

# **The New Context of the Agricultural Debate in Europe**



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**THE NEW CONTEXT OF THE AGRICULTURAL  
DEBATE IN EUROPE**

Franklin DEHOUSSE & Peter TIMMERMAN



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\* \* \*

**Egmont - The Royal Institute for International Relations**

Address Naamsestraat / Rue de Namur 69, 1000 Brussels, Belgium  
Phone 00-32-(0)2.223.41.14  
Fax 00-32-(0)2.223.41.16  
E-mail [info@egmontinstitute.be](mailto:info@egmontinstitute.be)  
Website: [www.egmontinstitute.be](http://www.egmontinstitute.be)

© Academia Press  
Eekhout 2  
9000 Gent  
Tel. 09/233 80 88 Fax 09/233 14 09  
[Info@academiapress.be](mailto:Info@academiapress.be) [www.academiapress.be](http://www.academiapress.be)

J. Story-Scientia bvba Wetenschappelijke Boekhandel  
Sint-Kwintensberg 87  
B-9000 Gent  
Tel. 09/225 57 57 Fax 09/233 14 09  
[Info@story.be](mailto:Info@story.be) [www.story.be](http://www.story.be)

Lay-out: [proccess.be](http://proccess.be)

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# Introduction

The Common Agricultural Policy (CAP) of the European Union (EU) was created in the early 1960s. During its first three decades, it was very successful, and European agriculture produced large surplus rather than deficits by the 1980s. This led to ever increasing market interventions in order to buy the surpluses and to subsidize the exports. Opponents of the CAP were thus offered useful arguments to question the budgetary and ethical consequences of the policy. In the framework of international trade negotiations in the GATT, and later WTO, the CAP also became unacceptable due to its increasing trade distorting character. The combination of internal European and international criticism led to three major CAP reforms since 1992<sup>1</sup>.

The first reform in 1992 reduced the level of the intervention prices of cereals, oilseeds and protein products, dairy products, beef, sheep and goat and tobacco. As compensatory measure, farmers were entitled to direct payments based on previous yields so their income was guaranteed, notwithstanding their lower level of production<sup>2</sup>. Other mechanisms to reduce production were also introduced, such as a scheme to set aside arable land<sup>3</sup>, an afforestation scheme<sup>4</sup>, an early retirement scheme<sup>5</sup> and an agri-environment scheme<sup>6</sup>.

A second large reform was approved in 1999, better known as the Agenda 2000 reform. The emphasis of CAP shifted further to direct income payments instead of production-based support<sup>7</sup>. The reforms focused on the grain, beef, oilseeds and dairy common market organisations (CMOs). Besides, a budgetary framework was introduced by the Agenda 2000 reforms for the period 2000-2006, with fixed annual expenditure ceilings<sup>8</sup>. Nonetheless, the most important change was the introduction of a double pillar structure to finance CAP expenditures. The first pillar, the Guarantee section, consisted of market measures and direct income payments to farmers. The second pillar, the Guidance section, focused on rural development measures<sup>9</sup>. Although the budgetary implications of this shift were initially modest, it was an important change in the overall

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1. For a detailed examination of the original regulations and of the first reforms, see DEHOUSSE, Franklin and VINCENT, Philippe, *L'éternelle Réforme de la Politique Agricole Commune et les Limites d'Agenda 2000*. In: *Studia Diplomatica*, Vol. LI, 5, 1998, pp. 1-132. (legal references and bibliography included)

2. Regulation 1765/92. (OJ 1992 L181/12-20)

3. *Ibid.* (OJ 1992 L181/12-20)

4. Regulation 2080/92. (OJ 1992 L215/96-99)

5. Regulation 2079/92. (OJ 1992 L215/91-95)

6. Regulation 2078/92. (OJ 1992 L215/85-90)

7. Regulation 1259/1999 (OJ 1999 L160/113-118)

8. Regulation 2040/2000. (OJ 2000 L244/27-32)

9. Regulation 1258/1999. (OJ 1999 L160/105)

orientation of CAP. A comprehensive rural development policy was designed, which included elements such as environmentally friendly agriculture, food safety and animal welfare<sup>10</sup>.

The CAP enters a new phase, linked to diverse evolutions. It is important to understand them. Different elements must be taken into consideration: the last 2003 reform (§ 1), the subsequent adaptations (§ 2), the evaluations (§ 3), the evolution of the international markets (§ 4).

Franklin DEHOUSSE & Peter TIMMERMAN<sup>11</sup>

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10. Regulation 1257/1999. (OJ 1999 L 160/84-87)

11. F. Dehousse is Professor at the University of Liège and Judge at the Court of first instance of the European Communities. Peter Timmerman is Researcher at the Egmont Institute. This comment is a personal one and does not represent the opinions of the institutions to which they belong

# 1. The 2003 Reform

The “mid-term” Review in 2003 had to address several different concerns. To net-contributing Member States, rising expenditure related to CAP represented a threat. On the eve of the EU-enlargement with 10 new Member States (NMS), fears for total derailing of the CAP budget lingered. European consumers, shocked by food crisis such as BSE or foot and mouth, expected nothing less than products of the highest standard. Internationally, EU CAP was one of the reasons why the Doha Round in the WTO-negotiations remained deadlocked<sup>12</sup>. In Luxemburg, the European agricultural ministers agreed on further CAP reforms in line with the previous reforms of 1992 and 1999 that would adapt CAP to the concerns at hand.

## 1.1. Objectives and scope

As often in agriculture, the reform envisaged many objectives: a competitive agricultural sector; production of quality products in an environmentally friendly way; a fair standard of living and income stability for the agricultural community; diversity in forms of agriculture, maintaining visual amenities and supporting rural communities; simplicity in agricultural policy and the sharing of responsibilities among the Commission and Member States; and justification of support through the provision of services that the public expects farmers to provide<sup>13</sup>.

In general, however, three main lines of reform can be pointed out: (1) improving the competitiveness and the market orientation of agriculture, while at the same time avoiding a budgetary derailing; (2) enhancing rural development, so that it can continue to provide rural public services; and (3) delivering production of the highest quality standards with respect for environmental sustainability, public, animal and plant health and animal welfare.

Regarding the scope of the reform, not all CMOs were included immediately as of 2003. The reforms did apply to the following products: durum wheat, protein crops, rice, nuts, energy crops, starch potatoes, milk, seeds, arable crops, sheep

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12. LE ROY, Anne, La politique agricole commune: 20ans de transformation et d’insertion mondiale., Revue de Marché commun et de l’Union européenne, No. 505, Février 2007, p. 119.

13. Communication from the Commission to the Council and the European Parliament: Mid-Term Review of the Common Agricultural Policy, European Commission, 10 July 2002, p. 2, COM(2002)394.

meat and goat meat, beef and veal and grain legumes<sup>14</sup>. Other CMOs would be dealt with in the following years.

## 1.2. Principles

The 2003 reforms were based on a set of general principles: (1) decoupling, (2) the single payment scheme, (3) cross-compliance, (4) modulation and (5) financial discipline.

### 1.2.1. *Decoupling*

Decoupling was introduced to remove the link between direct payments and production. Prior to the reform, farmers were entitled to receive direct payments only if they produced particular commodities. The receipt of direct payments influenced the profitability of growing particular crops or producing particular types of animals and thus affected farmers' business decisions. Decoupling income support enabled the farmers to select their business activities according to market demand. The reform shifted CAP support from production support to producer support<sup>15</sup>. In international trade negotiations, production-linked subsidies were more and more seen as trade-distorting and therefore unacceptable. Since 2003, a limited number of exceptions per sector ('partial decoupling' or 'recoupling') were allowed if disturbance of agricultural markets or risk of abandonment of production was feared by moving to the single payment scheme<sup>16</sup>.

Member States also have the option to take up 10% of their total national aid entitlement to be used for additional sectoral payments. These additional payments are taken from the direct payments to farmers and thus reduce the funds for basic SPS payments. This so-called 'national envelope' should be used to support agricultural activities that encourage the protection of the environment or for improving the quality and marketing of agricultural products<sup>17</sup>. Although this national envelope is clearly not meant as a way to recouple payments, its opaque formulation leaves an opportunity to do so.

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14. Regulation 1782/2003 (OJ 2003 L 270/7)

15. Ibid. (OJ 2003 L 270/4)

16. In specific, (1) up to 25% of arable area aid payments or 40% of durum wheat supplement, (2) up to 50% of sheep and goat payments and (3) up to 100% of suckler cow premium and 40% of slaughter premium or 100% of slaughter premium or 75% of beef special premium were allowed to remain coupled (OJ 2003 L 270/23-24)

17. Regulation 1782/2003. (OJ 2003 OJ270/24)

### 1.2.2. *Single Payment Scheme*

The single payment scheme (SPS), which is also referred to as single farm payment, was the instrument used to broaden the principle of decoupling. Through SPS, farmers received a single annual payment which replaced different previous premia. Three approaches were designed to calculate SPS: the basic or historic approach, the regional or flat rate approach and a mixed model. Calculations were in each model based on the average of payments received during the reference period 2000-2002. Member States were free to choose which calculation model to apply<sup>18</sup>.

Under the basic approach, each farmer is granted entitlements based on the individual payments received during the reference period (reference amounts) and the number of hectares he was farming during the reference period and which gave right to direct payments<sup>19</sup>. In the regional or flat rate approach, the sum of payments received by all farmers in a country or region during the reference period constitutes the reference amounts. Thus, reference amounts are not calculated at individual farmer level but at regional level. The reference amounts are then divided by the total number of eligible hectares declared by farmers in that region, which gives the value of 1 entitlement in that region. Finally, each farmer receives the number of entitlements declared eligible<sup>20</sup>. This system of calculation entails a redistributive effect at regional level<sup>21</sup>.

Member States were also left with a range of hybrid systems of calculation, such as the possibility to combine the historic and the regional model in different regions of their territory or a calculation partly based on the historic approach and partly on the regional. Further variation could also be introduced between a static or a dynamic system. In a dynamic system, there would be a transition period to move from historic to the regional model<sup>22</sup>.

Since SPS replaces several existing premia by one single scheme, it can thus also be seen as a technical simplification<sup>23</sup>.

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18. Ibid. (OJ 2003 L 270/15)

19. Ibid. (OJ 2003 L 270/16-18)

20. Ibid. (OJ 2003 L 270/21)

21. The 2003 CAP reform: Single Payment Scheme – The concept: Information Sheets, European Commission, p. 2, 24 January 2005. Accessed, 17 October 2007, [http://bookshop.europa.eu/eubookshop/FileCache/PUBPDF/KF6004733ENC/KF6004733ENC\\_002.pdf](http://bookshop.europa.eu/eubookshop/FileCache/PUBPDF/KF6004733ENC/KF6004733ENC_002.pdf)

22. Regulation 1782/2003 (OJ 2003 L 270/21-25)

23. The 2003 CAP reform: Single Payment Scheme – The concept: Information Sheets, o.c., p.1.

### 1.2.3. *Cross-compliance*

In order to receive full direct payments, independent of being coupled or decoupled, a farmer will have to respect cross-compliance standards. These cross-compliance standards are related to the environment, public, animal and plant health and animal welfare in agricultural production and land management. Observance of the cross-compliance standards was made compulsory. Failure to meet the cross-compliance standards can result in deductions from, or exclusion of direct payments. The reductions will be based on the severity, the extent, the permanence, the repetition and the intentionality of the non-compliance<sup>24</sup>.

