripled between 2004 and 2007.

<u>Comparison of EU agricultural subsidies with other countries</u>

The OECD has also produced the following graph showing how agricultural support varies across a wide range of countries and how levels of support have changed between 1995-7 and 2008-10, using the Producer Support Estimate measure[15]:

Figure 2.3 OECD and EE: Producer Support Estimate by country, 1995-97 and 2008-10
Per cent of gross farm receipts



The Producer Support Estimate measures the contribution of government policies to farm revenues, whether through market price support or budgetary transfers. It expresses the monetary value of policy transfers from consumers and taxpayers to producers as a percentage of gross farm receipts. It incorporates export subsidies, as well as Amber, Blue and Green box support.

We can see that EU levels of support have fallen quite considerably since 1995-7, but still remain slightly above the OECD average and well above levels in the USA, Canada, Mexico, Australia and New Zealand.

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[14] Alan Matthews, 'The mystery of the EU's disappearing AMS', capreform.eu, September 22nd 2011, http://capreform.eu/the-mystery-of-the-eus-disappearing-ams/

[15] OECD, 'Agricultural Policy Monitoring and Evaluation 2011: OECD Countries and Emerging Economies': http://www.oecd.org/document/32/0,3746,en_2649_37401_48625184_1_1_1_37401,00.html

Agricultural subsidies have fallen as a percentage of gross farm receipts for all countries apart from Turkey, Ukraine, and the BRIC countries, Brazil, Russia and China for which they have risen sharply. The fourth BRIC country, India, does not submit figures to the OECD.

EU Agricultural Tariffs

The EU employs a wide range of tariffs to protect its domestic industries with many of these tariffs applying to agricultural products. Under WTO agreements these tariffs are "bound" at maximum levels (bound duties), although countries may choose to set tariffs at lower rates than these bound maximums (applied Most Favoured Nation[16] duties). While some countries have certain tariffs which are not bound under WTO rules, 100% of the EU's tariffs are bound and have agreed maximum rates. The vast majority of EU tariffs are set at bound rates, and so in most cases bound duties and applied MFN duties tend to be the same.

"Depending on the tariff line, import tariffs can have specific rates in EUR/tonnes [Non AV tariffs] or Ad Valorem (AV) rates expressed in % of the border price, or both."[17] It is important to note that the vast majority of agricultural tariffs are Non-AV tariffs, and are calculated on the basis of weight (eg: 23€/100 kg). In order to calculate the 'Average MFN applied duty', these tariffs have to be converted into Ad Valorem Equivalents (AVEs). Changes in food prices and foreign exchange rates will also affect these calculations and distort their accuracy, and so consequently these figures should be viewed as good estimates prone to a degree of inaccuracy.

For 2009, the WTO calculates a trade weighted average of 3.2% for the applied Most Favoured Nation (MFN) EU tariffs, with Non-AV tariffs expressed as AV equivalents. For Non-agricultural products the average was only 2.7%, while the average tariff on agricultural products was 10.1%, over three times higher[18].

WTO summary of EU Agricultural Tariffs

Product Group (product groups consist of a number of relevant tariff chapters)	Simple average MFN applied duty (%)	Highest MFN applied duty (%)	% share of total EU imports (by value)	% share of agricultural imports	Trade weighted average duty (%)
Animal products	22.2	191	0.5	7.5	1.7
Dairy products	48.3	156	0.0	0.0	0.0
Fruit, Vegetables and Plants	11.1	119	1.8	26.9	3.0
Coffee, Tea	6.5	40	1.0	14.9	1.0
Cereals and Preparations	14.3	118	0.5	7.5	1.1
Oilseeds, Fats and Oils	5.7	92	1.6	23.9	1.4
Sugars and Confectionary	21.6	106	0.2	3.0	0.6
Beverages and Tobacco	20.0	147	0.7	10.4	2.1
Cotton	0.0	0	0.0	0.0	0.0
Other Agricultural products	4.1	99	0.4	6.0	0.2
Total Agricultural products	n/a	-	6.7	100.0	11.0

Figures of 0.0 represent a number greater than 0, but less than 0.05.
Trade weighted average duties represent average MFN applied duties weighted by % share of agricultural imports.

