CAP Reform and EU Enlargement

The future of European Agricultural Policy

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As I said in my introduction, a lot has happened since we organised our last seminar on the Common Agricultural Policy and Enlargement in November 2002 in Prague. Therefore, it might be good to look in a little more detail where we are at the moment and which perspectives we see for the future.

Let me start with an overview of recent developments of the CAP. Yes, we are clearly in a process of reform. Today, the rules of Agenda 2000 still apply. But after the Mid Term Review of 2002, the Council of Ministers decided in June 2003 on a new reform package.

A second reform package, covering mainly Mediterranean products, is currently in discussion in the Council and we hope it can be concluded this month.

For this year, the Commission has programmed to present proposals concerning the future development of the CMOs for sugar and fruit and vegetables.

And last, but not least, we will present, before the summer break, proposals for a reform of our rural development policy. Altogether, this represents a huge work programme and we hope that the corresponding decisions can be made by the Council of Ministers in 2005.

Of course, there are other factors and developments, sometimes even outside the agricultural context, which determine what can be done in the field of agricultural policy. You see the most important of them in the graph in blue and yellow on both sides of the central arrow. Those which are in yellow will be at the centre of our discussions today and tomorrow and we will have specific presentations on these subjects. So, I will try to concentrate my presentation on the CAP reform and the Commission's proposal on the financial perspective which has been adopted five weeks ago.

Let me start with the CAP reform of last June. It is a big step forward in a process of reform which started in 1992 and was deepened and extended through the Agenda 2000 reform.

The main thrust of both the 1992 and the Agenda 2000 reform was the shift from price support to direct income support. This was a first step to shift support from production to the producer, in a number of key sectors, namely cereals, oilseeds, protein crops and beef. But this step went only halfway. In fact, the direct income support remained coupled to factors of production, be it hectares linked to specific crops or headage payments for animals.

2. CAP-reform: Main elements and implementation in new Member States

Against this background, the new reform decided in June 2003 represents a logical and consistent step – or should I better say a "leap"- forward. Now, what are the main elements of the new reform?

- I think the most important element is the introduction of a **single payment scheme**. It will replace most of the direct payments currently available to farmers. The new payment will no longer be linked to what a farmer produces but will be "decoupled". Its amount will be calculated on the basis of historical references over the period 2000-2002. De-coupling should contribute to improve the market orientation of the sector. Management decisions will in the future be based on profitability considerations which are much less influenced than today by what the CAP offers in terms of subsidies for this or that specific sector of production.

  The new single payment scheme comes into operation on 1 January 2005, but implementation may be delayed by a Member State until 2007 at the latest. Full decoupling is the general principle. Member States may, however, decide to maintain a certain proportion of direct aids to farmers coupled, notably where they fear major market disturbances or abandonment of production as a result of the move to the single payment scheme. Member States may also decide on a regionalisation of the amount of premiums available. Within this regionalisation scheme, they may further apply a number of options to redistribute premiums among farmers.

- Another key element of the reform is the introduction of **cross compliance**. For this purpose, a set of 18 particularly relevant statutory requirements concerning environmental protection, food safety and animal health and welfare has been selected. A farmer who does not respect these requirements will face a reduction of his direct payments. Cross compliance applies further to the obligation to maintain all agricultural land in good agricultural and environmental condition, in order to avoid land abandonment and subsequent environmental problems.

- A key objective of the new reform is to strengthen **rural development** policy. This will be achieved via "modulation" – that means a transfer of funds from direct payments to rural development - and by introducing new measures into the menu available for rural support.

- These new measures include
  (1) Temporary and degressive support to help farmers adapt to the introduction of EU standards concerning the environment, public, animal and plant health, animal welfare and occupational safety.

  (2) support to help farmers meet the costs of using farm advisory services;

  (3) support for farmers who participate in recognised quality schemes or support for producer groups for information and promotion activities concerning their products in such quality schemes.

  (4) payments for farmers who enter into a commitment to improve the welfare of their farm animals, going beyond usual good animal husbandry practice.