The system of cross-compliance is constituted out of two components: the maintenance of good agricultural and environmental conditions (GAEC) and the statutory management requirements (SMRs).

Regardless if actual producing is taking place, a farmer must maintain his land in GAEC, which relate to four issues: soil erosion, soil organic matter, soil structure and minimum level of maintenance. It was left to the Member States to define the minimum requirements in the 4 domains designated and to ensure its compliance<sup>25</sup>. These rules were new in 2003 and covered an area of which the regulatory basis had been very limited until then<sup>26</sup>. The SMRs relate to 18 environmental, public, animal and plant health and animal welfare standards that a farmer has to comply with. The introduction of the SMRs did not create new obligations for farmers, since the legislation in question did already exist<sup>27</sup>. Thus, the system of cross-compliance bundled the existing legislation, facilitating its enforcement by Member States and creating more awareness among farmers.

All Member States had to set up a system of farm audits from 2007 on, in order to help farmers meet the cross-compliance standards. The system must advise farmers on a voluntary basis on land and farm management processes, notably in relation with the environment, food safety and animal welfare. Farmers receive feedback on how standards and good practices can be applied in the production process<sup>28</sup>.

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24. Regulation 1782/2003 (OJ 2003 L 270/8-9)

25. Ibid. (OJ 2003 L270/8)

26. Evaluation de l'Impact sur l'Environnement des OCM et des mesures de soutien direct relatives aux cultures arables, GEIE Alliance Environnement, July 2007, p. 94. Accessed, 14 December 2007, [http://ec.europa.eu/agriculture/eval/reports/ocm/full\\_text\\_fr.pdf](http://ec.europa.eu/agriculture/eval/reports/ocm/full_text_fr.pdf)

27. Regulation 1782/2003 (OJ 2003 L270/56-57)

28. Ibid. (OJ 2003 L270/10)

### 1.2.4. *Modulation*

Modulation is the process whereby the direct payments made to farmers (pillar 1) are reduced by a certain percentage, after which the funds made available in this way are transferred to finance rural development measures (pillar 2).

The mechanism of modulation was first introduced in the Agenda 2000 reform, on a voluntary basis. The possibility was created for Member States to reduce direct payments to farmers from the Guarantee section of the European Agricultural Guidance and Guarantee Fund (EAGGF) with maximally 20% in favour of the Guidance Section of EAGGF<sup>29</sup>. Its initial success was limited, since only the United Kingdom applied the voluntary modulation facility since 2001 to fund its agri-environmental scheme: the Entry Level Stewardship<sup>30</sup>.

The 2003 reform made modulation compulsory to all Member States and intensified its scope. Gradually, all direct aid to farmers and market measures were being reduced, however, direct payments up to €5,000 remained untouched for all farmers. After a phasing in period (3% in 2005; 4% in 2006), the annual modulation rate was set at 5% from 2007 onwards to 2012<sup>31</sup>. This resulted in €1.2 billion of extra funds for rural development measures per year in that period<sup>32</sup>. The allocation of the money among Member States is not on a 1 for 1 basis<sup>33</sup>.

Besides the system of compulsory modulation from 2005, the option for Member States to apply voluntary modulation was maintained as well. The maximum rate of combined compulsory and voluntary modulation was limited to 20% of the direct payments received by a farmer. From 2005 on, the funds made available for pillar 2 by voluntary modulation were to be applied on a regional level, a measure which was designed in order to allow the British regions England, Northern Ireland, Scotland and Wales to apply different rates<sup>34</sup>.

29. Regulation 1259/1999 (OJ 1999 L160/114-115)

30. Further information: Modulation questions & answers. Department for Environment, Food and Rural Affairs. Accessed, 10 December 2007, <http://www.defra.gov.uk/farm/singlepay/further-info/modulation.htm>

31. Regulation 1782/2003. (OJ 2003 L 270/9)

32. Decision 2006/410/EC. (OJ 2006 L 163/11)

33. The allocation key takes into account the Member States' agricultural area (weight of 65%) and agricultural employment (35%), after adjustment in function of the relative GDP/capita in purchasing power standard [Regulation 796/2004 (OJ 2004 L141/51-52)]. However, at first instance Member States retain 1 percentage point of the total amount of modulated funds. Secondly, Member States which received less than 80% of their modulated amount, are allocated an additional amount to ensure that the minimal level of 80% of modulated money remains in the same Member State. Under certain conditions, which were related to the abolition of rye intervention, a return of 90% was guaranteed [Regulation 1782/2003 (OJ 2003 L270/9)]. This applied to Germany.

34. Regulation 1655/2004 (OJ 2004 L298/3-5)

### 1.2.5. *Financial Discipline*

A financial discipline mechanism was provided for from 2007 onwards, in order to keep budgetary spending in check. The mechanism specifically targets market measures and direct aids, the expenditures from pillar 1. If projections indicate that the expenditures come within a margin of €300 million of the budgetary ceiling, an adjustment of payments will be proposed by the Commission<sup>35</sup>.

### 1.2.6. *Conclusion*

Though modestly baptized mid-term review, the 2003 reform was essential in more than one aspect. The single payment scheme, associated with cross-compliance, was the logical conclusion of decoupling. Another fundamental aspect was the greater autonomy given to the Member States in the framework of the CAP. They are provided with considerable flexibility on the implementation of the reform. The basic principles are fixed on EU level, such as the principle of decoupling, the modulation percentages, basic cross-compliance standards and the introduction of a financial discipline mechanism. When it comes to informing, controlling and sanctioning farmers on standards and the type of calculation for SPS, Member States take the leading role<sup>36</sup>. They can also define the method of calculation of SPS, and some aspects of modulation.

From the financial point of view, the reform has provoked a very heavy rebalancing of outlays, due to the rise of decoupled payments. This was of course linked to the development of the WTO Doha Development Round<sup>37</sup>.

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35. Ibid. (OJ 2003 L270/10)

36. Ibid. (OJ 2003 L270/8-16)

37. See GARZON, Isabelle, A changing global context in agricultural policy, in N. CHAMBON coord., *What future framework for agriculture after 2013?*, Paris: Notre Europe, 2008, pp. 1-38.

## 2. Subsequent Changes

### 2.1. The 2004 enlargement

In 2004, the accession of 10 new Member States<sup>38</sup> (NMS) to the EU had a considerable influence on European agriculture. Firstly, in the larger EU, the number of consumers has increased by a fifth. Secondly, agriculture is still far more economically and socially important in the NMS than in the EU-15. A few data are revealing: the total area dedicated to agriculture reaches 22% in the NMS, 4% in the EU-15; the share of agricultural workers in the total working population is 13% in the NMS, 1.6% in the EU-15; the share of agriculture in GDP is 2.8% in the NMS and 1.6% in the EU-15<sup>39</sup>.

Initially, some transitional measures were required in order to integrate the NMS into the CAP without radical budgetary shocks for the EU-15. In general, however, NMS applied the agricultural elements of the Community acquis from 1 May 2004. Farmers had immediate access to CAP market measures, such as export subsidies and intervention mechanisms. However, the annual increase of expenditure in nominal terms for market-related expenditure and direct payments (pillar 1) in the period 2007-2013 was limited to 1% per year. Direct payments were being gradually phased in over a period of 10 years. Beginning in 2004 at a level of 25%, direct payments were to be increased by three steps of 5% to reach 40% of the EU level in 2007. From then on, steps of 10% were taken so as to reach 100% in 2013<sup>40</sup>.

The NMS could opt to use the standard system of direct payments (SPS) or a simplified scheme until the end of 2008, the single area payment system (SAPS). SAPS provided for a uniform amount per hectare of agricultural land, up to a national ceiling resulting from the accession agreements. Agricultural land included arable land, permanent grassland, permanent crops and kitchen gardens<sup>41</sup>. SAPS was specifically designed because of its administrative simplicity, so it would later on be easier to switch to the SPS. Both SPS and SAPS are built on the base principle of decoupling.

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38. Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia and Slovenia.

39. Report on the integration of the new Member States into the CAP, European Parliament, Committee on Agriculture and Rural Development, 1 March 2007, p. 12. (PE 378.713v02-00)

40. Presidency Conclusions. Brussels European Council of 24 and 25 October 2002. Council of the European Union, Brussels, 26 November 2002, p. 5. (14702/02)

41. Decision 2004/281/EC (OJ 2004 L93/7)

The NMS were given the possibility to complement or top-up the direct payments in two ways. Either a maximum complement of 30%, funded by national resources<sup>42</sup>, or, in the first three years, by shifting up to 20% of rural development funds to direct payments<sup>43</sup>. Direct payments could maximally be complemented up to a level that is 10% higher than the level applied before accession. For the purpose of stimulating the cultivation of energy crops and because Member States applying to SAPS were not entitled to the energy crops scheme, complementary national direct payments for energy crops were allowed if approved by the Commission. The total amount of direct payments of a farmer was never to exceed the level applied in the EU-15<sup>44</sup>.

The system of cross-compliance was only partially mandatory for Member States under SAPS. Only the condition of good agricultural and environmental condition applies. For those NMS that chose to use SPS, cross-compliance applied fully<sup>45</sup>. Modulation and the financial discipline mechanism did not apply until the NMS were phased in completely.

A framework for Community support for sustainable agriculture and rural development for NMS had been set up in 1999, several years prior to accession. The Special Accession Programme for Agriculture and Rural Development (Sapard) had to facilitate the implementation of the Community acquis<sup>46</sup>. From 2004 on, NMS were entitled to all existing measures concerning rural development. On top of that, another transitional rural development regime was set up for the period 2004-2006: the Temporary Rural Development Instrument (TRDI). Funded by the Guarantee section of EAGGF<sup>47</sup>, TRDI supported the following specific rural development measures: farms undergoing restructuring, establishing producer groups, compliance with Community standards, technical assistance and complements to direct payments. Additionally, NMS could also benefit 'Leader +' -type measures, which support local partnership initiatives<sup>48</sup> and were funded by the Guidance section of EAGGF<sup>49</sup>.

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42. Ibid. (OJ 2004 L93/9)

43. Ibid. (OJ 2004 L93/6)

44. Ibid. (OJ 2004 L93/9)

45. Ibid. (OJ 2004 L93/7)

46. Regulation 1268/1999. (OJ 1999 L161/89)

47. Regulation 27/2004. (OJ 2004 L5/36-38)

48. Act concerning the conditions of accession of the Czech Republic, the Republic of Estonia, the Republic of Cyprus, the Republic of Latvia, the Republic of Lithuania, the Republic Hungary, the Republic of Malta, the Republic of Poland, the Republic of Slovenia and the Social Republic and the adjustments to the Treaties on which the European Union is founded. (OJ 2003 L236/365-367)

49. Regulation 583/2004. (OJ 2004 L91/2)

## 2.2. Consecutive reforms

The 2003 reforms were followed by a cycle of CMO reforms along the same basic principles. In 2004 the Agricultural Council agreed to reform the olive oil, cotton, tobacco and hop sectors<sup>50</sup>.