[16] Under WTO rules, countries are not allowed to discriminate in the tariff rates they set between their trading partners. This is known as the 'Most Favoured Nation' principle. It means all countries importing to a country pay the same tariff rates unless they have a preferential trade agreement e.g. a free trade agreement.
[17] OECD, 'Evaluation of Agricultural policy reforms in the European Union', December 2011, p51
[18] WTO, WTO Tariff Profiles – European Union (as of Feb 2012): http://stat.wto.org/TariffProfile/WSDBTariffPFView.aspx?Language=E&Country=E27

The table above gives a more detailed breakdown of the EU's agricultural tariffs by product groups, using the most recent data the WTO provide (as of 2012) on their Tariff Profiles.

A 2008 study looking at 2004 data by Sebastien Jean, Tim Josling and David Laborde found "the average bound duty for agricultural products in the EU was 22.9% in 2004 when weighted by imports."[19] This compares to the figure of 11.0% using the most recent WTO data (see table above), suggesting a significant fall in tariffs since 2004.

Much of this fall in tariffs can be accounted for by rises in global food prices. It is fluctuations in food prices which produce the greatest variations in average tariff rates expressed as ad valorem equivalents (as a percentage of import costs rather than by weight). For example, for a tariff line, even if the bound rate e.g. 23€/100 kg did not change, the ad valorem equivalent would change from year to year, depending on the price of the product. On a given year, say 2009 if the price of the product were €100/100 kg, the ad valorem equivalent of 23€/100 kg would be 23%. However, if in 2010, the price doubled to €200/100kg, then the ad valorem equivalent of the same duty would be halved to 11.5%.

It should also be noted that while the Average MFN applied duties and Trade weighted duties show the headline EU tariff rates across its agricultural imports, many countries have arrangements or trade deals with the EU which mean they pay different rates, as explained in a recent OECD report:

> "Applied tariffs may be lower than MFN rates, as part of preferences granted to specific countries, or in response to market conditions. Under preferential trade agreements (PTA), the European Union grants various tariff preferences on a reciprocal basis on selected agricultural products. As a result of preferential trade agreements in general, 18% of agricultural imports are duty free. Economic Partnership Agreements create a preferential trade area between the European Union and the Group of African, Caribbean and Pacific (ACP) countries. In the Euro Mediterranean partnership (Euromed) framework, several bilateral agreements have been signed or are being discussed with Mediterranean countries. The European Union has or negotiates PTAs with other countries. Bilateral agreements cover more aspects than market access, e.g. mutual recognition of standards.
>
> The European Union also provides tariff preferences under non-reciprocal arrangements. The generalised system of preferences grants trade concessions to developing countries, focussing on smaller, more disadvantaged countries. It includes three schemes: 1) the normal Generalised System of Preferences (GSP) provides preferences to 176 developing countries; 2) a GSP+ category offers additional tariff reductions to support vulnerable developing countries in their ratification and implementation of international conventions regarding sustainable development and good governance; and 3) the Everything But Arms (EBA) initiative provides duty-free, quota-free access for all products for 49 least developed countries."[20]

Recently the EU has completed a small number of bi-lateral trade liberalisations with countries including Albania (Stabilisation and Association Agreement signed in 2009), Algeria (Association Agreement signed in 2005), Bosnia (Stabilisation and Association Agreement signed in 2008), Croatia (Stabilisation and Association Agreement signed in 2005 – scheduled to become an EU member in 2012), Egypt (Association Agreement signed in 2004), Macedonia (Stabilisation and Association Agreement signed in 2004), Montenegro (Stabilisation and Association Agreement signed in 2010), Serbia (Stabilisation and Association Agreement signed in 2010), and most recently South Korea (Free Trade Agreement came into force in 2011). These agreements will have reduced the tariffs importers from these countries pay in practice.

