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MID-TERM REVIEW OF THE COMMON AGRICULTURAL POLICY: EXTERNAL IMPLICATIONS

WITH EVIDENCE

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TENTH REPORT

25 FEBRUARY 2003

By the Select Committee appointed to consider European Union documents and other matters relating to the European Union.

ORDERED TO REPORT

MID-TERM REVIEW OF THE COMMON AGRICULTURAL POLICY:

EXTERNAL IMPLICATIONS

10879/02	Communication of 10 July 2002 from the Commission to the Council and the European Parliament on the mid-term review of the common agricultural policy (COM (2002) 394)
COM(03)23	Legislative proposals[1] of 21 January 2003

PART 1: SUMMARY

1. The European Union is committed to a mid-term review of the Common Agricultural Policy (CAP) in 2003. Proposals made by the Commission in June 2002 for reforming an increasingly unsustainable CAP, although diluted by recent Council decisions, need to be implemented urgently.

2. Imminent enlargement of the EU and forthcoming World Trade Organisation negotiations have increased the urgency of reaching agreement on the proposals.

3. The principal features of the reform package are:

- a single farm payment, independent from production (*decoupling*)
- linking those payments to respect for environmental, food safety, animal welfare, health and occupational safety standards, as well as the requirement to keep all farmland in good condition (*cross-compliance*)
- a revised rural development policy with some increases in resources; new measures to promote quality and animal welfare; and help for farmers (through a farm advisory scheme) in meeting EU production standards
- a reduction in direct payments (*degressive modulation*) for bigger farms, to generate additional money for rural development and savings to finance further reforms
- revisions to the market policy of the CAP in relation to certain sectors (including milk and cereals).

[1] COM (2003) 23, (21 January 2003): (i) Proposal for a Council Regulation establishing common rules for direct support schemes under the common agricultural policy and support schemes for producers of certain crops; (ii) Proposal for a Council Regulation amending Regulation (EC) No.1257/1999 on support for rural development from the European Agricultural Guidance and Guarantee Fund (EAGGF) and repealing Regulation (EC) No.2826/2000; (iii) Proposal for a Council Regulation on the common organisation of the market in cereals; (iv) Proposal for a Council Regulation on the common organisation of the market in rice; (v) Proposal for a Council Regulation on the common organisation of the market in dried fodder for the marketing years 2004/05 to 2007/08; (vi) Proposal for a Council Regulation amending Regulation (EC) No.1255/1999 on the common organisation of the market in milk and milk products; and (vii) Proposal for a Council Regulation establishing a levy in the milk and milk-products sector.

4. The Report comments on the proposals under four headings:

EU enlargement

5. The proposals on decoupling are essential, to avoid compounding overproduction and market distortions in the enlarged Community, and should be reinforced by progressive abolition of market intervention and export subsidisation, particularly in the sugar and dairy sectors. Modulation (i.e. transfers from direct subsidies into structural measures) should be at a higher rate than proposed and possibly higher still for new Member States.

Implications for the World Trade Organisation Doha Round

6. Decoupling is also essential to a credible EU negotiating position in the WTO, as are urgent reforms to the sugar and dairy regimes.

Impact on Less Developed Countries

7. The CAP has for long had damaging effects on the economies of less developed countries, although the impact has varied from one country to another. In the worst cases it has led to impoverishment and the collapse of rural industries. The EU must abandon its direct subsidisation of exports and scale down its import tariffs.

Sustainability

8. Cross-compliance and higher levels of modulation are the key to environmental improvement and to reducing pressures for intensification. The Commission's proposals for a new farm advisory system should be used to promote best practice.

PART 2: BACKGROUND

The Common Agricultural Policy

9. The Common Agricultural Policy (CAP) was introduced in 1962 to respond to a strategic need for food security in Europe. The key objectives of the CAP, as enshrined in Article 33 of the EC Treaty, are to:

- increase agricultural productivity and thus ensure a fair standard of living for agricultural producers;
- stabilise markets;
- assure availability of supplies; and
- ensure reasonable prices to consumers.