The Agricultural Council agreed on a reform of the CMO for sugar in 2005. It introduced substantial cuts in reference prices (up to 36% in 4 years) and cuts in minimum prices of sugar beet. The loss of income was compensated for by a decoupled direct payment and sugar beet grown for non-food purposes was entitled to set-aside payments and payments for energy crops. Special arrangements were made for countries that enjoyed special trade agreements with the EU<sup>51</sup>. A special 4-year transitional restructuring scheme was set up to encourage producers to close shop<sup>52</sup>.

An agreement on the reform of the CMO in bananas was reached in 2006<sup>53</sup> and on the CMO in fruit and vegetables in 2007<sup>54</sup>. Currently a proposal of reform for the CMO for wine<sup>55</sup> and cotton<sup>56</sup> is circulating. A previous reform of the CMO of cotton in 2004 was annulled by the European Court of Justice in 2006, because the Court concluded that infringement of the proportionality principle had occurred<sup>57</sup>.

The financing instruments of CAP have also been reformed. The European Agricultural Guidance and Guarantee Fund (EAGGF), created in 1962, was from 2007 onwards replaced by two funds: the European Agricultural Guarantee Fund (EAGF) and the European Agricultural Fund for Rural Development (EAFRD).

The EAGF was designed to replace the Guarantee section of the former EAGGF. EAGF finances expenditures such as export subsidies, intervention measures, direct payments and certain informational and promotional measures. These expenditures are mostly related to first pillar measures and are jointly managed

50. Regulation 864/2004. (OJ 2004 L161/48-96)

51. Regulation 318/2006. (OJ 2006 L58/4-17)

52. Regulation 320/2006. (OJ 2006 L58/42-50)

53. Regulation 2013/2006. (OJ 2006 L384/13-19)

54. Regulation 1580/2007. (OJ 2007 L350/1-98)

55. Proposal for a Council Regulation on the common organisation of the market in wine and amending certain regulations, European Commission, 4 July 2007, 96 p. COM(2007)372.

56. Proposal for a Council Regulation amending Regulation (EC) No 1782/2003 establishing common rules for direct support schemes under the common agricultural policy and establishing certain support schemes for farmers, as regards the support scheme for cotton, European Commission, 9 November 2007, 14 p. COM(2007)701.

57. Judgement of the Court (Second Chamber), 7 September 2006, Case C-310/04.

by the Commission and the Member States. Besides, expenditures concerning specific veterinary measures and inspections, promotion, farm accounting information systems and farm survey systems will be managed centrally by the Commission<sup>58</sup>.

The EAFRD is replacing the former Guidance section of the EAGGF and will serve to finance measures related to the Rural Development Policy. As a way of achieving the Community objectives set in the Rural Development Policy and in order to guarantee a balanced global approach between Member States, a minimal contribution for each of the 4 axis is required in each Member State (10% for axis 1 and 3; 25% for axis 2; 5% for Leader)<sup>59</sup>. The expenditure will be jointly managed by the Commission and the Member States<sup>60</sup>.

Rural development measures require co-financing by the Member States on top of the Community funds provided through EAFRD. The EAFRD contributes minimally 20% and maximally 50% for axis 1 and 3 or 55% for axis 2 and Leader axis. For areas eligible under the Convergence Objective (regions whose GDP per capita is less than 75% of the EU average), respective EAFRD contribution can even amount up to 75 or 80%<sup>61</sup>. Portugal will not be subject to the national co-financing requirement<sup>62</sup>.

### **2.3. The new agreement on the financial perspectives**

Traditionally, the lion's share of European budget is spent on CAP. Since the end of the 1970s, the share of CAP expenditures in the total budget has decreased significantly from over 75% to some 45% in 2006<sup>63</sup>. In 2006 an Interinstitutional Agreement fixed the budgetary amounts per domain in a multiannual financial framework for the period 2007-2013.

It was difficult to come to a multiannual financial framework acceptable to all institutions. During the compromising process, the Commission's initial proposal was slashed from €1,025 billion to €864 billion. Paradoxically, the prin-

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58. Regulation 1290/2005 (OJ 2005 L209/6)

59. Regulation 1698/2005 (OJ 2005 L277/13); For more details on the 4 axis, see: 2.4 Rural Development Policy.

60. Regulation 1290/2005 (OJ 2005 L209/7)

61. Regulation 1698/2005 (OJ 2005 L277/28)

62. Regulation 1944/2006 (OJ 2006 L367/24)

63. RUDLOFF, Bettina, New budget priorities for the Common Agricultural Policy, In: EU Monitor 40, Deutsche Bank Research, 30 November 2006, p. 1. Accessed, 30 October 2007, [http://www.dbresearch.com/PROD/DBR\\_INTERNET\\_EN-PROD/PROD0000000000204375.pdf](http://www.dbresearch.com/PROD/DBR_INTERNET_EN-PROD/PROD0000000000204375.pdf)

cial victims were two of the EU's priorities. The "economic competitiveness" policy was reduced by €60 billion despite the importance attached to the Lisbon Strategy and the Cohesion Policy was reduced by €30 billion notwithstanding the accession of 12 NMS since 2004.

At the same time, the CAP budget was left fairly untouched. The compromise did reduce the heading of 'Preservation and Management of National Resources' with €27 billion, totalling €371 billion for the period 2007-2013. However, the clarification on how much of this budget is to be allocated to pillar 1 measures (market related expenditure and direct payments in agriculture) revealed that only €8 billion had been deleted from the original proposal, leaving the budget for pillar 1 at €293 billion. The agricultural budget was only so minimally affected, because the Member States had agreed back in 2002 on a ceiling for CAP expenditures and no consensus existed to change this agreement again in light of the financial framework. The 2002 compromise stated that the budget could grow maximally by 1% per year in nominal terms in the period 2007-2013 compared to 2006<sup>64</sup>.

Agriculture and rural development, along with environment, resorted under a new heading: 'Preservation and Management of National Resources'. The annual breakdown of the budget for 'Preservation and Management of National Resources' reveals that it is going to decrease gradually from about €55 billion per year to slightly over €51 billion. Four fifths of this budget (€43 billion in 2007 decreasing to €41 billion in 2013) was earmarked for first pillar expenditures: market measures and direct payments<sup>65</sup>. However, compulsory modulation was not yet calculated and would thus further reduce the share of first pillar expenditure<sup>66</sup>.

Concerning the second pillar of rural development, the allocations for EAFRD amounted in total to €88.3 billion during the period 2007-2013, resulting in an annual average of about €12.5 billion for pillar 2 measures<sup>67</sup>. The total amount of €88.3 billion is composed of 3 separate parts: (1) transfers from the EAGF to EAFRD worth €41.2 billion<sup>68</sup> and (2) an additional €27.7 billion which is transferred to EAFRD from the regional component of the Convergence Objec-

64. Presidency Conclusions. Brussels European Council of 24 and 25 October 2002, o.c., p. 5. (14702/02)

65. Interinstitutional Agreement between the European Parliament, the Council and the Commission on budgetary discipline and sound financial management. (OJ 2006 C139/10)

66. Final Comprehensive Proposal on the Financial Perspectives 2007-2013 from the Presidency. Council of the European Union, Brussels, 19 December 2005, p. 23. (15915/05)

67. Decision 2007/383/EC (OJ 2007 L142/21-22)

68. Final Comprehensive Proposal on the Financial Perspectives 2007-2013 from the Presidency, o.c., p. 24. (15915/05)

tive of the Cohesion Policy<sup>69</sup>. (3) On top of that, €18.5 billion is added resulting from modulation and other agreed transfers, such as in the CMO of cotton and tobacco.

These numbers reveal that first pillar measures still constitute the largest share of CAP expenditures, despite the rhetorical support for rural development policies<sup>70</sup>. On the one hand, the relative importance of the second pillar in relation to the first pillar of CAP has increased significantly when comparing the financial frameworks of 2000-2006 and 2007-2013. For the period 2000-2006, second pillar budget was 11.4% of that for the first pillar<sup>71</sup>, while in next 7 years, the budget for rural development measures amounted to 23.5% compared to the first pillar budget<sup>72</sup>. On the other hand, the total budget for rural development, including the financing part from EU Structural Funds, in relation to the overall EU budget did not show a similar evolution in the period 2000-2006. Instead, its share remained constant at about 10% of the global EU budget<sup>73</sup>. This was a consequence of the 2002 decision to limit further expansion of CAP budget by 1% nominally per year and the budgetary cuts made to reach a compromise on the multiannual framework.

A closer look on the first pillar expenditures shows that market related measures and direct payments still constitute the lion's share of CAP expenditures in 2007, but there was a further shift in its composition compared to 2006. Direct payments still expanded, while CAP was moving further away from the more trade distorting interventions in the agricultural markets. Comparison shows that the budget for interventions was reduced from €8.1 to 5.6 billion. Especially the reform of the sugar sector created a substantial change, reducing interventionist measures by a factor 4 (€1.4 to 0.3 billion). As interventionist measures were scaled back further, direct aids were scaled up from €34.1 to 36.9 billion. Especially the decoupled direct aids under SPS and SAPS were increased. They doubled in comparison to 2006 to reach over €30 billion<sup>74</sup>.

Regarding the financing of the second pillar of CAP, it is important to know that the EU Structural Policies contribute to rural development policy as well. This

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69. Decision 2006/493/EC (OJ 2006 L195/22-23)

70. Decision 2006/144/EC (OJ 2006 L55/21)

71. Own Calculations based on the Interinstitutional Agreement of 6 May 1999 between the European Parliament, the Council and the Commission on budgetary discipline and improvement of the budgetary procedure. (OJ 1999 C172/12)

72. Own Calculations based on the Interinstitutional Agreement between the European Parliament, the Council and the Commission on budgetary discipline and sound financial management. (OJ 2006 C139/10) and Decision 2006/493/EC (OJ 2006 L195/22-23)

73. Own Calculations based on the annual EU budget during the period 2000 and 2007.

74. Final Adoption of the general budget of the European Union for the financial year 2007. (OJ 2007 L77 II/279, 290, 323)

is a result of the historic evolution of the rural development policy. Support for rural areas is based in the Single European Act of 1986, which states that “the Community shall aim at reducing disparities between the levels of development of the various regions”<sup>75</sup>. So clearly, European rural development policy does not have its roots in CAP. However, the linkage between both is evident.