[19] Sebastien Jean, Tim Josling and David Laborde, 'The consequences for the European Union of the WTO Revised Draft Modalities for Agriculture', August 2008, p11

[20] OECD, 'Evaluation of Agricultural policy reforms in the European Union', December 2011, p52

In addition rising food prices and fluctuations in exchange rates will mean that tariffs on agricultural goods as ad valorem equivalents (expressed as a percentage of import cost) will have altered. These factors, in addition to the bilateral liberalisations listed above will have affected the actual tariffs many EU importers pay.

The following table analyses agricultural product groups according to whether they fall into a high tariff band (over 20%), a medium tariff band (: between 10% and 20%) or a low tariff band (below 10%):

	Product Groups	**Simple Average tariff range**	**% of imports**
High Tariff product group	Animal products, Dairy products, Sugars and Confectionary, Beverages and Tobacco	20% or higher	20.9
Medium Tariff product group	Fruit, Vegetables and Plants, Cereals and Preparations	10% to 19.9%	34.3
Low Tariff product group	Coffee, Tea, Oilseeds, Fats and Oils, Cotton, Other Agricultural products	Lower than 10%	44.8

While we know that the average tariffs for these products groups don't give an entirely accurate representation of the actual tariffs importers pay for products imported in these groups, we can see that generally speaking tariffs tend to be less than 20%.

<u>The EUs Doha proposals for agricultural tariffs</u>

At the start of the Doha round the G20 proposed cuts on the highest agricultural tariffs of 75% while the USA position was for 90% cuts in high agricultural tariffs for developed nations. The EU argued for 60% cuts as a realistic goal with a tariff cap of 100% as the highest possible agricultural tariff. The EU argued that this would reduce its highest tariffs by more than half and cut the average EU agricultural tariff by 46%.[21]

As of the 2008 Geneva round of discussion on Doha, the agreed cuts in agricultural tariffs for developed countries would range from a 50% cut for tariffs below 20% with reductions of up to 70% for tariffs above 75% and a minimum average cut of 54% to be phased in over a five year period. Meanwhile cuts for developing countries would be phased in over a longer period of eight years, and the level of cuts required in their agricultural tariffs would be two thirds of those required for developed countries.

All countries would be able to designate a select few tariff lines as 'sensitive products' if it had particular concern over the reduction in tariffs for a specific product. Developed countries would be able to designate either 4% or 6% of their tariff lines as sensitive products (with Japan being allowed 8%) while developing countries would be allowed to designate a second group of products from formula tariff cuts, by designating them as 'special products' meriting increased tariff protection in order to meet development or food security needs.[22]

The precise economic implications of sensitive and special products product designations would depend on the import value of the products concerned. Such designations may potentially represent large loopholes in the general tariff cut requirements.

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[21] Europa Press Release, 'Doha Round: EU offer on agricultural negotiations': http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/05/400

[22] Ronald Stewart-Brown, 'So near and yet so far in Geneva', Economic Affairs March 2009, p59

In addition a methodology has been agreed for converting all Non AV tariffs into their Ad Valorem Equivalents (AVEs) with the agreement aiming to remove and convert all non AV tariffs into the AV equivalents.

The future of the CAP and the Doha proposals

The CAP as it exists today is due to change again in 2013, with a new round of CAP reform. The budget is likely to stay the same in real terms, with the heads of state from France, Germany, the UK, the Netherlands and Finland proposing a small rise in the Budget in line with inflation, in a joint letter to the European Commission in December 2010. They write that "payment appropriations should increase, at most, by no more than inflation over the next financial perspectives" and that "commitment appropriations over the next multiannual financial framework should not exceed the 2013 level with a growth rate below the rate of inflation."[23] With the need for spending cuts across the EU, the call for spending restraint by the three biggest EU contributors (Germany, France and the UK) should mean that only the most generous scenario for funding the CAP will see it maintain its current share of spending in real terms.