- As far as market and price policies are concerned, the new reform continues the shift from price support to direct payments, in particular in the rice and dairy sector. The implementation of the reform of the common market organisation for milk, decided under Agenda 2000, is advanced by one year and starts now in 2004. In addition, the intervention price for butter will be reduced by 25% instead of 15%. Farmers will receive a partial compensation for the price reduction in the form of direct payments. These payments will be integrated into the single farm payment from 2006/07 onwards. However, Member States may decide to advance this integration. The quota system has been prolonged until 2014/15, and the general quota increases decided under Agenda 2000 have been postponed.

- For cereals the current intervention price and direct payment level will be retained, but monthly increments will be reduced by 50%. Rye will be excluded from the intervention system. New support for energy crops of 45 euro per hectare will be available for a Maximum Guaranteed Area of 1.5 Mio ha. Other reform decisions concern protein crops, starch potatoes, durum wheat, nuts and dried fodder. I mention them here to be complete, but I will not enter into the details.

- Finally, a **Financial Discipline** mechanism has been agreed in order to keep CAP spending in line with the strict budgetary ceiling laid down by EU leaders at the

European Council in October 2002 for the period up to 2013. When forecasts indicate that expenditure for market and income support (subheading 1a of the financial perspective) is likely to exceed established ceilings, minus a safety margin of € 300 million, direct aids will be reduced. The Council will fix the necessary adjustment each year based on a Commission proposal.

All these changes agreed by the Agricultural Council have been incorporated into legal texts which have been officially adopted by the Council in September last year. My colleagues in Brussels are now working hard to prepare the implementing rules which will guide the Member States to put the reform into practice. Of course, this work is done in close consultation with the Member States. A first regulation concerning the most urgent market reforms has already been published in December. The remaining regulations should be ready in spring.

What does all this mean for the new Member States? Well, Ladies and Gentlemen, EU-Membership is based on applying the acquis communautaire. The new rules for the CAP, which are now part of the acquis, will therefore also be applicable for the new Member States. Where necessary, we will have to adapt the Act of Accession and the CAP reform texts themselves, so that they can be applied also in the new Member States. The Council has reached a political agreement on the relevant Commission proposals for adaptation in last December. The consent of the European Parliament is also required on the adaptation of the act of accession.

A first proposal foresees that the new direct payments introduced by the CAP reform (for energy crops, nuts and dairy) would be subject to the same phasing-in schedule as all other direct payments (25%, 30%, 35% etc.). The possibility to top-up these direct payments is maintained in line with the negotiated terms of accession.

Concerning the new de-coupled single farm payment, the adaptation proposal maintains the option for the new Member States to apply a hectare-based Single Area Payment Scheme (SAPS) and makes the technical adjustments necessary for it to apply in the negotiated form. The proposal foresees that new Member States applying the SAPS move directly from this to the new single farm payment SAPS can be applied until the end of 2008 at the latest.

For rural development, the CAP reform introduces a general 'meeting standards' measure intended to help farmers adapt to the operating costs resulting from newly introduced EU standards. The proposal therefore deletes the separate 'Compliance with Community standards' measure created for the new Member States in the Act of Accession. Farmers from the new Member States will be able to benefit from the same possibilities as the farmers from the EU-15. Moreover, the Commission has now proposed to add a special derogation in favour of the new Member States: For the period 2004 to 2006, measures to support adaptation to newly introduced Community standards would in the new Member States also include investment aids and these investment aids would be financed by the Guarantee section of the EAGGF.

A second proposal of the Commission referred to adaptations of the CAP reform package. It was already adopted by the Council in December last year.

The new single farm payment raises a problem for the new Member States as it is not possible to calculate payment entitlements for their farmers on the basis of the same historical reference period as used in the EU-15 (2000-2002). Consequently, the proposal foresees that the new Member States apply the "regional implementation option" decided in the CAP reform for EU-15. This means that uniform per-hectare entitlements would be granted within any one region from regional financial envelopes. The regional envelopes themselves would be calculated by dividing the national envelope between regions. A national reserve, out of which additional entitlements could be granted for sector specific issues, would be set at 3% of the national ceiling, as for the current Member States.