10. The original CAP's main mechanisms to achieve this were market intervention to remove surpluses and protection for the domestic market through import taxes and export subsidies. These led to a deliberate increase in domestic food production and, in consequence, to a reduced dependence on imports. But as production responded, surpluses grew and required increasingly heavy expenditure. This led to friction with other suppliers to the world market who were not so reliant on subsidy.

11. In response to escalating production and expenditure a number of reforms have been introduced over the years. These have included:

- artificial constraint of production via mechanisms such as milk quotas and compulsory set-aside for arable crops;
- cuts in support prices, although they remain for the most part above world levels and producers have normally been given direct payments in compensation; this has allowed export subsidies to be reduced and should also allow import barriers to be reduced, although there is little evidence of any reduction in effective EU import tariffs since 1992;
- payments have been introduced for environmentally beneficial forms of farming while support for environmentally damaging investments has been reduced; and
- greater emphasis on rural development and encouraging farmers to look to markets and diversified forms of income to reduce their dependence on subsidy.

12. These changes were facilitated by the MacSharry reforms of 1992-93. That reform programme established a radically new approach to agricultural policy by switching the emphasis of support from markets to farmers. While retaining the "traditional" intervention in major commodity markets as a safety net, its influence for crop products, and to a lesser extent for beef, was replaced by direct subsidisation of the farmer. So-called "compensatory payments", based on historical yields and cultivated areas, replaced a net 34 per cent reduction in cereal intervention prices, thus allowing a pro rata reduction in export subsidies. Some €6 billion in market intervention costs and export subsidisation, in for example, the cereal sector, was replaced with €13+ billion in direct subsidies. This change was regarded by the European Commission as establishing the basis for the eventual scaling down of support, increasing competitiveness and targeting state subvention on income support for the less favoured sector of rural populations. Its efforts to move the policy in this direction have unfortunately, been continuously frustrated by the EU's Council of Ministers—most notably in 1999.

13. The most recent reform package, known as Agenda 2000, was agreed at the Berlin European Council in March 1999.[2] This brought cereal, milk and beef prices closer to world levels, and established the Rural Development Regulation, which enabled the formulation of an integrated EU rural development policy underpinning what has become known as the "second pillar" of the CAP.

14. The original Agenda 2000 proposals were watered down, largely as a result of French opposition at the Berlin summit of March 1999. The would-be reformers—the UK the Netherlands, Germany and the Scandinavian countries—did however extract from the negotiations a commitment to a review of the operation of the CAP (particularly in relation to the operation of the cereals, dairy and beef markets) mid-way through the "term" of the Agenda 2000 programme 2000–2006.

15. The United Kingdom has consistently argued for major reform of the CAP. The principal reasons for this have largely been domestic and economic: that is, that the CAP distorts markets,

[2] House of Lords European Communities Committee, 18th Report 1997–98, *CAP reform in Agenda 2000—The transition to competition: measures for rural development and the rural environment*, HL 84 (March 1998); 8th Report 1998–99, *A reformed CAP? The outcome of Agenda 2000*, HL 61 (May 1999).

encourages overproduction in the pursuit of subsidy rather than the demands of the real market, does not offer a sustainable framework within which EU producers can operate, and causes environmental damage. While recent reforms have moderated the domestic market burden of the CAP on consumers, they have not decreased, but rather increased the burden of the CAP on taxpayers. Since import tariffs have not effectively been reduced, the consumer's additional costs resulting from import barriers have diminished little since 1992.[3] But there are increasingly strong international reasons why urgent reform of the CAP is important. The forthcoming enlargement of the European Union, the EU commitments to substantial agricultural reform made under the Doha Development Agenda of the current World Trade Organisation (WTO) trade round, and the commitments entered into at the World Summit on Sustainable Development (Johannesburg, 2002) have created a markedly different international climate from that in which Agenda 2000 was agreed. It is therefore necessary to re-examine the CAP in a fresh light.