In the framework of the Cohesion Policy, 3 Community objectives have been set: (1) promoting the development and structural adjustment of regions whose development is lagging behind, (2) supporting the economic and social conversion of areas facing structural difficulties and (3) supporting the adaptation and modernisation of policies and systems of education, training and employment<sup>76</sup>. These objectives were commonly referred to as ‘Objective 1, 2 or 3’. In practice, this meant that Community Cohesion funding was available for rural development projects through Structural Funds such as the European Social Fund, the European Regional Development Fund and the Guidance Section of EAGGF.

Since the creation of a two-pillar structure for CAP in 2000, rural development is a formal element of CAP. However, part of the funding source remained the Structural Funds.

Under the new budgetary headings, ‘Cohesion for Growth and Employment’ now resorts under the heading of ‘Sustainable Growth’. The former ‘Objectives 1, 2 and 3’ were replaced by ‘Convergence’, ‘Regional Competitiveness’ and ‘Employment and Territorial Cooperation’. The ‘Convergence’ objective, which is similar to ‘Objective 1’ as it is “aimed at speeding up the convergence of the least-developed Member States and regions by improving conditions for growth and employment”<sup>77</sup>, is used to contribute to EAFRD<sup>78</sup>.

Also in 2007 EAFRD became the single financing mechanism for rural development measures, replacing previous contributing Funds. Financing of EAFRD is based on three parts: (1) a part directly out of EAGF, (2) a part from the Convergence Objective of the Cohesion Policy and (3) a part resulting from modulation.

In 2006, Structural Funds contributed for €3.8 billion to Agriculture and Rural Development under Objective 1. Additionally, €0.4 billion was attributed to Agriculture and Rural Development under Community Initiatives<sup>79</sup>. This refers

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75. See article 130a of the Single European Act (OJ 1987 L169/9)

76. Regulation 1260/1999. (OJ 1999 L161/7)

77. Regulation 1083/2006. (OJ 2006 L210/25-78)

78. Regulation 1698/2006 (OJ 2006 L277/28)

79. General Budget of the European Union for the financial year 2006. The Figures, European Commission, January 2006, p. 13. SEC(2006)50.

to the funding of the Leader+ Initiative, which is designed to help rural actors create a sustainable development strategy.

## 2.4. Rural Development Policy

The Agricultural Council adopted in 2005 and 2006 a set of objectives, general rules and a financial framework for the EU Rural Development Policy. This reflected the growing importance of rural development and the gradual shift from pillar 1 to pillar 2 support measures as described above. Rural development entered CAP in the 1970s, when less favoured areas were eligible for special measures. In the 1992 reform, agri-environmental measures and early retirement schemes were introduced. The Agenda 2000 reforms institutionalised rural development as the second pillar of CAP<sup>80</sup> and designed a list of policy measures for rural development<sup>81</sup>.

The EU Rural Development Policy has six strategic guidelines: (1) supporting restructuring to improve competitiveness of agriculture and forestry, (2) improving the environment and the countryside by supporting land management, (3) improving the quality of life and encouraging diversification of economic activities, (4) building local capacity for employment and diversification, (5) ensuring consistency in programming and (6) complementarity between Community instruments<sup>82</sup>.

The first three are also the thematic issues, or so-called axis, to deal with through a variation of measures. These are complemented by a horizontal axis, the Leader axis, which is a local development strategy working with local actors to support cooperation projects. It is important to note that the Leader approach distinguishes itself from other rural development measures because it is multisectoral rather than concentrated on agriculture alone. Through a bottom-up holistic approach, farm and non-farm investments are combined to develop the most promising sectors in an area<sup>83</sup>.

Member States have a large flexibility for the implementation of the Rural Development Policy. The framework and general objectives are delivered by the Community, but Member States are free to choose what policy measures they

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80. Regulation 1258/1999. (OJ 1999 L160/105)

81. Regulation 1257/1999. (OJ 1999 L160/85-94)

82. Decision 2006/144/EC. (OJ 2006 L55/24-28)

83. ESPON Project 2.1.3, The Territorial Impact of CAP and Rural Development Policy. Luxembourg, ESPON, August 2004, pp. 180-185. Accessed, 14 December 2007, [http://www.espon.eu/mmp/online/website/content/projects/243/277/index\\_EN.html](http://www.espon.eu/mmp/online/website/content/projects/243/277/index_EN.html)

believe will result in the highest added value. The different national strategy plans have to be evaluated by the Commission to ensure its consistency with the Community objectives<sup>84</sup>. On the other hand, Member States have to finance the rural development measures to a certain extent themselves. How much the EU co-finances depends on the measure and the region concerned. In 2005, agreement was reached on the European Agricultural Fund for Rural Development (EAFRD), which provided a new financing framework set to enter into force in 2007<sup>85</sup>.

The extension of the facility for voluntary modulation provoked conflicts between the Council and the European Parliament<sup>86</sup>. The Council unanimously adopted the proposed extension of it<sup>87</sup> in its December 2005 agreement on the financial framework 2007-2013<sup>88</sup>. The Member States must meet one of the two following criteria in order to be allowed to apply voluntary modulation: (1) the member state already applied voluntary modulation or (2) the member state was exempt from co-financing rural development measures<sup>89</sup>. In practice, this means that from 2007, only the United Kingdom (first criterion) and Portugal (second criterion<sup>90</sup>) have been able to apply voluntary modulation. The regulation also states explicitly that the net amount resulting from voluntary modulation is retained by the member state and that regional differentiation is possible, two points unmentioned of in the first proposal. The maximal aggregated level of compulsory and voluntary modulation remains 20%<sup>91</sup>.

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84. Regulation 1698/2005. (OJ 2005 L277/13)

85. Regulation 1290/2005 (OJ 2005 L209/6)

86. In the legislative procedure, European Parliament clashed with the Commission on the proposed regulation. The Parliament rejected the proposal twice and although it only had a consultative voice, it managed to get the proposal adopted in a way favourable to its concerns. The Parliament disfavoured the proposal amongst others because of “the danger of discrimination against farmers within the EU” and because of the “re-nationalisation of agricultural policy through the back door”. See GOEPEL Lutz, Second Report on the proposal for a Council regulation laying down rules for voluntary modulation of direct payments provided for in Regulation (EC) No 1782/2003 establishing common rules for direct support schemes under the common agricultural policy and establishing certain support schemes for farmers, and amending Regulation (EC) No 1290/2005, Committee on Agriculture and Rural Development, 26 January 2007, p.6. (A6 0009/2007).

87. Final Comprehensive Proposal on the Financial Perspectives 2007-2013 from the Presidency, o.c, p. 23. (15915/05)

88. Presidency Conclusions. Brussels European Council of 15 and 16 December 2005. Council of the European Union, Brussels, 30 January 2006, p. 2. (15914/1/05)

89. Regulation 378/2007 (OJ 2007 L95/2)

90. Regulation 1944/2006 (OJ 2006 L367/24)

91. Regulation 378/2007 (OJ 2007 L95/2-3)

## 2.5. The simplification of the CAP

In 2005, the Commission initiated a process to simplify the CAP. This simplification is designed as a technical rather than a political adaptation of CAP. The revision of CAP regulations fits in the broader policy aim of the Commission to produce better regulation, or more straightforward, to cut red tape. The Commission has proposed: (1) to streamline the agricultural legislation, (2) to create a single CMO for agricultural products replacing the existing 21 CMOs and (3) to test the feasibility of an 'EU net administrative cost method' to level down the administrative cost on farmers and (4) to reduce the 7 state aid regulations to 3: the exemption regulation, one set of guidelines and the *de minimis* regulation<sup>92</sup>.

In 2007 the Council backed the Commission's proposal to introduce a single CMO for agricultural products replacing the existing 21 existing CMOs<sup>93</sup>. The single CMO increases transparency and is a technical simplification, as it replaces over 650 legal articles in the current regulations with around 200<sup>94</sup>.

At the same moment, the Council of Agricultural Ministers backed the Commission's report and its ensuing proposals on simplification of the cross-compliance system<sup>95</sup>. The Commission's analysis of the system of cross-compliance standards found several shortcomings. The principal issues raised by the Member States, who have a large discretion in the implementation, were:

- in general, the system was felt as burdensome,
- the volume and technical nature of information hampered awareness-raising among farmers,
- control rates were not always met because the population subject to controls was known to late,
- the existence of inarticulate rules concerning on-the-spot checks and reporting,
- the calculation of reductions was difficult and some notions (e.g. "intentionality") were hard to define, leaving possible discrepancies between Member States<sup>96</sup>.

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92. Communication from the Commission on Simplification and Better Regulation for the Common Agricultural Policy, European Commission, 19 October 2005, pp. 8-9, COM(2005)509.

93. Regulation 1234/2007 (OJ 2007 L299/1-149)

94. Simplifying the Common Agricultural Policy: Council backs 'single Common Market Organisation', European Commission, 11 June 2007. (IP-07-795)

95. Council supports Commission move to improve Cross Compliance system, European Commission, 11 June 2007. (IP/07/796)

96. Report from the Commission to the Council on the application of the system of cross-compliance, European Commission, 29 March 2007, pp. 4-5. COM(2007)147.

The major proposed adaptations outlined in the report were:

- Member States should be allowed to tolerate minor cases of non-compliance and reductions below a minimal threshold (?50) should not be applied. However, a warning letter should still be sent and follow-up ensured.
- Introduction of a single control rate of 1% minimum of on-the-spot checks.
- If notice has to be given of on-the-spot checks, this needs to happen 14 days in advance. Only half of the land parcels need to be subjected to control. The farmer must receive the control report within 3 months after the check.
- A simplification of '10-month rule', which obliges the farmer to keep at his disposal for 10 months any land parcels declared to activate entitlements to SPS.
- A phasing-in period of 3 years for NMS applying to SAPS, for whom the SMRs will come into force from 2009 onwards<sup>97</sup>.

By the end of 2007, the Commission adopted a new regulation including some of these proposals to improve the cross-compliance system<sup>98</sup>.

## 2.6. The 2007 enlargement

In 2007, Bulgaria and Romania acceded to the EU. In both countries, the impact of agriculture on the national economy was far more significant than in the EU-25. The Bulgarian agriculture accounted for 7.2% of the GDP in 2005, compared to 1.3% in the EU-25. Employment in agriculture corresponded to 9.3% of the total employment, whereas this was 5.0% in the EU-25<sup>99</sup>. The Romanian situation was similar, with agriculture accounting for 8% of the GDP and 32.8% of the national employment in 2005<sup>100</sup>.

The Accession Treaty of Bulgaria and Romania provided for similar transitional measures as given to the 10 NMS in 2004. Specifically, direct payments were also going to be phased in gradually over a period of 10 years, with potential top-ups paid from national resources or from rural development funds in order to compensate the temporarily lower levels of direct support. Both countries could opt to apply SAPS instead of SPS, with a less stringent cross-compliance system attached to it. Regarding rural development, a number of specific addi-

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97. *Ibid.*, pp. 6-9.

