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Point-de-Vue

The EU Budget and the CAP: An Agenda for the Review?

By David Harvey

Summary

The promised review of the EU Budget in 2008 offers an opportunity to bring CAP financing into line with logic, justice and the rest of EU policy. Currently, the CAP is unique amongst European policies in being both mandatory and requiring 100 per cent financing by the EU budget. While this made good sense at the policy's inception, it is now an obsolete anachronism.

A sensible and defensible agenda for financial reform, which is all that is on the reform agenda at present, is to make the EU budget responsible for only a fraction (say 25 per cent) of the costs of the current CAP, instead of the present 100 per cent. This would bring CAP financing into line with other EU policies, and make member states separately responsible for the balance for their own farmers, as they so wish, up to the CAP budgetary ceiling already agreed. Any resulting competition between member states in the extent and means by which they continue (or not) to support farmers through direct payments would be controlled through EU Competition and single market policies. Such competition would also provide a good opportunity for experiments with policy development, to the advantage of all, since different policies are required for the different stages of development and different local conditions now evident within the EU.

(from Economist, 24.12.05, p 43)

Listen to my voters, behind me. How can I accept another CAP reform?

"A little competition between member states with different farm policies should help us all learn what sorts of farm policies are better and what worse for different conditions."

The final Summit decision on the EU Budget in December 2005 produced a classic European fudge. It is surely little wonder that the European Union is scarcely taken seriously as a world power when it behaves like this. Part of the difficulty, no doubt, is that the negotiations and disputes are about peanuts. The arguments are about amounts that total only marginally more than 1 per cent of GDP, compared with national budgets of more than 40 per cent. Little surprise, then, that the associated debates are of barely parish council standard, at least if the press accounts are to be believed.

The Blair Government of the UK has been blamed (*Economist*, 24.12.05) for failing to back the 'sensible idea put forward by Italy and others that a chunk of CAP support should be switched from Brussels to national governments.' Mr. Blair has also been blamed for accepting (under the shrouds of the Iraq crisis) the October 2002 deal to freeze CAP funding until 2013. This lacklustre agreement has now been confirmed, apparently, by the acceptance of the 2007-2013 budget.

However, the Summit did promise to review the EU Budget in 2008. *Agra Europe*, at least, is confident that this agreement 'will provide the means to further effective reform,' arguing that there 'are important parallels with the unsatisfactory outcome of the Agenda 2000 attempt at reform – which was wrecked by France's President Chirac at the 1999 Berlin Summit - and the subsequent successful Mid-Term Review of 2003'. And also that conditions may be more conducive to change in two years' time, when the WTO Doha round should have made progress and governments will have changed in a number of countries.

Lest there be any excuse not to address the major failings of the present EU Budget structure then, it is important to begin to examine their nature now. There are four critical facts about the CAP and the EU budget that could form the basis of a potential solution.

Fact 1 – CAP financing is unique

The CAP is the only European policy that is both mandatory and 100 per cent funded from the EU budget. All other policies are subject to member state contributions. The unique character of the CAP budget provisions made excellent sense at the policy's inception. In the beginning, when the EU was a net importer of food, the CAP generated funds for the EU budget, rather than being a drain on it. Food was effectively taxed, through import levies, while the bulk of farm support was provided through consumers paying in excess of world market prices. By the same token, of course, the net-importing member states (especially Germany and, later, the UK) effectively paid out to support the net exporting countries, such as France. Common and mandatory financing were essential elements of the structure of the policy and for economic union. Since internal EU food prices needed to be set at a common level, the common import tariffs properly accrued to the EU budget as 'own resources', rather than to the individual member states.

Fact 2 – The CAP has already been radically reformed

But the CAP has been radically reformed, and the special character for the CAP budget provision is now an obsolete anachronism. Much farm support is now being paid directly from the budget by the EU taxpayers (more than €30bn of the total CAP spend of €38bn), through single farm payments. Although several market intervention mechanisms still exist, these will decline over time as the EU plays its part in the WTO negotiations. Furthermore, single farm payments are justified on the grounds of care and maintenance of the rural environment, and not on securing food supplies. Neither the values of environmental care, nor the costs of providing for it are uniform across the Union – there is no logic, other than historical precedent, requiring payments to be the same, or that they be commonly financed, or that they be mandatory rather than discretionary. Nor, incidentally, is there good reason to suppose that these single farm payments, with cross-compliance, will be efficient or very effective in delivering the objective of sustainable rural environments (see, e.g. Harvey, 2003). However, from the point of view of a review of the financing of the CAP, this may be considered irrelevant.