Box 1

The language of the CAP

It is commonly agreed—even among those with professional interests in "playing the system"—that the illogicality of the CAP is matched only by the impenetrability of its jargon. We have therefore tried to minimise the use of technical terms in this Report. An abbreviated glossary of acronyms and technical terms is on the inside front cover, with cross-references to fuller explanations in the text.

Proposals for reform of the Common Agricultural Policy

16. The Commission's proposals of July 2002[4] for the mid-term review of the CAP took the opportunity (to some observers' surprise) to propose a much more ambitious programme of changes than was originally envisaged in the original undertaking to conduct a mid-term review. Pressure from consumers for change, in the wake of the BSE, dioxin and foot and mouth episodes stimulated the Commission into proposing much more comprehensive changes which, if accepted by the Council, would have resulted in a radical change in the style and operation of European agricultural and rural policy.

The Inquiry

17. This inquiry, by Sub-Committee D (Environment, Agriculture, Public Health and Consumer Protection)[5], with specialist advice from Mr Brian Gardner[6], has focused in particular on the external aspects of CAP reform—i.e. the implications for EU enlargement, international trade and relations with developing countries. The aim has been to test the validity of the statement, in paragraph 3.2 of the Commission's Communication (under the heading "External effects"), that although the adjustments to the CAP have been proposed "to meet internal needs and expectations, *they will also help the EU to adapt to external challenges*" (emphasis added).

The Committee's call for evidence

18. In calling for evidence at the end of July 2002, the Committee invited witnesses[7] to address the following questions in particular:

- What impact would the proposed reforms have on the current state of negotiations on EU enlargement? Was Commissioner Fischler justified in saying "they will make enlargement easier"?[8]

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[3] The total average annual budgetary cost of the CAP is currently €40-42 billion (compared with €32 billion in 1991), of which direct subsidies to producers amount to approximately €28 billion. In addition, the consumer loss resulting from import tariffs, other barriers and market price manipulation amounts to a further €53+ billion, according to OECD calculations. The total annual producer subsidy equivalent (PSE)—the total of budgetary and consumer loss—for the EU is therefore put by the OECD at €93–95 billion a year.

[4] COM (2002) 394 (10 July 2002): Communication from the Commission to the Council and the European Parliament on the mid-term review of the common agricultural policy.

[5] See Appendix 1 for membership.

[6] Editor of *Food Policy International* and European agriculture policy analyst.

[7] A list of witnesses and others who helped with the inquiry is at Appendix 2.

[8] Presentation by Commissioner Franz Fischler to the European Parliament Agriculture Committee, Brussels, 10 July 2002 (Speech/02/330).

- How far could the proposals be considered compatible with WTO requirements, e.g. the objectives of the Doha Round? Would they, as Commissioner Fischler has suggested, strengthen the EU's hand in the WTO negotiations?
- Would the Commission's proposals assist with the pursuit of global sustainable development goals?
- What are the implications for the EU's relations with Less Developed Countries?

Parallel work in the House of Commons

19. Whilst focusing on aspects of the mid-term review which are important in their own right, the Committee also wished its inquiry to complement, rather than duplicate, related inquiries by the House of Commons Environment, Food and Rural Affairs Committee. From the Commons Committee's many conclusions and recommendations, contained in two reports published in November 2002 and January 2003[9], the following are particularly relevant and indicate a general meeting of minds on the main issues before this inquiry:

- Internationally, the mid-term review of the Common Agricultural Policy, the process of European Union enlargement, and the WTO Doha Round may lead to significant changes in European agricultural policy, with obvious implications for the United Kingdom, where both the farming industry and policy-making are in flux.
- The primary role of farming should be to produce food that consumers want to buy, in an open and competitive marketplace. Future interventions in the marketplace should not be made without proper assessment of their justification (whether as short-term or longer term structural measures), timescale, consistency with international obligations, and impact on the wider rural economy.
- The measures proposed by the Commission for the mid-term review are the minimum reforms required; unfortunately they probably go far beyond what the European Council will agree.
- However important the international dimension and however likely it is that WTO negotiations will ultimately prove to be the main drivers for reform of the CAP, it is important to frame reforms in terms of Europe's own needs and farmers' desire for certainty.
- The proposal to decouple the vast majority of direct support payments from production is welcomed.
- The Commission's failure to present more than options on the reform of the dairy sector, rather than detailed and clearly time-tabled proposals to bring to an end the current system of milk quotas, was regrettable.[10]
- The proposals for decoupling and dynamic modulation[11] would make the transition to the full CAP easier for the new Member States.
- A far-reaching mid-term review that ensures European agriculture is able to offer meaningful progress on trade liberalisation talks and ensure its own budgetary stability would be far better for farmers across the European Union than a continuing cycle of repeated minor reforms of the CAP.