Christopher Haskins describes the political divisions over the CAP negotiations:

> "The accession of central and eastern European countries to the EU has had a major impact on discussions about the future of the CAP. Farmers in new member-states will not receive full CAP payments until 2013, and the Commission is now suggesting that there could be further transitional arrangements even after 2013"[24]
>
> "The Commission's 2010 communication on the post 2013 CAP essentially argued for only minor reform, thus reflecting the view of DG Agriculture rather than DGs Climate Action, Environment, Regional Development or Budget. In the European Parliament, the European Peoples Party's position is similarly traditional and anti-reform. The Socialists and Liberals in the Parliament are calling for more substantial reform in order to promote public goods, including climate protection, biodiversity, employment creation and a reduction in regional disparities.
>
> The French government is arguing for the preservation of a large CAP budget on the pretext of ensuring European food security, and wants some new subsidies for 'risk management'. France opposes the redistribution of subsidies, which would see western member-states getting less and eastern ones getting more. Germany's official position is also against significant change, but parts of the German government are tacitly hoping for reform, partly because of Germany's reliance on an open world trading system, which the current CAP undermines, and partly because of Germany's position as the largest net contributor to the EU budget.
>
> Sweden, Denmark and the Netherlands favour significant CAP reform. So does the UK, which remains strongly opposed to any increase in CAP spending, and equally strongly in favour of the UK's annual rebate."[25]

In a letter of 13th May 2008, Alistair Darling, then the UK's Chancellor of the Exchequer wrote to Dr Andrej Bajuk, Slovenia's Minister of Finance, saying that there needed to be "fundamental reform of Europe's agricultural sector" including "phasing out of all elements of the CAP that are designed to keep EU agricultural prices above world market levels" and "an end to direct payments to EU farmers"; and "a close

[23] Valentin Zahrnt, 'A guide to CAP reform politics: issues, positions and dynamics', ECIPE working paper no.3 2011, p17
[24] Christopher Haskins, 'A chance for further CAP Reform', Centre for European Reform, February 2011, p2
[25] Christopher Haskins, 'A chance for further CAP Reform', Centre for European Reform, February 2011, p5-6

examination of the direct and indirect effects of EU biofuels policy, including a full assessment of its effect on food prices…"[26]

France's Nicolas Sarkozy takes a very different position saying "In a world where there are 800 million poor people who cannot satisfy their hunger and where a kid dies every 30 seconds from hunger, I will never accept a reduction in agricultural protection on the altar of global liberalism."[27] Clearly the CAP and its future are divisive issues amongst EU member states.

Valentin Zahrnt points to the 'gang of five', the UK, Sweden, Denmark, the Netherlands and Malta being the main proponents of CAP reform, with the UK leading the group and being the most likely to pick a fight. However these countries are on the "reformist fringe"[28] with most other member states and parties in the European Parliament being much less keen on championing whole sale reform. The Commission which has previously supported moderate reform of the CAP looks likely to be the body to broker an agreement between the divided groups.

Regarding the proposals the EU has made at the WTO Doha round in terms of agricultural subsidies, the EU's AMS would be reduced by 70% over the same five year time span, and its Overall Trade Distorting Domestic Support (OTDS), which includes amber box, blue box and *de minimis* subsides, would be cut by 80%. The *de minimis* exemption would be reduced by 50% and blue box expenditure would be capped at 2.5% of the value of farm production in 1995-2000. Export subsidies would be totally eliminated by 2013.[29]

Commenting on the 2011 EU reported subsidy levels (see 'EU domestic support table on page 8), The International Centre for Trade and Sustainable Development (ICTSD) said that "For the first time ever, the recent figures would put the EU's overall trade-distorting support below the proposed new ceiling of 22 billion euros that would be established by a Doha Round accord under the terms currently being considered at the WTO."[30]

UK AGRICULTURAL POLICY UNDER THE CAP

John Rockliffe of the Scottish Agricultural College explains how Single Farm Payments (part of Pillar 1), the vast bulk of CAP funds, work in England as part of the CAP.