On cross compliance, farmers in the new Member States will become subject to the CAP reform rules from 2005 onwards. The adaptation foresees two exceptions, however. First, the transition periods negotiated by some countries, for example concerning the implementation of the Habitat directive, will remain intact. Second, for those new Member States choosing to apply SAPS, any land benefiting from payments under SAPS must be maintained in good agricultural condition compatible with the environment. The new CAP reform rules on cross-compliance are optional under SAPS.

As regards the mechanisms of financial discipline and modulation, the proposals foresee that these should not be applicable to the new Member States until their level of direct payments reaches the then applicable level of direct payments in the EU.

I think these are the main points as regards the reform decisions of last year, Ladies and Gentlemen. Now, what can we say about the impact we expect?

In the context of our yearly work on the medium term prospects for agricultural markets and income in the European Union, we have this year also undertaken a model analysis concerning this question. The analysis is on the way of being published and Wolfgang Münch will present the results this afternoon. I will therefore limit myself to highlighting the main conclusions.

Let me start with the cereals sector: After the exceptional weather conditions which led to a sharp drop of yields and production in 2003, we expect a recovery back to normal in 2004. In the medium term, yields would continue to increase moderately and production is expected to reach some 274 Mio t. in 2010. The additional supply would be absorbed by a sustained domestic demand and the marketable surplus of cereals will stabilise at around 20 Mio t.

Compared to a continuation of current policies under Agenda 2000, the reform will lead only to a small reduction of production. According to our projections, the total cereal area in EU-25 would be some 1.5 to 2% smaller than under Agenda 2000. It would stand around 54 Mio ha. in 2010. However, higher yielding cereals would gain area and offset some of the total reduction in the cereal area.

The reform will significantly reduce rye production by 11% and that of durum wheat by 6%. These reductions would in the first place concern the present Member States. The stronger market orientation for rye production could well result in more segmented markets, with clear differences between bread and feed rye prices.

The internal trade of cereals in the enlarged EU is projected to increase, most notably for barley and maize. The barley markets in the new Member States would expand, whereas maize from the new Member States would find additional feed demand in EU-15.

The oilseed area and production, including that for energy use, is expected to expand, mainly in the new Member States.

Finally, the decoupling of the area payments would, according to our projections, only lead to a limited expansion of voluntary set-aside, mainly from rye and durum wheat areas in EU-15.

These are the main points I wanted to highlight as far as cereals and oilseeds are concerned. Let me now pass on to the animal sectors.

As regards the beef sector, our medium term outlook shows a relatively stable production around 8 Mio t. Despite a modest decline of beef consumption linked to higher prices, beef markets are projected to remain relatively balanced until 2010. The introduction of de-coupling under the new CAP reform is expected to lead to a reduction of production and a strong increase of producer prices of 7 to 8% as compared to Agenda 2000. Under Agenda 2000 conditions, the beef price would have been reduced as a result of enlargement.

Higher beef prices under the reform will weaken beef demand, in particular in the new Member States. The building up of beef herds in these countries will therefore remain limited and this even more so as the direct payments will be, to a large extent, de-coupled. As a result, beef production in the new Member States will remain predominantly linked to milk production. In the pork sector, EU-25 production is forecast to increase steadily over the medium term to 23 Mio t. in 2010, with around 15% taking place in the new Member States. Poultry production would also expand, from some 11 Mio t. in 2004 to 12 Mio t. in 2010. Both markets would benefit from the positive demand trends foreseen for the new Member States where per capita meat consumption would increase by 20 to 25% over the medium term, in particular for poultry meet.

Accession and the effects of the single market are expected to lead to a redirection of trade according to the relative competitiveness of the Member States. Some Accession Countries have gained increasing competitiveness in the area of poultry production, mainly due to foreign direct investments into production and processing. Upon enlargement, an increasing part of poultry production (up to 600.000 t.) is projected to be directed to the current Member States.

