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Future CAP financing for 2014–2020: Implications for the ACP

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1. CAP spending in context

1.1. How important is the agricultural sector in the EU?

While agriculture in the European Union accounts for less than 1.6% of gross value-added, 5.1% of employment, 6.7% of exports and 5.7% of imports, the contribution of the food and drink sector is far more significant, constituting one of the largest industrial sectors in the EU. For the EU, therefore, the value-added food and drinks sector is of far greater economic value than the agricultural sector *per se*.

Nevertheless, in 2011 direct aid to farmers and market-related expenditures accounted for 30% of the EU budget, while rural development expenditures accounted for a further 11%. This contrasts to an allocation of around 70% of the total EU budget to Common Agricultural Policy (CAP) expenditures in the pre-reform period. EU budgetary expenditures on the CAP have thus been declining as a percentage of total EU budget expenditures for some time (although the initial shift from price support to direct expenditures did boost agricultural expenditures considerably in the first years of the reform process).

EU budget agricultural expenditures however need to be seen from the perspective that agriculture is the main common policy area, and is primarily financed from the common EU budget. Given that the sum of the budgets of the EU member states' budgets is 50 times larger than the EU budget, when payments to agriculture are placed in this context then 'agriculture occupies 11th position in cumulated spending, with only 1.1% of the total, behind research and development' expenditures.

1.2. The structure of EU agricultural spending

Current EU agricultural sector spending is divided between two complementary 'pillars':

- Pillar 1: 'market-related expenditures and direct payments', with a total allocation of €281.8 billion available for the period 2007–2013.
- Pillar 2: various rural development programmes. For the period 2007–2013, some €89.9 billion was allocated to these programmes under the EU budget. However Pillar 2 measures are co-financed by EU member states, and hence the overall level of public sector support is substantially higher than the nominal EU budget.

Within Pillar 1 expenditures, the EU makes use of a wide range of policy tools (see Table 1). How the individual tools are used in individual sectors can have an important bearing on production and trade outcomes.

It is these specific production and trade outcomes which impact on individual sectors and countries across the African, Caribbean and Pacific (ACP) region. Addressing these specific problematical outcomes potentially offers an important area for engagement by ACP governments, both individually and collectively.

This needs to be seen in the context of the importance of these expenditures within the EU farming system. According to the Commission staff working paper released to accompany the EC's proposals of 29 June 2011 for a Council regulation on the multi-annual financial framework, 'direct payments currently account for about 30% of sector income in EU15 and 20% in EU12, with total subsidies accounting for about 40% of sector income'.

This level of financial aid has profound production and trade outcomes. As noted in the World Trade Organization (WTO) 2011 review of EU trade policy, 'in total, during the ten years to 2009, taxpayers and consumers in the EU have transferred nearly €1 trillion to agricultural producers…, which represents a high level of support and keeps production and exports higher, and imports lower, than would otherwise be the case'. As a consequence, despite 20 years of reform, the CAP 'continues to have negative effects both within and outside the EU' (see *Agritrade* article 'Agricultural dimensions of the WTO EU trade policy review', August 2011).

Table 1: The tool box financed from the EU budget

Pillar 1 : €281.8 billion 2014–2020 (proposal)	Pillar 2: €89.9 billion 2014–2020 (proposal)
Traditional market management tools • Minimum price arrangements • Processing aids • Intervention buying and storage • Withdrawals • Export subsidies • Set-aside • Production quotas. **Direct aid payments** • Coupled direct aid payments • Partially decoupled direct aid payments • Decoupled direct aid payments. **Transitional and emergency measures** • Dedicated restructuring funds (e.g. the €8 billion sugar sector restructuring fund) • Emergency measures in response to sector-specific crises (such as the October 2008 €600 million dairy sector initiative). **Other tools** • Horizontal programme of support to veterinary and plant health measures • Horizontal programme of support for the promotion of products on EU and international markets.	**Axis I – Rural Development Investment** (2007–2013: €53 billion, co-financed by EU and member states) • 'Restructuring and modernisation of the agriculture sector' • 'Improving integration in the agrifood chain' • 'Facilitating innovation and access to research and development' • 'Encouraging the take-up and diffusion of information and communication technologies' • 'Fostering dynamic entrepreneurship' • 'Developing new outlets for agricultural … products' • 'Improving the environmental performance of farms'. **Axis II – Improving the environment and countryside** **Axis III – Improving the quality of life in rural areas and encouraging diversification of the rural economy** **Axis IV – building local capacity for employment and diversification (LEADER programmes)**

Pillar 2, the rural development programmes, is organised under the main axes in Table 1, variously aimed at delivering:

- specific environmental goods;
- improving the quality of life and promoting economic diversification in rural areas;
- under Axis I, enhancing the competitiveness of the agriculture and forestry sectors.