98. Regulation 1550/2007 (OJ 2007 L337/79-84)

99. Background Note Bulgaria, European Commission, DG for Agriculture and Rural Development. Accessed, 28 March 2008, [http://ec.europa.eu/agriculture/publi/ms\\_factsheets/2007/bulgaria\\_en.pdf](http://ec.europa.eu/agriculture/publi/ms_factsheets/2007/bulgaria_en.pdf)

100. Background Note Romania, European Commission, DG for Agriculture and Rural Development. Accessed, 28 March 2008, [http://ec.europa.eu/agriculture/publi/ms\\_factsheets/2007/romania\\_en.pdf](http://ec.europa.eu/agriculture/publi/ms_factsheets/2007/romania_en.pdf)

tional support measures were designed for farm restructuring, early retirement, investments and 'Leader +' -type measures. Besides these provisions, Bulgaria agreed specific transitional measures concerning milk and veterinary and phytosanitary legislation. Romania obtained similar concessions regarding wine and veterinary and phytosanitary legislation<sup>101</sup>.

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101. Documents concerning the accession of the Republic of Bulgaria and Romania to the European Union. (OJ 2005 L157/3-395)

### 3. The Evaluations

After a few years, a lot of reports have been published about the implementation of the 2003 reform. They are important to understand some propositions of revision presently discussed.

#### 3.1. The situation in the new Member States

An evaluation by the Commission of the situation in the NMS 1 year after enlargement concluded that enlargement had a generally positive effect on their agricultural sector. Farm income had increased by 56% in nominal terms in 2004 due to improved prices and EU direct payments. Land prices increased only modestly, consumer prices generally increased<sup>102</sup>.

In 2006, the Committee on Agriculture and Development of the European Parliament issued a report on the integration of NMS in CAP. In general, its conclusions were in line with the Commission's findings. The Committee stated that the integration was a success, resulting in a win-win situation for both old and new Member States. The functioning of the single market was not disrupted in the integrating process, nor were there any problems relating to food safety<sup>103</sup>.

Nonetheless, the report was also critical on some issues. The main critique concerns the possibility for NMS to complement national direct payments. Because this cofunding would have led to strains on the national budget, most Member States opted for so-called negative modulation, which regroups rural development funds to pay for the top-ups. This negative modulation turns one of the basic ideas of the CAP reform completely upside down<sup>104</sup>. More generally, national cofunding is seen by some as re-nationalisation of agricultural policies<sup>105</sup>. Furthermore, since CAP expenses are based on European objectives, regardless of which Member States is to benefit from it, cofunding is contradictory to the general concept of financial solidarity between Member States as stated in the Treaty<sup>106</sup>.

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102. Prospects for Agricultural Markets and Income 2005-2012, European Commission, July 2005, pp.24-25. Accessed, 31 October 2007, <http://ec.europa.eu/agriculture/publi/caprep/prospects2005/fullrep.pdf>

103. Report on the integration of the new Member States into the CAP, o.c., p. 13.

104. Ibid., p. 14.

105. LE ROY, o.c., p. 121.

106. "The Community shall have as its task [...] by implementing common policies or activities [...] to promote throughout the Community [...] economic and social cohesion and solidarity among Member States." See article 2 of the Consolidated Versions of the Treaty on European Union and of the Treaty Establishing the European Union Community. (OJ 2006 C321/44)

The lower level of direct payments in NMS during the phasing in period was also criticized for hindering the necessary adaptation and created unequal conditions for competition on the internal market<sup>107</sup>. The report criticized also the system's complexity. The rural development programme, as well as its predecessor Sapard, were not able to realise the goals set, due to administrative complexity and limited Community funding<sup>108</sup>. 'Production for subsidies' was noted in the NMS as well, notwithstanding the decoupled nature of payments. Some Member States reportedly were of the opinion that coupled payments have to remain possible until 2013 in order to reach more balanced development and long-term sustainability. This does not confirm the concept of decoupling, as promoted by the Commission<sup>109</sup>.

### 3.2. Direct payments

Concerning the implementation of the direct payments under the CAP reform, two general trends can be distinguished.

Firstly, a majority of the former EU-15<sup>110</sup> established the SPS on a historical basis<sup>111</sup>. Despite decoupling of support, this calculation method is still linked to previous production levels (minimum €5,000) and therefore not fully representative of the spirit embedded in the CAP reforms<sup>112</sup>. Secondly, all but two NMS<sup>113</sup> decided to implement SAPS rather than immediately introduce SPS<sup>114</sup>. According to the parliamentary report quoted above, this was due to the complexity of SPS. At the end of 2006, the Council approved an extension of SAPS until the end of 2010<sup>115</sup>. The facility of national envelopes was partially or for the full 10% applied in 8 Member States<sup>116</sup>.

A 2008 report on the added value of CAP expenditure has been critical on the system of direct payments, despite the general acknowledgement that the 2003

107. Report on the integration of the new Member States into the CAP, o.c., p. 7.

108. *Ibid.*, p. 15.

109. *Ibid.*, p. 16-17.

110. Austria, Belgium, France, Greece, Ireland, Italy, the Netherlands, Portugal, Spain and the British regions Scotland and Wales.

111. Overview of the Implementation of Direct Payments under the CAP in Member States, European Commission, January 2008, Accessed 2 April 2008, [http://ec.europa.eu/agriculture/markets/sfp/pdf/2008\\_01\\_dp\\_capFVrev.pdf](http://ec.europa.eu/agriculture/markets/sfp/pdf/2008_01_dp_capFVrev.pdf)

112. DOORNBOSCH, Richard, STEENBLIK, Ronald, Biofuels: Is the cure worse than the disease? Round Table on Sustainable Development, OECD, Paris, 11-12 September 2007, p. 44. Accessed, 18 October 2007, [http://www.foeurope.org/publications/2007/OECD\\_Biofuels\\_Cure\\_Worse\\_Than\\_Disease\\_Sept07.pdf](http://www.foeurope.org/publications/2007/OECD_Biofuels_Cure_Worse_Than_Disease_Sept07.pdf)

113. Slovenia and Malta.

114. Overview of the implementation of direct payments under the CAP in Member States, o.c.

115. Regulation 2012/2006. (OJ 2006 L384/11)

116. Overview of the implementation of direct payments under the CAP in Member States, o.c.

reforms removed considerable irregularities and the direct payments in particular were a large improvement to price support. Direct payments were found inefficient in targeting their objectives, such as providing income support or encouraging environmentally friendly farming practices. The argument of providing income support does not make sense, because the direct payments are not based on an analysis of the individual needs of farmers and thus fail in targeting low-income farmers. Instead, direct payments are still linked to yields per hectare during an earlier period. Similarly, the amount of direct payments had no relation to the real costs for cross-compliance measures<sup>117</sup>.

### 3.3. Cross-compliance

The Commission issued a report on the application of the system of cross-compliance in 2007. The report, based on data provided by 23 Member States for 2005, stated that 4.92% of farmers affected by cross-compliance obligations received on-the-spot checks or a total of 240,898 checks was executed. These resulted in reductions of direct payments, amounting to €9.84 million, for 11.9% of farmers controlled<sup>118</sup>.

### 3.4. Administrative burden of reformed CAP

In 2007 an external study on the administrative burden arising from CAP was published. The study made a cross-country comparison of the existing administrative costs in 2006 between 5 Member States, namely Denmark, France, Germany, Ireland and Italy.

Despite substantial differences between the selected Member States due to the national discretion in selecting and implementing a model of SPS<sup>119</sup>, it was concluded that it were not so much the different implementation models of the CAP

117. NUNEZ FERRER, Jorge, KADITI, Eleni, *The EU Added Value of Agricultural Expenditure – from market to multifunctionality – gathering criticism and success stories of the CAP*. Brussels, CEPS, February 2008, pp. 3-4, 12. Accessed, 10 February 2008, [http://www.europarl.europa.eu/meetdocs/2004\\_2009/documents/dv/200/200802/20080227\\_cap\\_study\\_en.pdf](http://www.europarl.europa.eu/meetdocs/2004_2009/documents/dv/200/200802/20080227_cap_study_en.pdf)

118. Report from the Commission to the Council on the application of the system of cross-compliance, o.c., p. 4. On the shortcomings identified in the report and their respective proposed solutions, see § 2.5.

119. The 2003 CAP reform gave Member States considerable discretion concerning the implementation of SPS and its timing. The selected Member States covered the different implementation options (Denmark: regional static-hybrid/France: historic with maximum recoupling/Germany: regional dynamic-hybrid/Ireland: historic without recoupling/Italy: historic with some recoupling) and had different “maturity” in implementation (the reform was initiated in 2005 in Denmark, Germany, Ireland and Italy, whilst only in 2006 in France).

reform that had impact on the administrative costs of farmers, but a set of four other factors.

Firstly, regarding the transposition of CAP regulations, there is a great disparity between the Member States in the national legal set-up. To transpose four Regulations, between 1 (Ireland) and 13 (Italy) legal acts were needed. The number of information obligations farmers had to fulfil ranged between 21 (Ireland) and 107 (Italy). The administrative forms used and the amount of details requested differed among countries as well. Pre-printed forms (Denmark and Ireland), based on previous information, could reduce administrative burden.

Secondly, the involvement of the public administration can be very different. For instance in Italy, there is a comprehensive state-funded service at the disposal of the mostly small-scale farmers. In other countries, similar services are conducted by private companies, and thus at a higher cost for the farmer. The adequate use of technical means, notably on line services, can reduce the farmer's administrative costs substantially.

Thirdly, business cultures differ. The outsourcing of administrative work is widespread in Denmark and, to a lesser extent, in Ireland. In France and Italy, farmers were reported to do the administrative work themselves.

Fourthly, there are structural differences between farms. A low average farm size (Italy) is reflected in less diversity in production and thus a relatively lower cost level than countries with predominantly large farms. Besides, some farmers are affected by regional differences if they hold land in different administrative regions (France and Germany)<sup>120</sup>.

The study also showed that the system of cross-compliance only takes a minimal share in the total administrative costs of farmers, ranging between 0.3% in Italy and 4.3% in Denmark<sup>121</sup>.

### 3.5. Decoupling

Although it was central principle of the 2003 reform, the implementation shows that decoupling was not wholeheartedly adopted. A large majority of Member States has made use of one or more of the options left in the reforms to retain

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120. Study to assess the administrative burden on farms arising from the CAP, European Commission, Directorat-General for Agriculture and Rural Development, October 2007, pp. 5-12.

121. *Ibid.*, pp. 19, 60.

some coupled support. Only Ireland, Luxemburg, Malta and the United Kingdom have introduced decoupling without at the same time retaining some sort of coupled support<sup>122</sup>.

An impact study on decoupling in 11 EU regions<sup>123</sup> compared the consequences of the 2003 reforms with a hypothetical continuation of the Agenda 2000 reforms. Despite the heterogeneity between the regions studied and the fact that policy measures were directed at individual farmer level, the study was capable to draw some general conclusions on a regional level.