20. The Commission's package of legislative proposals (see paragraph 25 below) was published as we were finishing work on this inquiry and after the House of Commons Committee's report on the mid-term review had gone to press.

Developments since the Commission's Communication of July 2002

21. Subsequent consideration and development of the Commission's proposals was significantly affected by decisions of the Council of Ministers in October and November 2002. EU Foreign Ministers meeting in Brussels on 18 November 2002 agreed that the candidate countries would join the Union from May 2004. This followed the European Council of October 24–25 agreement of terms for the application of the CAP to the ten new Member States and, importantly, the parameters within

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9 House of Commons Environment, Food and Rural Affairs Committee, 9th Report, 2001–02, *The Future of UK Agriculture in a Changing World*, HC 550–I; 3rd Report, 2002–03, *The Mid-term Review of the Common Agricultural Policy*, HC 151.

10 The position is now even more regrettable. In the Commission's modified reform package of January 2003 (see paragraph 25) radical reform of the dairy sector is clearly a long way off, with the proposal to continue the competition-restricting milk delivery quota system for another eleven years.

11 See Box 2 and footnotes.

which the agricultural support budget (section 1a) will operate over the next ten years. The EU leaders agreed that the existing CAP, most importantly the direct payment system, should be applied in the new Member States in the gradual manner recommended by the European Commission.

22. The agricultural budget for the enlarged EU ("EU25") is to be frozen at the 2006 estimated level of €45.3 billion (1a, Guarantee) plus an annual adjustment for inflation of 1 per cent p.a to 2013. These limits are to apply only to EU25; if Bulgaria and Romania join the Union in 2007 as planned, new financing arrangements will have to be made to deal with the not inconsiderable cost of applying the CAP to these two highly agricultural countries. It was agreed that the CAP, reformed or not, would be applied on a gradual basis with most importantly direct payments being made at the level of 25 per cent of the EU15 level in 2004, at 30 per cent in 2005, 35 per cent in 2006 and 40 per cent in 2007. The remaining 60 per cent would be applied in equal tranches in the remaining six years to 2013.

23. Extrapolation of the budget agreement suggests a limit of €48.6 billion by 2013 compared with current CAP spending of approximately €41 billion. This would suggest a margin of about €7 billion for the cost of applying the CAP fully to the new member states by 2012–13. Even without the additional cost of Bulgaria and Romanian accession to the agricultural common market, it would appear unlikely that the cost of the CAP for EU25 will be met within these budget limits—unless substantial progress is made within the current mid-term review of the CAP with both modulation—the reduction of total subsidy payments—and subsidy capping.

24. There is uncertainty on what was agreed on the issue of the possible reform of the CAP at the end of October summit. It is maintained by a majority of observers and commentators that in return for the agreement to impose relatively tight ceilings on agricultural subsidy and market support spending, the French Government was able to secure a commitment to delay CAP reform until after 2006. This is definitely not the view of the European Commission or the Governments of Denmark, Sweden, the Netherlands and the United Kingdom. There is however still considerable doubt on this issue. The official communiqué makes no mention of any undertaking to delay any reforms until after the end of the current budgetary period in 2006. On the contrary, the communiqué re-affirms the Union's commitment to continuing the mid-term review and its role in the Doha round of agricultural trade negotiations. The communiqué states that the Council "agreed specifically that the limit on agricultural spending would be without prejudice either to the European Commission's mid-term review of agriculture based on part 22 of the Berlin Conclusions or to the Doha round."[12]

25. In the light of the Council decisions and continuing negotiations, the Commission modified its original proposals and published them, in the form of draft Regulations, on 22 January 2003.[13] We have taken these latest proposals into account in drawing up our conclusions on the mid-term review. The six main elements of the proposals as they now stand are described in Box 2. Compared with the original reform plan, they reflect the decision to keep options open by setting aside financial resources for a continuation of the "traditional" CAP, which under the plan was intended to be effectively eliminated by 2012.