Nevertheless, the principles of subsidiarity – that decisions should be taken, incentives provided and penalties or regulations applied at the lowest sensible and appropriate level – and of co-financing (and hence co-responsibility) should be applied here as with social and regional fund spending. The historical legacy of mandatory CAP spending, exclusively financed from the EU budget, is no longer either legitimate or sensible. It should be discontinued, as recently argued strongly by (*inter alia*) Lord Christopher Haskins, farm policy advisor to the UK's ruling Labour party.

Fact 3 – The Central European countries are differently treated

The Central European countries, with large farming populations and low incomes, have joined the CAP on very unequal terms - their farmers are only paid 25 per cent of the payment rates to their richer and more fortunate western cousins, though this proportion is set to rise in the future. There is neither logic nor justice in this glaring inequity. Of course, some argue that there is logic here, since the poor central European farmers never had high support prices in the first place, so hardly need compensating payments for the support price reductions. But this logic completely misses the point – the benefits of the high support (whether by supported prices or by direct payments).

Political economy strongly suggests that generous farm support is of substantial assistance to economic democracies moving from predominantly agrarian to commercial/industrial structures. The reduction in farm labour forces from over 20 per cent to less than 5 per cent, and the associated urbanisation of the population, as economies grow, is a natural economic process. As we get richer we spend smaller fractions of our total income on food, though more on services. As a result, fewer people are able to earn full time livings from farming, so have to find something else to do. The economic signals encouraging this transition are falling relative farm incomes. But the transition is traumatic – the less able, less wealthy and the elderly tend to get left behind. Couple this with an increasingly prosperous non-farm population (many with fond memories of farming and relatives still trying to make a living at it), and a decently democratic political system, and it is far from surprising that advanced economies seek to support their farmers. Few, if any advanced economies have managed this transition without substantial farm support. Yet the EU is denying its less advantaged members the levels of support that its rich members enjoyed (and, arguably, could not have done without) during their own transitions. This is not the behaviour of a Union that aspires to be a world power.

Of course, we in the richer west, with our now transformed agricultural systems, can argue that the high levels of support did not, in the end, do any good, and therefore are not a good example to follow. Indeed, the WTO rules are now preventing the emerging economies from following the rich countries example – do as we say now, not as we did then. But, whatever else farm support does, it increases the asset values of existing farmers and rural estate owners when it is first introduced (or increased). This increase in asset values gives the existing stakeholders in the rural estate an increased capacity to adapt, respond and adjust. So long as the signals and incentives about how to adapt and adjust are sensible and sustainable, (i.e., not including artificially increased farm product prices) then this increased capacity can be beneficial in assisting adjustment and encouraging sustainable rural development. It is, of course, true that there are many counter-arguments to the policy of supporting farmer incomes, and also true that, once implemented, they generate considerable dependencies that are hard to break. Harvey, (2004) and Thurston, (2005) for example, further explore some of these arguments.

But the critical point is that different sorts of farm policies are needed at different stages and conditions of political-economic development. In the original European Community, the conditions of the founding member states were sufficiently similar that a common policy made sense. Now, however, conditions across the EU are markedly different, and appropriate farm policies are also different (Harvey, 1995). Continued enforcement of a common policy will prove divisive rather than cohesive.

Fact 4 – The British rebate is only because of the CAP

The British budgetary rebate is only justified (if at all) because of the operation of the CAP funding. Britain contributes a lot to EU funds because it is a large economy and densely populated, and tends to be a food importer rather than an exporter. But she gets relatively little back through the CAP, because the size of the UK farm sector is relatively small. In addition, the present CAP funding system, including the budget rebate, has consequences which tend to aggravate an apparent British predisposition to be antagonistic to the EU (though not necessarily to Europe), because budget considerations over-rule common sense and logic. For instance, British governments tend to be nervous about proposing or supporting proposals to re-direct CAP spending towards smaller or less advantaged farms, simply because the UK would loose CAP spending because the average size of farm in the UK tends to be larger than on the continent. British governments tend also to be reluctant to sign up to other European programmes, or to commit spending to these programmes. Since the rebate depends on the gap between the UK contributions to the EU budget and UK receipts from the EU budget, the more EU spending there is in the UK, the lower the rebate. The result is that it actually costs the British taxpayer, via H.M. Treasury, something like £2.50 for every extra £1 it tries to spend on European programmes. Not surprisingly the Treasury frequently decides that, at this price, the extra spending is simply not worthwhile. On the other hand, giving up the rebate without some change in the CAP funding is as attractive an option to any UK government as eliminating (or even reducing) farm support is to any French government. The *impasse* is self-evident in the 'crisis' surrounding the budget agreement in December 2005. The fudge taken to resolve this *impasse* this time was to promise to review the budget in two years time. Is there any chance of progress then? Only if there is an outline of a possible solution.