Decoupling had a double effect on the structural changes under way following the Agenda 2000 reform. The decline in number of farms was less strong in all regions under decoupling as it would have been under Agenda 2000. The main reason is that decoupled payments offer farmers additional income opportunities which were previously not there, for example through maintaining GAEC. Especially farms with grassland benefited from this and remained in the sector. On the other hand, another structural change, the decline in cattle husbandry, was effected positively by decoupling. Ruminant production declined stronger in all regions under decoupling. Even where partial decoupling was applied, the coupled payments only had a limited influence on the declining trend<sup>124</sup>. The study also found that decoupling had a positive effect on farm income. The growth in farm income was stronger under decoupling than it would be under the Agenda 2000 reform<sup>125</sup>.

Finally, the rental prices of both arable land and grassland increased under a decoupling policy. The rationale for this is that decoupling redistributed cattle payments from cattle to arable land, and in case of grassland, that it came eligible for payments on condition of maintaining GAEC, whereas previous is was not<sup>126</sup>.

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122. Overview of the Implementation of Direct Payments under the CAP in Member States, o.c.

123. Brittany (France), Saxony and Hohenlohe (Germany), Southeast (United Kingdom), Jönköping and Västerbotten (Sweden), Colli Esini and Piana di Sibari (Italy), Vysocina (Czech Republic), Nitra (Slovak Republic) and Siauliai (Lithuania).

124. SAHRBACHER, Christoph, SCHNICKE, Hauke, KELLERMANN, Konrad, HAPPE, Kathrin, BRADY, Mark, Impacts of Decoupling policies in selected regions of Europe. March 2007, pp. 34-37. Accessed, 6 December 2007, [http://www.sli.lu.se/IDEMA/WPs/IDEMA%20deliverable\\_23.pdf](http://www.sli.lu.se/IDEMA/WPs/IDEMA%20deliverable_23.pdf)

125. Ibid., p. 38-40.

126. Ibid., pp. 40-44.



## 4. The New External Constraints on the Cap

The external context of the CAP has changed quite a lot during the last years. This explains why the debate about the CAP is fundamentally different from the previous period. Firstly, agricultural prices have been rising against a secular trend. Secondly, the growing thirst for energy sources offer new opportunities for agricultural production, especially biofuels. Thirdly, though progressing very slowly, the WTO negotiations of the Doha Development Round should impose new constraints to the EU.

This new situation has been strongly emphasized during the year 2007. In a time span of less than a month, the Commission made three important announcements. Firstly, the Agricultural Council adopted the Commission's proposal to abolish compulsory set-aside for the autumn of 2007 and spring of 2008 sowings in response to the tightening market of cereals<sup>127</sup>. Introduced in 1988 and made compulsory in the 1992 reforms, market forces at least temporarily ended the obligatory set-aside arrangements. Secondly, a proposed suspension of import duties on cereals was approved by the Agricultural Council<sup>128</sup>. Again, the motive for this decision was the price level of cereals on the international markets. Thirdly, the Management Committee for Direct Payments adopted the Commission's proposal to reduce the aid per hectare for energy crops because the applications had exceeded the maximum eligible area of 2 million hectares<sup>129</sup>. Since the introduction of the support scheme for energy crops in 2003, applications exceeded the eligible area for the first time in 2007.

### 4.1. The rise of world agricultural prices

Since 2006, food prices have been rising on a worldwide scale. There have been reports of higher than average food price inflation on a regular basis in 2007. Britain's Bank of England stated that between March 2006 and March 2007 the annual food inflation rate reached 6%, almost a six-year high<sup>130</sup>. The US Labor Department reported an annual food inflation of 4.2%, twice the rate of overall

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127. Regulation 1107/2007. (OJ 2007 L253/1)

128. Regulation 1202/2007. (OJ 2007 L271/7)

129. Regulation 1413/2007. (OJ 2007 L314/6)

130. Inflation Report August 2007, Bank of England, 8 August 2007. Accessed, 16 October 2007, <http://www.bankofengland.co.uk/publications/inflationreport/ir07aug.pdf>

inflation<sup>131</sup>. In the euro-zone the difference remained more modest: 2.3% food inflation against 2.1% overall inflation between September 2006 and 2007<sup>132</sup>.

One of the main causes for this food price inflation is the rise of prices of agricultural raw materials. For instance in the US, some basic agricultural commodities have known serious price elevations in 2007: around 90% for wheat, 40% for soybeans, 35% for eggs and 18% for milk. Because of the strong global rise in agricultural commodities, a new term was made to describe it: agflation<sup>133</sup>.

One could remember that agricultural markets have always been marked by consecutive periods of high and low prices. Real prices have risen in the periods of 1900-1918, 1933-1948, and 1973-1980, 2000-2008, even if the long-term remained downward<sup>134</sup>. For some, the difference of the current cycle is that virtually all agricultural commodities are affected by rising prices at the same time, so market correction as a result of farmers changing to more profitable crops is less likely<sup>135</sup>. According to the FAO/OECD 2008 Agricultural Outlook, “prices will gradually come down... but there is strong reason to believe that there are now also permanent factors underpinning prices that will work to keep them both at higher average levels than in the past and reduce the long-term decline in real terms”.

Several specific reasons can be pointed out for this food price inflation. Some of them are certainly transitory. The 2008 Agricultural Outlook of the Organisation for Economic Co-Operation and Development (OECD) and the Food and Agricultural Organisation (FAO) refers to both temporary and structural reasons. Weather related supply shortfalls (e.g. in Australia and Ukraine) and low stocks are seen as temporary of nature. The structural changes identified are the increased feedstock demand for biofuels production and growing prosperity in emerging economies such as China and India, which leads in turn to a growing demand for agricultural raw materials. Another important aspect is the high level of energy prices, which affects production and transportation costs and trickles down in consumer prices<sup>136</sup>.

131. Bureau of Labor Statistics, News, USDL-07-1400, 19 September 2007. Accessed, 16 October 2007, <http://www.bls.gov/news.release/pdf/cpi.pdf>

132. Eurostat, Euro-indicators, Newsrelease 138/2007, 16 October 2007. Accessed, 16 October 2007, [http://epp.eurostat.ec.europa.eu/pls/portal/docs/PAGE/PGP\\_PRD\\_CAT\\_PREREL/PGE\\_CAT\\_PREREL\\_YEAR\\_2007/PGE\\_CAT\\_PREREL\\_YEAR\\_2007\\_MONTH\\_10/2-16102007-EN-APP.PDF](http://epp.eurostat.ec.europa.eu/pls/portal/docs/PAGE/PGP_PRD_CAT_PREREL/PGE_CAT_PREREL_YEAR_2007/PGE_CAT_PREREL_YEAR_2007_MONTH_10/2-16102007-EN-APP.PDF)

133. The Agonies of Agflation, *The Economist*, 25 August 2007.

134. See MAZOYER, Paul et ROUDART, Laurence, *L'Histoire des agricultures du monde – du néolithique à la crise contemporaine*, Paris: Points, 2002.

135. An Expensive Dinner, *The Economist*, 3 November 2007.

136. Agricultural Outlook 2008-2017, OECD-FAO, pp. 10-15, 28 May 2008. Accessed 03 June 2008, <http://www.fao.org/es/esc/common/ecg/550/en/AgOut2017E.pdf>

## 4.2. The increasing demand for biofuels

Rising petroleum prices, concerns about energy supply security and the debate concerning global warming and reducing greenhouse gas (GHG) emissions have given an enormous boost to the production of biofuels. Biofuels are by some portrayed as the ultimate solution for soaring energy prices, obtaining larger energy security and reducing GHG emissions. Governments have set benchmark goals and support biofuels production and introduction through tax incentives or subsidy programmes. As indicated above, the steep ascent of biofuels is putting pressure on the price level of agricultural commodities. In 2007, the OECD and FAO noted in their co-authored *Agricultural Outlook* that, although not new, “the increased demand for agricultural products in the form of bioenergy feedstocks... constituted an important change from previous market situations”<sup>137</sup> that will “evoke a debate about the ‘food versus fuel’ issue”<sup>138</sup>. The central issue in the ‘food versus fuel’ debate is whether it is wise to burden agriculture with our energy supply as well, because the consequent rising price levels of agricultural commodities pose both an opportunity and a threat. On the one hand, farmers in developed as well in developing as countries can benefit from higher market prices for their products. On the other hand, food price inflation could have a negative impact on net food importing countries. There remain also serious questions about the production efficiency and sustainability of biofuels.

### 4.2.1. *The need of a definition*

Biofuels are an aggregate for fuels derived from biomass, mainly of agricultural origin. The term commonly refers to liquid transportation fuels. The most frequent are (bio)ethanol (ethyl alcohol) and biodiesel (fatty-acid methyl ester). Ethanol can be derived from sugarcane, sugar beet, corn (maize), wheat and starchy cereals such as barley, sorghum and rye. The lion’s share of the world’s ethanol production is situated in Brazil and the US. Biodiesel is produced from oilseeds crops, namely soybean, sunflower seeds, rapeseed and palm oil. The EU is the largest producer of biodiesel in the world<sup>139</sup>.

A distinction is made between first and second generation biofuels. Biodiesel and ethanol derived from the crops as described above are first generation biofuels. The basic material for first generation biofuels are the oil, sugar or starchy

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137. *Ibid.*, pp. 20-21.

138. *Ibid.*, p. 10.

139. Communication from the Commission: An EU Strategy for Biofuels, European Commission, 8 February 2006, p. 18, COM(2006)34.

content of the specific crops, whereas cellulose is the basic product in second generation biofuels. This provides for far more possible biomass feedstocks, since cellulose is found a wider range of biomass sources. In specific, waste of food crops, switchgrass, willows and jatropha have high potential, because these sources of feedstock do not necessarily conflict with food production<sup>140</sup>.

However, technological breakthroughs are needed to improve the cost effectiveness of second generation biofuels. In the context of technological evolution, the issue of genetical modification of crops remains a point of discussion. Genetic engineering or biotechnology is put forward as an optimum way of upgrading crops yields while at the same time reducing production costs. Therefore, it promises both economic and environmental advantages. However, biotechnology remains controversial and constrained by regulation and bans. Irrespective of the political or scientific motivation for these bans, development of biotechnology is hampered by it<sup>141</sup>.

#### 4.2.2. *Efficiency*

The efficiency of biofuels can be expressed in two ways: (1) via a traditional economic cost/benefit calculation or (2) by estimating the potential for reduction in GHG emission.

*Cost benefit calculation:* In 2006, the Commission stated that the production of biofuels, using the most modern first generation technologies, would economically break even if the price per barrel would reach €60 for biodiesel and €90 for bioethanol<sup>142</sup>. Recalculated in the equivalent dollar price at the time of the publication<sup>143</sup>, this means \$71.6 per barrel of biodiesel and \$107.4 per barrel of bioethanol. The OECD stated in 2007 regarding competitiveness of biofuels without massive government intervention, that only Brazil's ethanol production from sugar cane is competitive with minimum oil prices of \$ 70 US per barrel<sup>144</sup>.