On the other hand, a part of the pork production in the new Member States would have a comparative disadvantage with respect to quality, i.e. lean meat content, and feed efficiency. Here the analyses suggest that for the current Member States a market of additional 300.000 t. of pork might open in the new Member States.

The reform affects the production and consumption of pork and poultry only indirectly because no direct changes to the market regime have been made.

Pork production might expand partly due to new producers coming from the beef sector. Additional demand from consumers shifting from beef to pork and poultry because of higher beef prices would generate an expansion of both consumption and production. Altogether this might lead to slightly lower prices than under Agenda 2000.

As regards milk and dairy products, subsistence production of milk still has a significant share in total milk production in many of the new Member States. It accounts for almost 20% of total production. However, with economic development, subsistence production will gradually decline and be replaced by increased market production. Due to the milk quota system in place, total milk production will remain relatively stable at some 22 to 23 Mio t. in the new Member States and 122 to 123 Mio t. in EU-15.

In the early years of accession, butter and, to a lesser extent, skimmed milk powder production is projected to expand in the new Member States, mainly due to the increase in prices and the existing production structures in these countries. However, in the medium term, production in EU-25 should decline, because of the lower competitiveness of butter in comparison to other dairy products. Intervention of bulk products will become less interesting as a market outlet as intervention prices will go down. High value added products like cheeses and fresh milk products will become more competitive on internal as well as external markets. Their production will increase.

Altogether, these developments should lead to a better market balance for dairy products and to a gradual increase in average milk prices in EU-25 from 2007 onwards. They will, however, remain over the whole projection period – i.e. until 2010 – 3 to 4% lower than under Agenda 2000.

Looking at the agricultural sector as a whole, medium term perspectives in the new Member States would appear to be quite positive according to our projections. Sector income, as measured by the GVA, should improve significantly over time. In 2010, sector income should be some 35% higher than in 2002. This strong development in farm income in the new Member States is largely related to the phasing-in of direct payments, the effect of rural development measures and, last but not least, improved efficiency of production. The de-coupled nature of direct payment reduces the incentives to invest in production areas characterised by weak markets and high direct payments which would have been the case under Agenda 2000.

For EU-15, sector income, including direct payments, would be little affected by the CAP reform. Until 2010, they would stay somewhat below Agenda 2000 results. From then onwards, they would be slightly superior. This outlook is slightly more positive for the current Member States than the outlook without enlargement. The main difference would appear to lie in the more positive market dynamics of the enlarged EU. And these dynamics would appear to be even more pronounced under the CAP reform.

These are, in a nutshell, the main outcomes of our analysis, Ladies and Gentlemen. As I said, Wolfgang Münch will give us more details this afternoon. But let us continue to look forward: what are the main tasks and challenges ahead and which factors will influence the future development of the CAP?

Already last autumn, the Commission tabled a second package of reform proposals. They concern cotton, olive oil, tobacco and hops. The second package follows the same line as the first one. The Commission proposes to fully decouple direct payments for tobacco and to introduce 60% decoupling for olive oil and cotton. In addition, part of the current expenditure for tobacco and cotton will be used to increase rural development funds for those regions where farmers are particularly affected by the reform. For hops as well, decoupling of direct payment has been proposed.

Another market organisation which is more and more in the limelight of public debate is that of sugar. Sooner or later a reform would appear to be unavoidable in this sector. The Commission is convinced, however, that we first need a substantial and well informed discussion. Only after such a discussion can a reform proposal be elaborated. Therefore, we tried last autumn to launch the debate, at EU level, by describing and analysing three options for the future of the sugar regime. The discussions still go on, but we expect to present more detailed proposals in the summer. Furthermore, the market organisation for fruit and vegetables is also very likely to be subject to a review later this year.

Once decisions have been made on these remaining reviews and reforms, we should have a policy framework in place which should give us a decade of relative stability without major new reforms. This is at least my personal expectation and hope. Some may call it wishful thinking. But I am convinced that after all these reforms, we urgently need a longer period of stability in order to ensure a successful implementation of these new and, in some respects, quite radical reforms, to offer a reliable economic perspective to farmers and their families when they make their choices for the future and last, but certainly not least, to complete the integration of the new Member States in all fields of the CAP. We should not underestimate the huge tasks and challenges which all this will imply.

