The EU Budget at Risk of a New Policy Blunder

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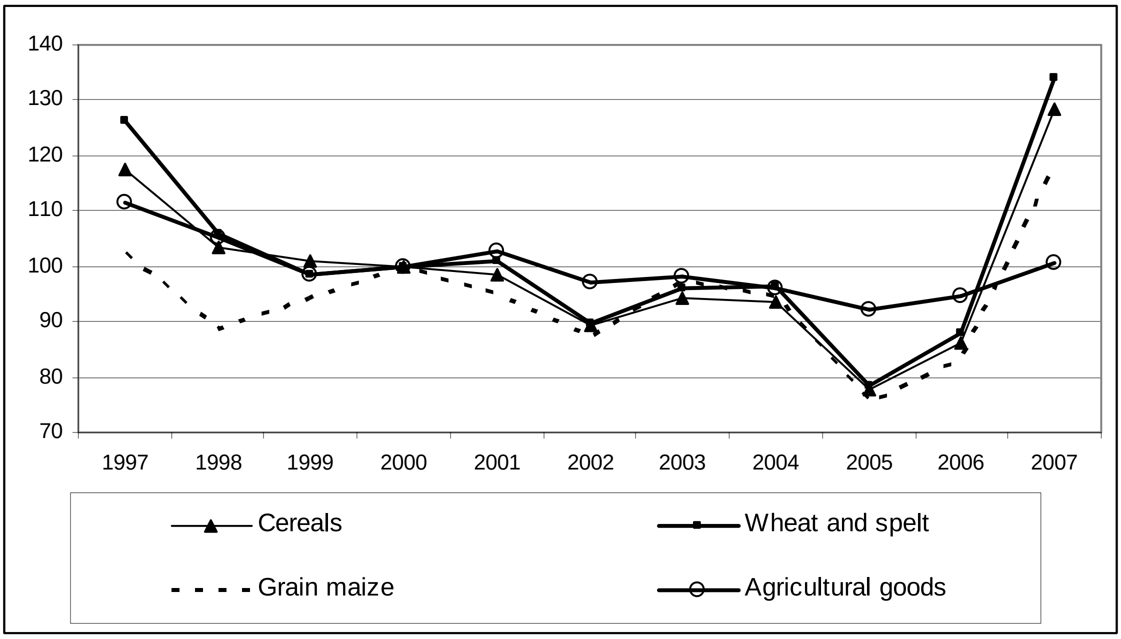
It was expected that concrete proposals for the review of the EU budget would be advanced this year, but we seem to be even further away from this important policy exercise than we were in 2005. The European Commission has finished a round of public consultation, but is under pressure to refrain from making any proposals until after the French Presidency and even further until after the European Parliament elections in 2009 (and probably not before a new European Commission is in place). Such delays, perhaps even until 2010, may turn out to be beneficial, as there seems to be a lack of direction on how to proceed, but it may also serve as a pretext to block *ex-ante* any meaningful reform of the Common Agricultural Policy in a way that is reminiscent of previous such attempts.

The food sector is in the throes of crisis worldwide: bad harvests and the diversion of food crops to produce biofuels have created shortages and the linking of the price of cereals to the price of oil has triggered a chain reaction throughout the agricultural sector. In combination, these factors have increased costs across the food industry at a time when demand for meat is also rapidly rising in emerging markets, with heavy requirements for animal feed. In dollar terms, the price for some cereals has more than doubled in the world market.

This situation is being used by the French Presidency as grounds for defending the CAP in the name of food security and as a weapon to fight price volatility. In reality, however, the CAP is ill-suited to address the present concerns and an increase in subsidies is unjustifiable. Nor does the French government seem to be considering a fundamental reallocation of present agricultural subsidies.

In Europe, the current price crisis also has to be viewed against a bit of historical background. Prices of agricultural products have declined over the last decade in real terms, and thus the increases in the last two years have been rather limited, as shown in the figure below.

Deflated price index of agricultural products (year 2000=100)



Source: Eurostat.

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The strong euro has also clearly benefited Europe as far as prices are concerned, as euro-denominated oil and food products have increased less. Thus, in relation to other parts of the world, consumers and producers in the EU have benefited from lower costs.

Export price increases for the period 6 June 2007 to 6 June 2008

	In dollars	In euro
WHEAT (US HRW - Gulf)	63.4%	41.6%
WHEAT EU (France Standard) - Rouen	38.6%	20.1%
MAIZE (US 3YC - Gulf)	62.7%	40.9%
BARLEY (EU (France) - Rouen)	34.9%	16.9%
SOYBEANS (US No.2 - Gulf)	83.1%	58.7%
SOYBEANS (Argentina - Up River)	83.6%	58.9%
RICE (Thai 100% Grade B - Bangko)k	160.5%	125.7%

Source: International Grains Council data.

It seems odd to defend subsidies, as real agricultural incomes have been increasing over the last few years and, according to Eurostat data, rose by 5.4% in the EU27 in 2007. The actual figures vary from one member state to another – at the top of the league stands Lithuania with 39.3% along with some other new member states, but also old member states registered important increases, such as Sweden (16.5%), Finland (14.4%), Germany (12.5%), Spain (10.3%), Austria (8.8%) and France (7.5%). Only 7 member states experienced a decline in income from the agricultural sector. The differences are based on the weight of products, with cereal producer prices increasing 46% in 2007, while other prices like pig meat or olive oil fell by 12% and 19%, respectively.

The political outrage over high prices and the call for policy intervention also seem contradictory (if not hypocritical), since it was the CAP that artificially kept prices well above world prices in the past. Now that the market is the culprit, this is regarded as a dangerous development.

There is no need for more subsidies, for producers will certainly react to high prices and produce more cereals. While high prices may not fall in the foreseeable future to the same levels of three years ago, there are a couple of reasons to believe that there will be an important reversal soon. First, prices will increase supply and the increased supply will bring prices down. Second, there is no shortage of land. In fact, there is a substantial amount of idle agricultural land. According to the FAO, land under cultivation in the former Soviet Union has fallen by over 30 million hectares since the 1980s. These lands will eventually be farmed again, especially under high world prices. Moreover, a quick and more cost-effective strategy would be to invest in technical assistance to improve production technologies in developing countries, which are producing well below their capacity. This would make a large contribution not only towards allowing them to feed their own people, but towards developing their agricultural economies. Let us not forget that subsidised excess production in developed countries is often considered a cause of low local production in poor countries.

For longer-term concerns in the food industry, investment in agricultural research (which has been declining for many years), rather than subsidies, could make an important difference for the future. For example, funds could be directed towards creating second-generation biofuel technologies that are not based on cereals and towards developing new (e.g. high yielding, stress and disease resistant) crop varieties. It is probable that the French Presidency will seek to strike a deal in the name of world food security to maintain (if not increase) the present budgetary allocation for the CAP for the next Financial Perspectives, similar to the agreement struck between Chirac and Schroeder in 2002. We risk suffering through another period of budget sclerosis and waste. Without a Lisbon Treaty and a meaningful budget, the coming years of the EU look uninspiring at best and worryingly decadent at worst.