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140. Biofuels for Transport: An international Perspective, International Energy Agency, Paris, April 2004, pp. 37-39. Accessed, 18 October 2007, <http://www.iea.org/textbase/nppdf/free/2004/biofuels2004.pdf>

141. RAJAGOPAL, Deepak, ZILBERMAN, David, Review of Environmental, Economic and Policy Aspects of Biofuels. The World Bank, Policy Research Working Paper 4341, September 2007, p. 71. Accessed, 23 October 2007, [http://www-wds.worldbank.org/external/default/WDSContentServer/IW3P/IB/2007/09/04/000158349\\_20070904162607/Rendered/PDF/wps4341.pdf](http://www-wds.worldbank.org/external/default/WDSContentServer/IW3P/IB/2007/09/04/000158349_20070904162607/Rendered/PDF/wps4341.pdf)

142. Communication from the Commission: An EU Strategy for Biofuels, o.c., p. 5.

143. On 8 Februari 2006, €1 was trading for \$1.1934 US. See: <http://fx.sauder.ubc.ca/>

144. DOORNBOSCH, Richard, o.c., p. 18.

Presently, many governmental policies aim at making the production and use of biofuels financially attractive. They use a wide range of policy tools, such as excise tax credits, renewable fuel standards and mandatory blending, agricultural subsidies, support for R&D, vehicle subsidies, loans and loan grants, etc. This web of policy instruments is aimed at specific target groups in the production process, covering the entire production process from farmers over industrial producers to the consumer<sup>145</sup>. It is questionable whether this approach is cost effective at the moment. Nonetheless, there are two basic rationales for massive public investments in the energy sector, a political and moral conviction to change our use of energy and the infant industry argument, since it is very expensive to invest in R&D and commercialisation of innovative energy which will not pay off as long as there are abundant cheap alternatives<sup>146</sup>.

*Environmental calculation:* The efficiency in terms of reducing GHG emissions depends on numerous variables: agricultural practices (e.g. use of fertilizers), choice of feedstocks (energy value), the land use changes (e.g. clearing rain forest for palm plantations), the refining and conversion method, the proximity to feedstocks, etc. Due to this complexity, a full ‘well-to-wheel’ analysis of every type of biofuel is as difficult as desirable in order to clarify the potential for reduction of GHG emission. In general, however, second generation biofuels are produced more efficiently than first generation biofuels<sup>147</sup>. Only in 2004, the International Energy Agency (IEA) found that ethanol from sugarcane and from cellulosic feedstocks had the highest estimated GHG emission reduction (some 70 to 90%). The biofuels promoted massively in the EU and US were deemed less potential: ethanol from grain (20 to 40%), ethanol from sugar beet (50%) and biodiesel from rapeseed (40 to 60%) score low to medium<sup>148</sup>. More recent American research confirmed the high potential of second generation cellulosic feedstocks (91%), the moderate potential for biodiesel (68%) and ethanol from sugar (56%) and the low potential for ethanol from grain (22%)<sup>149</sup>.

#### 4.2.3. *Potential*

Studies concerning future global energy demand all project a rising demand for energy. On a global level, there would be an increase in energy demand of over

145. RAJAGOPAL, Deepak, ZILBERMAN, David, o.c., pp. 59-67.

146. EIKELAND, Per Ove, Biofuels: the New Oil for the Petroleum Industry? The Fridtjof Nansen Institute, January 2006, pp. 13-14. Accessed, 27 October 2007, <http://www.fni.no/doc&pdf/FNI-R1505.pdf>

147. Ibid., p. 17

148. Biofuels for Transport: An international Perspective, o.c., pp. 52-64.

149. Greenhouse Gas Impacts of Expanded Renewable and Alternative Fuels Use, US Environmental Protection Agency, April 2007. Accessed, 7 November 2007, <http://www.epa.gov/otaq/renewablefuels/420f07035.pdf>

50% by 2030<sup>150</sup>. Although the largest part of this growth will be attributable to developing countries, rising demand is also projected in developed countries. In the US, energy consumption is expected to grow annually 1.1% between 2005 and 2030<sup>151</sup>. During the same period European energy demand is expected to continue to grow with an annual rate of 0.6%<sup>152</sup>.

With respect to biofuels, much attention is devoted to the potential introduction in the road transportation sector. First generation biofuels as biodiesel and ethanol can be introduced quite easily in this market without high costs. Road transportation constitutes one of the main sources of GHG emissions and is still expanding. Transportation consumes 30% of the global energy, 99% of which is supplied by petroleum. In the EU, road transportation accounts for over 30% of the total energy consumption<sup>153</sup> and is responsible for an estimated 21% of all GHG emissions<sup>154</sup>. Research estimates that 90% of Europe's increase of CO<sub>2</sub> emissions between 1990 (the reference year of the Kyoto Protocol) and 2010 will be attributable to transport<sup>155</sup>. Unsurprisingly, major attention and effort is given to the potential benefits biofuels can bring in this sector.

According to the IEA's World Energy Outlook 2006, biofuels accounted for roughly 1% of the total road transport fuel consumption in 2006<sup>156</sup>. In the EU, the total market share of biofuels in road transportation reached 1% in 2005<sup>157</sup>, while in the US about 3% was reached<sup>158</sup>.

Projections concerning the capacity to expand biofuels production vary substantially. Interestingly, European sources have generally presented a positive view

150. World Energy Outlook 2005, Paris, International Energy Agency, 2005, p. 79

151. Annual Energy Outlook 2007 with Projections to 2030, Washington DC, US Department of Energy, p. 72, February 2007. Accessed, 7 November 2007, [http://www.eia.doe.gov/oiaf/aeo/pdf/0383\(2007\).pdf](http://www.eia.doe.gov/oiaf/aeo/pdf/0383(2007).pdf)

152. European Energy and Transport Scenarios on Key Drivers, European Commission p. 36, September 2004. Accessed, 6 November 2007, [http://ec.europa.eu/dgs/energy\\_transport/figures/scenarios/doc/2005\\_flyer\\_scenarios\\_on\\_key\\_drivers.pdf](http://ec.europa.eu/dgs/energy_transport/figures/scenarios/doc/2005_flyer_scenarios_on_key_drivers.pdf)

153. Biofuels in the European Union. A Vision for 2030 and Beyond, European Commission, 2006, p. 3. Accessed, 19 October 2007, [http://ec.europa.eu/research/energy/pdf/biofuels\\_vision\\_2030\\_en.pdf](http://ec.europa.eu/research/energy/pdf/biofuels_vision_2030_en.pdf)

154. Fact Sheet: Biofuels in the EU: an Agricultural Perspective, European Commission, p. 5, 18 December 2006. Accessed, 16 October 2007, [http://bookshop.europa.eu/eubookshop/FileCache/PUBPDF/KF7606341ENC/KF7606341ENC\\_002.pdf](http://bookshop.europa.eu/eubookshop/FileCache/PUBPDF/KF7606341ENC/KF7606341ENC_002.pdf)

155. Biofuels in the European Union. A Vision for 2030 and Beyond, o.c., p. 3.

156. World Energy Outlook 2006, Paris, International Energy Agency, 2006, p. 387.

157. Biofuels Progress Report. Report on the Progress made in the use of biofuels and other renewable fuels in the Member States of the European Union, European Commission, p. 6, 10 January 2007. COM(2006)845

158. Biofuels in the U.S. Transportation Sector, Washington DC, US Department of Energy, February 2007. Accessed, 16 November 2007, <http://www.eia.doe.gov/oiaf/analysispaper/bio-mass.html>

of an increasing use of biofuels<sup>159</sup>. On the other side, international sources have generally developed a more cautious analysis, linking the impact of biofuels on food prices or on the environment<sup>160</sup>.

#### 4.2.4. *Consequences*

The new interaction between the agricultural and energy markets is a complex one. On both sides, substitutability is only partial. Return on investment can be evaluated on very different time frames. The availability of commodities is not the same for both markets<sup>161</sup>. Nonetheless, a massive shift towards the production and use of biofuels carries the potential of introducing consequences which will

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159. The European Environmental Agency issued in 2006 a study which concluded that significant amounts of biomass were technically available in Europe to support ambitious renewable energy targets, even if strict environmental constraints were applied (How much bioenergy can Europe produce without harming the environment?, European Environmental Agency, Copenhagen, 2006, p. 6. Accessed, 18 October 2007). A study by the Biofuels Research Advisory Council for the European Commission continues on that premise and states that it is possible to provide up to 25% of Europe's transportation energy needs with biofuels by 2030, in contrast to the 0.7% in 2004. According to the study, between 4 and 18% of the total agricultural land in the EU would be needed to produce the needed feedstocks for the aims set in the 2003 Biofuels Directive. It recognises the ambitious nature of this goal, but claims it is achievable if domestic production, imports and R&D are intensified (Biofuels in the European Union. A Vision for 2030 and Beyond, o.c., pp. 3, 30-31).

160. More critical reports were published by several international bodies. The United Nations Energy Division warned in 2007 that there exists considerable risk of increased CO<sub>2</sub> emissions by using biofuels in the transportation sector. The potential benefits of biofuels threaten to be destroyed in the production process of the biofuels. The choice of feedstocks, the land use changes, the agricultural practice and the actual conversion into biofuels risk to erase the gains in CO<sub>2</sub> emission by the use of biofuels. The report concludes that it would be more appropriate to use biofuels for combined heat and power production, where they would replace coal-fired production, which would leave a greater margin for GHG emission reductions ( Sustainable Bioenergy: A Framework for Decision Makers, United Nations Energy, May 2007, pp. 48-49. Accessed, 18 October 2007, <http://esa.un.org/un-energy/pdf/susdev.Biofuels.FAO.pdf> ). A 2007 study of the OECD found that it is technically possible to produce up to 11% of total global demand for fuel in the transportation sector by 2050. This statement is accompanied by a clear-cut warning that such an expansion of biofuels production would have serious consequences on the wider economy and put high pressure on the environment and biodiversity (DOORNBOOSCH, Richard, o.c., p. 4).

The World Bank's World Development Report 2008, which for the first time in 25 years focussed on the potential role of agriculture in poverty reduction, is also very cautious on the topic of biofuels. It concludes that agriculture faces large and unpredictable uncertainties due to changing consumer demands and new uses. Warnings are issued on the social effect of massive crop cultivation for biofuels, because many of the world's poor, both rural and urban, are net food buyers and benefit from low world food prices (World Development Report 2008: Agriculture for Development. The World Bank, Washington DC, 19 October 2007, pp.70-71). A similar message was given by Jean Ziegler, a UN expert on the right to food. He even called using food crops for energy a 'crime against humanity' and demanded a 5-year moratorium on biofuels to allow scientific progress to mitigate the consequences for the poor (Un Expert calls using food crops for fuel 'crime against humanity', International Herald Tribune, 26 October 2007).

161. See SCHMIDHUBER, Josef, Impact of an increased biomass use on agricultural markets, prices, and food security: A longer-term perspective, in N. CHAMBON coord., What future framework for agriculture after 2013?, Paris: Notre Europe, 2008, pp. 60-99.

affect the world as a whole. Those consequences can be both positive and negative, in the short and in the long term, in developed and in developing countries.