[12] Presidency Conclusions, Brussels European Council, 24–25 October 2002, SN 300/02.

[13] See footnote 1 for references.

Box 2

The Commission's mid-term review proposals (22 January 2003)

Decoupling[14]

Existing direct payments to producers will be compounded into a single income payment based on direct subsidy payments for all products in the years 2000 to 2002 (dairy payments would be calculated on the basis of what the subsidy would have been had they applied in those years). Subsidy entitlement will be divided into units by dividing the total farm payment by its hectarage; these entitlements will be transferable in whole or in part.

Cross-compliance[15]

Direct payments will only be fully paid if recipients conform with EU environment, food safety, animal health and welfare standards. Non-compliance to be penalised by 10 to 100 per cent reduction in subsidy payments.

Strengthening of Pillar 2[16] **policies**

New subsidy schemes to improve quality, provide consumer information, to aid compliance with EU environmental health, public health, plant and animal health regulations, farm advisory services and improvement in animal welfare.

Modulation[17] **(degressive)**

The application of modulation (originally to take effect from 2004) has been delayed until 2007 and will apply only to farms drawing more than €5,000 a year in subsidies. The amount received by the farms in this category will "degress"—they will be reduced by a larger amount each year and the reduction will be greater the larger the subsidy payment. The largest beneficiaries, drawing more than €50,000 in subsidy a year, will lose only 1 per cent in 2007, but by 2013 their payment will be cut by 19 per cent compared with the original proposal for a maximum of 20 per cent. Whereas in the July proposals all of the money thus saved, €3-4 billion, would have been transferred to Pillar 2, in the January 2003 version only approximately a third of the saving, 6 per cent of total direct payments, €1.48 billion, will be transferred to Pillar 2. The other two thirds will be put back into Pillar 1 to cover possible shortfalls created by the October 2002 budget limitation agreement.

Farm Advisory Scheme

The Farm Advisory scheme, in the July 2002 proposals known as the Farm Audit, will be compulsory only for farms drawing more than €15,000 a year, rather than €5000 as in the original proposals. It is essential to the operation of the cross-compliance conditions.

Dairy policy changes

Present quota regime to remain in place until 2014, combined with the bringing forward of price adjustments from those previously scheduled 2005 to 2004. An effective 28 per cent cut in the milk target price by the end of the 2004-09 period through progressive cuts in the butter and skim milk powder prices, to be compensated for by direct subsidies. The global milk delivery quota to be increased by 2 per cent—1 per cent in each of the years 2007 and 2008 (resulting in a total increase of 3.5 per cent when the 1.5 per cent increase already scheduled for the post 2005 period under Agenda 2000 is included).

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14 The separation of subsidies to supplement farm incomes from subsidies to support production, so that levels of production are no longer artificially maintained or stimulated.

15 Making subsidies conditional on compliance with environmental and other conditions not related to production.

16 Pillar 1 of the CAP subsidises production, while Pillar 2 supports rural development, environmental protection and other structural measures.

17 Movement of funds from Pillar 1 to Pillar 2, or (in the case of the latest mid-term review proposals) for other purposes, through reductions in direct production subsidies. "Dynamic modulation" is the gradual application of modulation—in the original mid-term review proposals 3 per cent a year to achieve an eventual switch of 20 per cent.