Member states generally have considerable flexibility in designing rural development programmes in the light of local needs. The level of expenditures on programmes impacting on the competitiveness of food and agricultural production (Axis I measures) can vary from member state to member state. Overall, however, around €53 billion in public sector financing (from the EU budget and member states) has been mobilised in support of measures explicitly aimed at enhancing the competitiveness of EU food and agricultural sector enterprises in the period 2007 to 2013.

2. The agricultural dimension of the EC's multi-annual financial framework proposal

2.1. The financial framework

Overall, for the 7 years from 2014 to 2020, the EC is proposing to maintain 'market-related expenditures and direct payments' at the same level as for the 2007–13 period. However, from 2014 to 2020 'market related expenditures and direct payments' are projected to decline by 10%, from €42,244 million to €38,060 million. This will see the item in the EU budget fall as a proportion from 29.6% of total appropriations in 2014 to 25.25% in 2020.

Table 2: Market-related expenditures and direct payments: multiannual financial framework (€ millions)

2014	2015	2016	2017	2018	2019	2020	Total 2014–20
42,244	41,623	41,029	40,420	39,618	38,831	38,060	281,825

Source: EC, 'Proposal for a Council Regulation laying down the multiannual financial framework for the years 2014-2020', Annex, COM(2011) 398 final, 29 June 2011.

This development however is in line with the existing trend, which has seen the EU shifting money away from market-related expenditures and direct payments to rural development expenditures (which includes via the vehicle of 'modulation' – setting a cap on total payments to large farmers and transferring these funds to rural development measures, within the national envelope). This reflects the gradual policy shift away from traditional farm subsidies towards what are seen as investment support measures. In this context it should be noted that the proposed multi-annual financial framework envisages the allocation of some €89.9 billion to rural development expenditures for the period 2014–2020. In nominal terms this is similar to the allocation under the EU budget during the 2007–2013 period.

2.2. The chosen scenario for the deployment of funding

In terms of scenarios for the future orientation of the CAP, the EC has rejected the options of a simple continuation of the current policy and the wholesale dismantling of public support to agriculture. The EC has opted for a scenario which includes a streamlining of market instruments, encouragement of more collective action by farmers, and a redistribution of the financial envelope between member states. While the precise structure is still to be determined, it is proposed that payments would be based around the use of different components:

- a basic income support component;
- an area-based payment for naturally handicapped areas;
- a green payment applicable across the whole of the EU;
- a voluntary coupled support element for specific sectors.

Thus coupled payments are to be retained in certain sectors, subject to national policy determination.

A significant innovation in the proposals for the 2014–20 multi-annual framework is the building-in of greater budgetary flexibility. Most notably in the agricultural sector, this includes the establishment of a special reserve with an allocation of €500 million per annum (€3.5 billion for the 7-year period). This introduction of increased budgetary flexibility is a concrete policy response to increased price volatility on global agricultural markets. The explicit aim of this expanded financial provision for safety-net measures is to ensure that sudden price declines do not undermine the basis for agricultural production in the affected sector within the EU.

The detailed rules for the operation of this special reserve have yet to be determined, however it is likely to build on the experience in the EU dairy sector over the period 2008–10.

The policy of 'modulation' is to be continued, with the rate of modulation (i.e. how much money is held back for reallocation) having been progressively increased in recent years. Small farmers by their very nature would be excluded from having these payments capped.

Under this scenario, rural development policy would be better focused on supporting innovation and addressing climate change and environmental issues. The types of interventions allowed would also be streamlined, reducing the number of measures in the 'tool kit' from some 40 to around 20.

Since rural development expenditures are co-financed with member states and reach beyond agriculture and agro-processing activities, it is unclear what overall impact the proposals will have on rural development expenditures that impact on the competitiveness of EU food and agricultural production.

This overall approach to the financial framework for the 2014–2020 period is seen as 'a combination of broad-brush and more targeted measures', designed to better meet long-term objectives. The main challenge is seen as being 'to find ways to keep additional costs for the farming sector reasonable, and management as simple as possible'.

3. Implications for the ACP

Within the EU's broad approach a number of orientations are particularly noteworthy when viewing this issue from an ACP perspective.