Energy security can be enhanced through diversification. Oil-importing countries can reduce the dependence on foreign sources of energy and secure a part of its energy needs through domestic production. Prices of petroleum and natural gas are under pressure because of the fact that they are finite resources, exploited in some politically unstable parts of the world<sup>162</sup>.

Global warming can be mitigated and GHG emissions reduced. Traditional energy production, based on fossil fuels such as petroleum, coal and natural gas, contributes to the problem of global warming. Combustion of fossil fuels causes GHG emissions in the atmosphere, specifically CO<sub>2</sub>, which have been stockpiled for centuries beneath the surface of the earth. Biofuels have the potential to reduce the emission of GHG, since they don't introduce any new GHG into the atmosphere. Biomass absorbs quantities of CO<sub>2</sub> during its lifetime, which are emitted again (partially) when biomass is used to produce energy<sup>163</sup>.

Poverty can be reduced through an economic revival of agriculture in developing countries. The rising price levels of food commodities will benefit agriculture in developing countries. Many developing countries, who are now net-importers of food<sup>164</sup>, will get the opportunity to produce at competitive levels on world markets. Offsetting agricultural commodities at a higher price will result in higher incomes for millions of people involved in agriculture and will provoke new investments, which in turn will provide jobs to millions of people<sup>165</sup>.

On the other hand, food price inflation can aggravate poverty as well. The surge of prices of basic agricultural commodities such as corn, wheat, soybean or rice to decade highs will have the heaviest impact on the world's poor. Higher agricultural commodity prices pressure the price level of food and feed (which indirectly pressures food price, for instance for meat). As they spend large portions of their household budget on food (over 50%<sup>166</sup>), a limited increase in prices

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162. HAZELL, Peter, PACHAURI, R.K., Bioenergy and Agriculture: Promises and Challenges, Overview. International Food Policy Research Institute 2020 Focus No. 14, December 2006.

163. KNUDSEN, Odin, Bioenergy and Agriculture: Promises and Challenges, Potential for Carbon Payments for Bioenergy. International Food Policy Research Institute 2020 Focus No. 14, December 2006.

164. DIOUF, Jacques, SEVERINO, Jean-Michel, Feeding Africa, International Herald Tribune, 19 October 2007.

165. FERREIRA SIMOES, Antonio José, Biofuels will help fight Hunger, International Herald Tribune, 6 August 2007.

166. UNDP Annual Report 2007. Making Globalization Work for All, United Nations Development Programme, June 2007, P. 2. Accessed, 15 October 2007, <http://www.undp.org/publications/annualreport2007/IAR07-ENG.pdf>

could seriously hit the world's poorest people<sup>167</sup>. In comparison, the weight of food in the consumer price index in the EU is only 13.9%<sup>168</sup>. This could even result in political instability in low and middle income countries and in turn affect global economic progress<sup>169</sup>.

Environmental sustainability and biodiversity could be threatened by biofuels. A large scale turnover towards energy crops contains risks for long-term environmental sustainability. Research showed that large-scale drainage of peatlands and forest clearings for palm oil in South-East Asia are a significant source of global CO<sub>2</sub> emissions. Tropical peatlands contain large quantities of CO<sub>2</sub>, which is released by draining it. Additional CO<sub>2</sub> emissions are caused by burning large areas in order to facilitate agricultural plantations<sup>170</sup>. Palm oil, which is mostly used in food products, becomes increasingly planted for biofuels. In Indonesia, oil palm plantations are expected to triple in size to 16.5 million hectares by 2020<sup>171</sup>, whilst the country found itself already third on the global CO<sub>2</sub> emissions ranking in 2006 specifically due to peatland degradation<sup>172</sup>. Besides, global environmental sustainability and biodiversity are also pressured by monocropping, intensive water usage, land degradation and pollution by fertilizers<sup>173</sup>. The use of genetically modified organisms for second generation biofuels is a potential liability.

Finally, social disruption could also be a consequence. In general, large-scale biofuel industry has a competitive advantage over small farmers because of the economies of scale. Especially in developing countries, where social protection is less guaranteed, this could have devastating social effects. There have already

167. RUNGE, C. Ford, SENAUER, Benjamin, How Biofuels Could Starve the Poor, In: Foreign Affairs, May/June 2007.

168. Prospects for Agricultural Markets and Income in the European Union 2007-2014, European Commission, July 2007, p. 18. Accessed, 26 November 2007, <http://ec.europa.eu/agriculture/publi/caprep/prospects2007a/fullrep.pdf>

169. BROWN, Lester, Biofuels Blunder: Massive Diversion of U.S. Grain to Fuel Cars is Raising World Food Prices, Risking Political Instability. Briefing before U.S. Senate Committee on Environment and Public Works,

13 June 2007. Accessed, 22 October 2007, <http://www.earth-policy.org/Transcripts/SenateEPW07.htm>

170. HOOIJER, Aljosja, SILVIUS, Marcel, WÖSTEN, Henk, PAGE, Susan, Peat-CO<sub>2</sub>. Assessment of CO<sub>2</sub> emissions from drained peatlands in SE Asia, Delft Hydraulics Report Q3943 (2006), pp. 1, 12, 7 December 2006. Accessed, 6 November 2007, <http://www.wetlands.org/getfile-fromdb.aspx?ID=b16d46c5-ea7b-469a-a265-408b59aab5d1>

171. The use of palm oil for biofuel and as biomass for energy, Friends of the Earth, August 2006, p. 3. Accessed, 6 November 2007, [http://www.foe.co.uk/resource/briefings/palm\\_oil\\_biofuel\\_position.pdf](http://www.foe.co.uk/resource/briefings/palm_oil_biofuel_position.pdf)

172. HOOIJER, Aljosja, SILVIUS, Marcel, WÖSTEN, Henk, PAGE, Susan, o.c., p. 0.

173. DUFEY, Annie, International Trade in Biofuels: Good for Development? And good for Environment? International Institute for Environment and Development, 2007. Accessed, 22 October 2007, <http://www.iied.org/pubs/pdf/full/11068IIED.pdf>

been reports of forced expulsions of farmers from their land and degrading and unhealthy work conditions<sup>174</sup>. The extra employment created has a predominantly seasonal character and is expected to diminish due to mechanization of the cultivation<sup>175</sup>.

### 4.3. The perspectives of a new WTO agreement

Finally, though it has been going on since 2001, one must mention the negotiations of the Doha Development Round. A new compromise on agriculture was presented at the beginning of 2008.

Some elements have been known for a long time, like the interdiction of export subsidies to be applied to developed countries in 2013 (and developing ones in 2016). The new compromise details some new restrictions to be applied to internal supports. Basically, they imply the abandonment of the so-called blue box and the addition of the legal constraints in the green box (id est strengthening of the decoupling principle). The new text also reduces further the ability of developed countries (and especially the EU) to impose restrictions on so-called sensible products. Finally, it would require more market access in the developed countries.

In the Uruguay agricultural agreement, direct payments under production limiting programmes were exempt from reduction commitments. In the current agricultural draft modalities, this Blue Box support would be reduced by 2.5% compared to the value of production in the base period (1995-2000). The reductions would apply from the first day of the implementation period. Product-specific Blue Box support would also be capped at the average value of support provided to those products during 1995-2000. Should Members exceed their limits for either product-specific or overall Blue Box support, the entirety of this support must be included in the calculation of the Current AMS, and thus result in larger cuts (70% for the EU).

Regarding SPS payments, which are considered Green Box payments that are not tied to a limit because they are considered to be minimally trade distorting,

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174. Biofuels. Implications for the South. Report of Seminar, Brussels, European Parliament, pp. 3-4, 27 June 2007. Accessed, 6 November 2007, <http://www.investmentwatch.org/docs/agrofuelsseminarEPjune2007.pdf>

175. Challenges and Opportunities for Developing Countries in Producing Biofuels. United Nations Conference On Trade And Development, UNCTAD, p. 21, 27 November 2006. (UNCTAD/DITC/COM/2006/15) Accessed, 6 November 2007, [http://www.unctad.org/en/docs/ditcom200615\\_en.pdf](http://www.unctad.org/en/docs/ditcom200615_en.pdf)

the draft provides two options for updating the base periods used to calculate the amount of decoupled support. Both options aim to ensure that such updates do not affect producer expectations or decisions. However, the extent to which the European decoupled direct payments are compatible with the Green Box is questioned by some and could be the subject of a future WTO challenge<sup>176</sup>.

The absence of an agreement covering non agricultural products and services seems nonetheless to indicate that the conclusion of any global deal remains a far-fetched perspective. The political context, especially the perspective of a changing administration in Washington, will certainly not simplify the situation. Nonetheless, one cannot exclude, on the other side, that the present changing tides on the international agricultural markets, could precisely facilitate a deal, at least on this topic.

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176. SWINBANK, Alan, TRANTER, Richard, Decoupling EU Farm Support: Does the New Single Payments Scheme fit within the Green Box? In: *The Estey Centre Journal of International Law and Trade Policy*, 2005, 6, 1, pp.57-58. Accessed, 8 April 2008, [http://www.esteyjournal.com/j\\_pdfs/swinbanktranter6-1.pdf](http://www.esteyjournal.com/j_pdfs/swinbanktranter6-1.pdf)



## 5. Conclusion: A New Context requires a New Approach

Agriculture has entered a new and uncertain phase. Since 2000, most real prices have increased. It is however difficult to determine whether this is a normal cyclical evolution or a fundamental change. Both interpretations can be defended. On one side, there have already been periods of rising prices during the XXth century, between 1933 and 1948 for example, or 1973 and 1980<sup>177</sup>. On the other side, at least two structural changes can be observed. Firstly, the rising standard of living in some important developing countries (beginning with China and India) provokes a substantial increase of demand for agricultural products. Secondly, the rising price of fossil energy sources provokes an increasing demand for biofuels. Both changes appear as long term ones. In the sidelines, one must also mention the possibility of new production limits created by climate warming, though they remain presently difficult to evaluate with precision.

Those familiar with the traditional setting of the agricultural negotiations of the EU may have some difficulties to get used to the new agricultural context. Rising demand, new uses of agricultural products, and rising prices form quite a new picture. This new picture will require deep adaptations, but it also offers opportunities. It is from that perspective that the new propositions of the European Commission (the so-called “health check”) need to be analysed.

Important changes have become possible, but they will require imagination in various directions. Firstly, agricultural prices have been going down for so long that it is inherently difficult to adapt to another mind setting (which was, paradoxically enough, the original mind setting of the Treaty of Rome’s authors in 1957). Secondly, the present situation indicates that nothing is eternal. What goes up can also go down, and designing a house for both good and bad weather is sometimes a little bit more complex.

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177. This “traditional” analysis is clearly adopted by the FAO/OECD agricultural previsions for the period 2008-2017. Accessed, 4 June 2008, <http://www.fao.org/es/esc/common/ecg/550/en/AgOut2017E.pdf>.