PART 3: ANALYSIS AND OPINION

SCOPE OF THIS REPORT

26. It is clear that the European Union's Common Agricultural Policy does not meet current economic, social and environmental requirements. This is recognised by the European Commission and the governments of only a minority of EU Member States. The Commission has sought to remedy these shortcomings by proposing a set of reforms which have to be recognised as radical. The purpose of this Report is to discover what the impact of these proposals would be, were they to be accepted by the Council of Ministers, on the external aspects of European agriculture policy. We have found it convenient to structure our findings under the following headings:

- eastward enlargement of the European Union
- the Doha Round of agricultural trade liberalisation negotiations
- the impact on the trade and agriculture of the less developed countries
- the long term sustainability of agriculture.

27. Throughout this part of the Report we present a qualitative overview of the key issues, based on our appraisal of the evidence, without observing too rigid a distinction between factual reportage and opinion. The passages highlighted in bold type contain specific conclusions and recommendations to which we wish to draw particular attention.

VIABLE AGRICULTURE AND RURAL POLICY: THE MID-TERM REVIEW PROPOSALS TESTED AGAINST OECD CRITERIA

28. It is helpful to begin this analysis by examining how far the current CAP and the reformed policy, as proposed by the Commission in its July 2002 blueprint for the mid-term review of European Union agriculture policy, meet accepted criteria for a viable agriculture and rural policy, such as those agreed by the OECD Ministerial Agriculture Committee in 1998 (see Box 3).

Box 3

OECD Criteria for viable agriculture and rural policy

The OECD Committee for Agriculture, meeting at ministerial level in 1998, agreed that governments should provide an appropriate framework to ensure that the agro-food sector:

- is responsive to market signals;
- is efficient, sustainable, viable and innovative, so as to provide opportunities to improve standards of living for producers;
- is further integrated into the multilateral trading system;
- provides consumers with access to adequate and reliable supplies of food, which meets their concerns, particularly with regard to safety and quality;
- contributes to the sustainable management of natural resources and the quality of the environment;
- contributes to the socio-economic development of rural areas, including the generation of employment opportunities through its multifunctional characteristics, the policies for which must be transparent;
- contributes to food security at the national and global levels.[18]

Response to market signals

29. In terms of gross agricultural production, most major sectors of the EU agriculture industry are currently heavily insulated from market stimuli. Either market intervention or direct production subsidies ensure that there is little response to fluctuations in international prices for the major agricultural commodities. The change to an income subsidy based system as recommended in the European Commission's mid-term review proposals would be likely to achieve this objective—provided that all current market support and production subsidies were removed. There would also have to be serious limits on the total amount of subsidy that any one farm business could draw in

[18] OECD (2002): *Agricultural Policies in OECD Countries: A Positive Reform Agenda.*

subsidy, otherwise it would still act as a subsidy to production. In this respect the January 2003 proposals have diluted the original July 2002 ones, which we regret.

Efficiency and sustainability

30. There is little doubt that the part of European agriculture that produces over 80 per cent of agricultural output is efficient in terms of productivity: production of most commodities increases every year with less labour and fewer inputs. Some would argue that without subsidies it might be more efficient. It is difficult to decide what "sustainable" means in this context: in economic and production terms modern European agriculture is sustainable—if it were not production would be falling rather than rising. It is however clear that in many aspects, in the provision of public goods and in damage to the environment, modern intensive agriculture is not sustainable.

Integration into the multilateral trading system

31. European agriculture is certainly not integrated into the multilateral trading system. Indeed, its relationship with the international market is outstandingly dysfunctional. Directly subsidised exports of dairy products, beef, sugar and coarse grains and indirectly subsidised wheat exports damage the domestic agricultural markets of developing countries and the international markets of competitive developed countries. Escalating tariffs and proliferating tariff quotas restrict access to the European market, with, for example, the European Commission introducing new tariff rate quotas for cereals from January 2003. The gross cost to the taxpayer of the CAP continues to increase.[19] Application of the Commission's mid-term review proposals should offer the opportunity for the market distorting elements of the present system eventually to be eliminated.

Provision of access to adequate and reliable supplies of safe and high quality food

32. Modern agriculture in temperate climate zones has delivered security of food supply. European agriculture in its present state would provide this security, with or without current policies. Generally, European food is safe and of high quality. With the exception of the atypical BSE episode, most food safety problems are created after food leaves the primary producer.