But, of course, stability does not mean stagnation or standstill. The economic and the political situation will continue to evolve, new challenges will have to be met, and adjustments may become necessary. One of these challenges is certainly the ongoing WTO negotiation in the framework of the Doha Round. Bob Norris will give us more detail on this tomorrow.

Another important factor for the future is the financial perspective. The financial perspective is a multi-annual financial planning framework which has to be agreed by the European Parliament, the Council of Ministers and the Commission. It defines the broad political priorities for the period covered and sets ceilings for expenditure under the different parts or headings of the EU budget. These ceilings must be respected in the annual budget procedure.

Five weeks ago, on the 10th of February, the Commission has tabled the orientations she proposes for the next financial perspective concerning the years 2007 to 2013. The project is focused on 3 broad priorities:

1. Boost economic growth on a sustainable path;

2. Guarantee freedom, justice and security to citizens at European level and

3. Make Europe a global partner in the world with a strong and coherent voice.

The new framework refers to an EU-27: it is assumed that Bulgaria and Romania will become Member States in 2007.

The perspective is divided in 5 headings. Agriculture and rural development are proposed to be financed under heading 2 – “Sustainable management and protection of natural resources” – together with the fishery and environmental policies.

As you are certainly aware, agricultural expenditure for market support and direct payments has already been fixed for the whole period until 2013 by the European council of Heads of State and Government at their meeting in October 2002 in Brussels. The Commission has taken over these figures in its proposal. They have only been adapted to accommodate the two additional new Member States from 2007 onwards.

Based on this approach, expenditure for market support and direct payments would increase in nominal terms from some 45.5 Bio € in 2006 to around 50.5 Bio € in 2013. This is an increase of about 11% in nominal terms. In real terms, measured in constant 2004 prices and with an assumed inflation rate of 2%, it would decrease by 3%, from 43.7 Bio € in 2006 to 42.3 Bio € in 2013 and this despite the enlargement to 27 Member States.

As regards the rural development policy and its implementation and management, it has often been stressed that a radical simplification is needed. This was also one of the main conclusions of the Salzburg Conference on Rural development of last November. A first important step in this direction has now been made in the proposal for the new financial perspective. The Commission proposes a single Rural Development Fund which would comprise the funds of the EAGGF Guarantee section for rural development and those of the EAGGF Guidance section. Moving to one programming and funding instrument for the next period, would allow to reduce the number of programmes to manage, to facilitate a coherent programming and to reduce the current complications of financial management and controls.

Following the Commission’s proposal, the total budget available for rural development would increase substantially between 2006 and 2013. In 2004 prices, the increase would be around 25%, from 10.5 Bio € in 2006 to 13.2 Bio € in 2013. In current prices it would be 44%, from 11 to 15.8 Bio €. This increase is exclusively due to enlargement.

All these figures concerning rural development expenditure do not yet take into account the modulation mechanism which applies only to EU-15 until the phasing of direct payments in the new Member States is completed. Modulation should lead to transfer of 1.2 Bio € in current prices from the first pillar to the rural development budget.

Taking agricultural market support, direct income payments and rural development expenditure together, the total would pass from 54.3 Bio € in 2006 to 55.5 Bio € in 2013.

Both figures are in constant 2004 prices and imply an increase in real terms of 2%, exclusively resulting from enlargement. In current prices, applying an annual rate of inflation of 2%, the budget for 2013 would reach some 66.3 Bio €. This implies an increase in nominal terms of 16% compared to 2006.

Looking at the share of expenditure for agriculture and rural development in the overall budget, it would represent 45% in 2006 and decrease to 35% in 2013, a fact which reflects the shift in budgetary resources towards new priorities.

Despite this shift, the CAP, which has been a cornerstone of European integration in the past, will continue to be, for the years ahead, an important Community policy. The role of rural development policy will even grow. We should therefore not miss the chance we have in the coming months to make this policy fit for the 2007-2013 programme generation. Let’s work together to make it a success.