> "The Single Farm Payment (SFP) was introduced in 2005 following reform of the CAP. Prior to the introduction of SFP farmers in England received support payments which were closely related to their production system [crops, livestock etc]. The overriding requirement was to complete a declaration of land farmed as at 15th May each year – the IACS application form. Completion of the IACS application then allowed farmers to make claims under the various support payment schemes which applied to their particular farming system.
>
> These schemes were: Suckler Cow Premium Scheme; Sheep Annual Premium Scheme; Beef Special Premium Scheme; Extensification Premium Scheme; Slaughter Premium Scheme; Arable Aid Scheme. Each scheme had its own rules for eligible stock, retention period, claim period, etc., while the suckler cow premium scheme and sheep annual premium scheme also operated within a quota system. All the schemes were related to the number of animals kept or number of hectares of crops

[26] Alistair Darling, 'Letter to Dr Andrej Bejuk, Minister of Finance, Slovenia' 13th May 2008
[27] Nicolas Sarkozy quoted in Carsten Daugbjerg & Alan Swinbank, "Ideas, institutions and Trade: The WTO & and the curious role of EU farm policy in trade liberalisation', p193
[28] Valentin Zahrnt, 'A guide to CAP reform politics: issues, positions and dynamics', ECIPE working paper no.3 2011, p16
[29] Carsten Daugbjerg & Alan Swinbank, "Ideas, institutions and Trade: The WTO & and the curious role of EU farm policy in trade liberalisation', p168
[30] ICTSD, 'EU halves production linked farm subsidies, but delinked support jumps', Bridges Weekly Trade New Digest, Volume 15 Number 2, 26th January 2011: http://ictsd.org/i/news/bridgesweekly/99589/

> grown so had the effect of encouraging many producers to 'farm for the subsidy' rather than as their top priority producing what the market required."[31]

As part of the CAP reforms, the decision was taken to 'decouple' support payments from production. Member States were given some leeway and could choose to maintain a limited amount of specific subsidy for certain production systems, but the vast majority of payments would now be unrelated to production but instead based on the area of land famers owned. By moving payments away from production, the worst trade distorting elements of the CAP would be phased out. Farmers would also be encouraged to produce what the market demanded and the most publically objectionable consequences of the CAP (milk lakes and butter mountains etc) would be reduced significantly.

In many cases (especially in the case of intensive beef and sheep production) the effect of decoupling would mean a significant reduction in the support farmers received. In order to help farmers adjust to the new policy of decoupled payment, the move to a fully decoupled system would be phased in over eight years, starting in 2005 and ending fully decoupled in 2012. While intensive farms would generally receive a reduction in support, extensive farmers such as organic production units would generally receive an increase in support. Now that we have reached 2012, payments are now no longer linked to production and related wholly to the amount of land farmers have, irrespective of the lands agricultural use.

Support payments over the transition period where based on a combination of the new flat rate area payment system, and on the previous 'historic' production linked system. Payments are made under the 'Single Payment Scheme' (SPS).

> "The historic element of the payment was calculated from the support payments received under the previous system during the 'reference period' of 2000, 2001 and 2002. The establishment of the level of this historic payment was not straightforward in many instances since a large number of farms in England were affected by FMD which had an impact on the level of support payments received in 2001 and most likely 2002. Allowance also had to be made for new entrants and farmers undergoing expansion during the reference period. Having calculated the 'historic' allowance this was then added to the 'area' payment to arrive at the value of each 'entitlement'.
>
> For England there was a once and for all time to establish an entitlement to claim support payments on land – 15th May 2005. All land farmed on the 15th May had to be included on the SPS application form, with each hectare declared as farmed land then being allocated an 'entitlement'. The historic element was spread over each entitlement and added to the area element to arrive at the value for that entitlement. The differing levels of historic support means that the value of entitlements varies from farm to farm. Any land not included on the 2005 SPS application has no entitlement attached to it. "[32]

Under the new flat rate area scheme, land in England falls into one of three categories: 'Moorland', 'SDA' [Severely Disadvantaged Area] or 'Outside SDA' with different payment levels for each. For 2005 the rates per hectare were – Moorland €33.6, SDA €235.9 and Outside SDA €282. For 2011 these rates were €40.82 for Moorland, €233.95 for SDA and €289.94 for Outside SDA land[33], all at broadly similar rates to the 2005 levels.