A solution?

So, what might a solution look like? The four facts above can be used to develop an answer. First, get rid of the unique character of CAP funding; treat farm spending like all other EU programmes. Make it discretionary, and co-financed by the member states. Second, retain the existing CAP as a frame-work for member state action and spending - including the presently agreed cap on total CAP spending, so that there is no necessity for further CAP reform - unless individual member states decide to use their discretion not to operate specific bits of CAP support. Third, reduce the glaring inequity between the central European members and their richer western counterparts, by limiting the EU budget's contribution towards each member state's CAP spending to, say, 25 per cent of the total. There is even a case, on equity grounds, for the EU budget to bear a greater proportion of CAP spending for the poorer member states, and a smaller proportion for the richer member states. Fourth, get rid of the UK rebate, which would then be no longer necessary or justified.

Who might object to this solution, and on what defensible grounds? France can hardly object – if she wants to continue CAP spending, she can, under the same conditions as now, with the simple exception that she will have to pay towards her own farmers' support. France might complain, but can hardly object that her long advantage from the CAP is finally being reined in. Likewise, the UK could not object about giving up the rebate, which is no longer justified at all. The central European states might actually be able to use the negotiations to make the richer west better live up to their responsibilities.

But surely, some might say, re-nationalising the CAP undermines one of the central pillars of the European Union. Which particular pillar is being undermined here? Subsidiarity? Co-responsibility? Cohesion? Justice? Equity? Logic? Common sense? Fair trade? Freedom of - movement? The only pillars being demolished in this solution are historical precedent and squatters rights – the very pillars that the formation and foundation of the EU was designed to blow up for ever.

But, surely member states would try to gain advantage by increasing the support to their own farmers? What advantage, exactly, would that be? In any event, the total level of CAP spending has already been capped, by agreement, and that agreement should be retained. In addition, each member state is bound by the laws of competition and the rules of the single market, so unfair competitive advantage is ruled out. More likely, some member states would choose to reduce their farm spending, and seek to spend their resources in other ways. At least, they will do so if they are prepared to take on their own farmers (or buy them out with some form of compensation). At present, the governments most keen on eliminating the CAP (from a particularly cynical point of view) can have it both ways – arguing for radical reform (i.e. elimination) to please the bulk of their electorates, but knowing that it will only happen if all the rest of the member states agree, which is unlikely, so they will never have to face down their own farmers. Even if it did actually happen, these reforming governments could then pass on the blame for the farmers' pain to the EU – a win-win strategy.

But, if we adopt this solution, governments will have to be honest, and put both their money and their reputations where their mouths are. If the economists and reformers (e.g. Jack Thurston; UK Joint Defra/Treasury Vision) are right, these countries will gain the advantage by eliminating the CAP (or at least its Pillar 1), and the results will be plain for all to see. If they are wrong, then the world will know that economists cannot be trusted. In any event, a little competition between member states with different farm policies should help us all learn what sorts of farm policies are better and what worse for different conditions. We can't loose, as ordinary people and taxpayers. Vote for it, or tell me why I am wrong.

Further Reading

Agra-Europe, January 6th 2005, no. 2189: Budget deal opens way to completion of CAP reform

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Harvey, D. R., (2003), Agri-environmental relationships and multi-functionality: some further considerations, *The World Economy*, **26** (5), 705 – 725

Harvey, D. R., (2004), Policy Dependency and Reform: Economic gains versus political pains, *Agricultural Economics*, **31**, 265 – 275.

UK Joint Treasury/DEFRA publication, (2005), *A vision for the CAP*. December, (http://www.defra.gov.uk/farm/capreform/vision.htm)

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