3.1. Acknowledging and addressing the external effects of the CAP

In response to the EC proposal for the multiannual financial framework, the European confederation of relief and development NGOs (CONCORD) argued that freezing CAP expenditures in nominal terms 'does not necessarily induce a reduction of the CAP's external impacts, particularly for developing countries'. CONCORD maintains that 'the EU has a global responsibility to promote a sustainable model of agriculture in Europe, while minimising the harmful impacts for the smallholder farmers, who represent 85% of the agricultural sector in developing countries'. However, in getting to grips with this challenge, the principal need is to understand the external effects of deploying the various EU policy tools in various sectors, and how individual ACP countries are affected. Remedial measures can then be set in place to ameliorate the negative effects of the deployment of CAP policy tools on ACP countries.

This is the critical issue to be addressed in the implementation of CAP measures up to 2020, given the trajectory for the CAP implicit in the EC's multiannual financial framework proposals.

3.2. Defraying the costs of new standards through direct aid payments

The existence of a green payment component to direct aid payments, if deployed to support EU farmers in implementing progressively stricter production standards, could become a trade issue. This would occur if at the same time EU production standards were 'internationalised', becoming a prerequisite for imported agricultural products placed for sale on the EU market. In this context, such payments could give EU producers a competitive edge.

3.3. The adjustment displacement effects of insulating EU producers from price volatility

With payment levels being held constant one would expect the contribution of direct aid payments to farm incomes to fall in an era of rising agricultural prices. However, these payments are likely to take on particular significance in times of price volatility. Put simply, in the coming period they are likely to play an even greater role in insulating EU producers from the worst effects of price volatility, thereby ensuring that price volatility does not undermine the basis for agricultural production in the EU.

This raises the question of what the precise impact on ACP agricultural producers will be resulting from the displacement of adjustment costs associated with price volatility to non-EU producers. This will need to be addressed at the level of individual ACP sectors and countries, and will be determined by how in practice the EU deploys the policy tools that will remain available under a reformed CAP.

Developments in the EU dairy sector in the period from 2008 to 2010 are illustrative of the potential impact of these measures in the future. In 2008–09, in the face of a rapid decline in the prices of dairy products (down 30–40% over an 18-month period), the EU initiated a series of safety-net measures to cushion the effects of price reductions on EU milk producers. This saw the ceiling for intervention buying of skimmed-milk powder (SMP) of 109,000 tonnes being abandoned, with eventually some 282,587 tonnes of SMP being bought into intervention. It also subsequently saw a 148% increase in the budget for export refunds (from €181 million to €449 million, although in the face of a recovery in global dairy prices, actual expenditures were €186.4 million, only slightly higher than in 2009). There was nevertheless a 63% expansion in EU SMP exports in 2010.

While Nigeria and Ghana are the main ACP markets for EU exports of milk powder, even relatively small volumes of EU exports to smaller ACP markets can have an impact on the functioning of the local dairy sector. It is still too early to tell what the consequences have been, but the sharp expansion in EU exports could well have disrupted milk supply arrangements in a number of ACP countries, where dairy processors can modify the mix of imported milk powder and local milk in a range of dairy products, in the light of the price and availability of SMP imports. There is thus a distinct possibility that this by-product of the EU safety-net policy (i.e. increased exports of milk powder from EU intervention stores) could have inadvertently disrupted the development of long-term milk supply arrangements in ACP countries.

This highlights the importance of dovetailing the deployment of EU policy tools in particular sectors with ACP development strategies in these sectors. Significantly, within the EU system the scope exists for tailored deployment of EU policy tools in support of ACP sector development strategies. These opportunities need to be systematically exploited, based on clear decisions by individual ACP governments on how trade in particular agricultural commodities can be regulated to support domestic strategies for the development of specific agricultural sectors.

3.4. Continuation of coupled payments and the cotton sector

The EU's commitment to the continued use of sector-specific coupled payments is likely to carry implications for ACP cotton producers. This is particularly the case since in 2011 some €256 million was being deployed in the form of coupled cotton sector assistance. With coupled assistance only 35% of the total level of assistance made available from the public purse to EU cotton farmers, this could mean that when world cotton prices fall, EU cotton producers are partially insulated from the income consequences of these price declines, with production consequently being sustained at higher levels than would be the case in the absence of such payments.

This gives added importance to the WAEMU cotton initiative launched in March 2011 to put cotton sector reform back on the top of the WTO agenda and to ensure that proposals are tabled as part of the CAP reform process (and US Farm Bill review) to eliminate the current distortions on international cotton markets arising from OECD agricultural support programmes (see *Agritrade* article, 'WAEMU cotton initiative launched', April 2011).

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