The payments made to farmers over the transition period were based on a combination of the historic payments they received and the new area payments. Over time the historic level of support based on the old production linked system would decrease as a percentage of total payments, while the new payments based on

[31] John Rockliffe, 'Support Payment for Farmers in England', Scottish Agricultural College, November 2007
[32] John Rockliffe, 'Support Payment for Farmers in England', Scottish Agricultural College, November 2007
[33] Rural Payments Agency, '2011 Single Payments Scheme':
http://rpa.defra.gov.uk/rpa/index.nsf/7801c6143933bb248025713f003702eb/0199816c617a580c80257935002ccc35!OpenDocument

area would increase. The table below shows the payments farmers received as divided between their levels of historic support and the new system of payments linked to their area of land:

	2005	2006	2007	2008	2009	2010	2011	2012
% Area	10	15	30	45	60	75	90	100
% Historic	90	85	70	55	40	25	10	0

So we can see that as of 2012, the level of historic payments has been completely phased out and the new payments based on land area are fully in place.

The sterling value of the payments actually famers receive is subject to the changes in the exchange rate (€v£), and as adjusted for 'modulation'. Farmers can also face fines which reduce their payments, under what is known as 'financial discipline'.

Modulation involves the transfer of money from direct payments schemes like the English Single Farm Payment (Pillar 1) to a wider range of rural development schemes (Pillar 2). The amount of money transferred is known as the 'modulation rate' and is set in percentage terms.

> "The CAP reform agreement has for the first time set a compulsory EU-wide modulation rate of 3% of direct payments in 2005, increasing to 5% from 2007 onwards. The UK has agreed a levy of an additional national modulation rate. This higher modulation rate will be used to fund agri-environmental spending, as part of the Governments Strategy on Sustainable Farming and Food, in particular, the new Environmental Stewardship Scheme."[34]

As of 2012, the Modulation rate (falling outside the Single Farm Payments) is 5% across the EU and 14% in the UK, making for an overall UK Modulation rate of 19%. This Modulation rate is taken out of Farm Payments, meaning that in the UK roughly 80% of payments are made through the Single Farm Payments, and the other 20% comes from various environmental modulation payments.

The Table below shows historic modulation rates across the UK: [35]

UK modulation rates

Year	EU Rate	Additional UK National Rate	**Overall Rate**
2005	3%	2%	**5%**
2006	4%	6%	**10%**
2007	5%	12%	**17%**
2008	5%	13%	**18%**
2009-12	5%	14%	**19%**

Unlike Single Farm Payments which are determined by the EU, national Governments may dictate the qualifications for payments related to modulation rates. This means schemes vary in their objectives, with some aiming to improve competitiveness (Axes 1 of Pillar 2) and others aiming to help the Environment (Axes 2 of Pillar 2). England's main source of environmentally qualified funding takes the form of 'The Rural Development Programme for England', which is itself comprised of numerous different schemes designed to promote sustainable farming. The majority of the UKs modulation and general Pillar 2 funds fall under Axes 2 of Pillar 2.

[34] The University of Reading ECIFM, Agricultural Support, http://www.ecifm.rdg.ac.uk/agsup.htm
[35] The University of Reading ECIFM, Agricultural Support, http://www.ecifm.rdg.ac.uk/agsup.htm

WHAT IF THE UK LEFT THE EU?

The implications for UK agriculture of the UK leaving the EU need to be considered in terms of both tariffs and subsidies.

Looking first at subsidies, Professor Wyn Grant of Warwick University outlines several possible CAP replacement policies should the UK decide to leave the EU or repatriate powers over agriculture:

> "Supposing Britain left the EU or repatriated CAP payments, the withdrawal of subsidies overnight would cause chaos in agriculture. In principle one might want to see a return to a deficiency payments system which was the more market attuned form of subsidy that existed before Britain joined the EU.
>
> However, in practice, it would be costly to dismantle the existing (albeit rather inefficient) administrative apparatus and replace it with a new one. One would therefore have to pay farmers the SFP on an historic basis, tapering the amount paid over time so that one might start at 90 per cent of the existing payment.
>
> More radically one could compensate farmers for the subsidy by issuing them with interest bearing bonds which could also be sold on the market but that would probably be unacceptable to the parties involved.
>
> Meanwhile British farmers who had opted to be paid in euros have been converting them into pounds on the spot market rather than waiting for a more favourable rate (which, of course, might well not materialise). It is generally larger farmers who take payments in euros and they usually have some form of relatively sophisticated risk management in place, including hedging."[36]

It is important to note that under the current Single Payment Scheme, Single Farm Payments often consist of the majority of farmers income, meaning they are very much dependant on these subsidies for farms to remain viable. Looking at figures provided by Inside Track on the composition of farmer's income we can see that for the year 2008/9, SPS payments provided £1,320 million of support to farmers, out of a total net income of £2,910 million, which represented 45.4% of net income. For 2009/10, SPS payments provided £1,520 million in support out of a total net income of £2,430 million, representing 62.6% of farmer's net income for that year.[37] If farmers lost between 45% and 65% of their income they would obviously suffer and many farms would have to make rapid changes or close. In addition, it appears that SPS payments are of more importance to smaller farmers than larger farmers, and without them many smaller farmers would not survive.

Clearly the best policy would be to continue with the existing Pillar 1 (Single Farm Payment) and Pillar 2 schemes in the immediate future. But in the medium term the UK would be at liberty to pursue at domestic level the same reform agenda it continues to push at EU level, but without the constraint of other member states and groups hostile to reform. Other trade distorting measures could be scrapped relatively quickly, eliminating the most harmful remaining components of the CAP. The Government could then take a view on the right levels of agricultural subsides, to meet the needs of UK farmers, consumers and tax payers.

New Zealand provides an example of how Agricultural subsidies could ultimately be eliminated, with the New Zealand Labour Government of the 1980s undertaking a series of free market reforms which removed any income support or protection for their farming industry. Since subsidy removal the agricultural sector has grown faster than the rest of the economy. Agriculture's contribution to the New Zealand gross domestic

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[36] Wyn Grant, 'The European Crisis, Britain and the CAP', commonagriculturalpolicy.blogspot.com, December 21st 2011, http://commonagpolicy.blogspot.com/2011/12/european-crisis-britain-and-cap.html#comments

[37] Inside Track, February 2011, p6

product (GDP) has risen from 14.2% in 1986-87 to 16.6% in 1999-2000 and Agriculture accounts for 11.4% of the total workforce[38].

Looking at tariffs, for reasons argued in Ronald Stewart Brown's Daily Telegraph article, 'Britain must now think through European trade options'[39], the Trade Policy Research Centre has concluded that if the UK were to leave the EU the interests of both parties would be best served by negotiating a new bilateral customs union agreement, so as to retain free movement of goods between the UK and the EU. This would necessitate retaining EU tariffs for most categories of import. However the rules contained in Article XXIV of the General Agreement on Tariffs and Trade (GATT) only requires that "substantially" the same duties and other regulations of commerce are applied by each of the members of a customs union to the trade of countries not included in the customs union.

This would leave scope for the UK to negotiate with the EU for the exclusion from the common tariff commitment of some high tariff agricultural product groups such as sugar. In practice most free trade agreements negotiated under Article XXIV of the GATT exclude significant portions of agricultural trade from their product coverage, and there would seem no reasons why the same principles should not be applied to a customs union agreement.

[38] Laura Sayre, 'Farming without Subsidies', Rodale Institute: http://newfarm.rodaleinstitute.org/features/0303/newzealand_subsidies.shtml

[39] Ronald Stewart-Brown, 'Britain must now think through European trade options' in the Daily Telegraph, January 6th 2012: http://www.telegraph.co.uk/finance/economics/8994679/Britain-must-now-think-through-European-trade-options.html