Contribution to the sustainable management of natural resources and the quality of the environment

33. Whether or not modern European agriculture "contributes to the sustainable management of natural resources and the quality of the environment" depends on definitions. It is clear that, in certain areas, modern agriculture has damaged the environment. Adoption of the mid-term review proposals would provide the means of reducing any harmful effects of agriculture on the environment. It does at least represent a step in the direction of making farmers more accountable for the environmental effects of their activities.

Contribution to the socio-economic development of rural areas

34. It is doubtful whether modern agriculture contributes much to the "socio-economic development of rural areas". While it certainly puts money into the local economy, agricultural modernisation has been a major cause of reduction in agricultural employment in parts of Europe. This of course emphasises the need for specific, non-agricultural policies, to deal with the challenges of maintaining rural social structures.

Contribution to national and international food security

35. European agriculture contributes to world food security by ensuring that the EU never needs to draw extensively on world food supplies to maintain its own consumption. It contributes to insecurity by undermining markets in third countries and thus diminishing food production capacity in countries which need to increase their own food security. Application of the Commission's proposals should moderate this disruptive influence of European agriculture—provided that the full implications of the plan are followed through.

36. The Commission's proposals rightly stress the multifunctional role of agriculture. However, the Commission is recommending that the vital non-production functions of agriculture—the maintenance of rural structure, conservation of the countryside and environmental care—should be addressed through specific policy instruments, rather than by supporting agricultural production and markets. Implicit in these proposals is the acceptance that production based policies cannot deliver the non-

[19] See paragraph 15, footnote 3.

Box 4

CAP is something we can be proud of

Letter to *The Financial Times*, 23 September 2002

Sir,—Certain critics blame many of Europe's difficulties—and the world's—on the common agricultural policy. The media often take these criticisms on board without appropriate detachment.

The CAP is accused of encouraging overproduction. This is not fair. Butter mountains are things of the past. The CAP has been able to control production and at the same time allow ever-increasing levels of imports. The European Union is a big importer of agri-food products. We are far from being "fortress Europe". Storage, when it occurs, is for strictly sanitary reasons or for dealing with limited cyclical situations.

It is also claimed that the CAP, with its emphasis on production, encourages pollution. Let us not forget that, when Europe adopted the model in the 1960s, it was primarily to feed the population of a continent that was not self-sufficient. Production for its own sake is something else. Improvement of Europe's competitiveness came at this price. But today rational agricultural practices are developing and it is more than 10 years since the EU developed agri-environmental measures, confirmed by decisions taken in the context of Agenda 2000. Since the 1992 reform, followed by Agenda 2000, the changeover to sustainable agriculture has been steady, maintaining market competitiveness and contributing to the protection of the rural environment, while seeking to respond better to consumer demands.

It has also been said that the CAP was responsible for the BSE (mad cow disease) crisis. In reality, it was a lack of, rather than excess of, European policy that favoured its spread. Quality has continued to improve over recent decades. Food is safer now than 20 years ago. It is consumer reaction that has become stronger and that is good.

It is also widely asserted that the CAP costs Europe too much. But the financial framework agreed in Berlin has been largely respected and support for agriculture amounts to less than 1 per cent of total public expenditure by the EU and Member States, compared with 1.5 per cent in the US.

Some also claim that the CAP is responsible for causing hunger in developing countries. Nothing could be further from the truth. Agriculture in some of these countries, particularly in Africa, is primarily concerned with promoting self-sufficiency in food. This is seriously undermined by destruction of traditional agriculture in favour of cash crops, which encourages an increase in imports and in the indebtedness of these states. Production of crops such as cocoa and coffee depends on the markets for primary products, which have nothing to do with the CAP.

Let us stop the false accusations. Let us be justifiably proud of the progress made over the last 40 years. Together we can build a future for our agriculture. We wish to make a constructive contribution that respects the programme agreed in Berlin.

First, let us tackle the problems that exist in a number of production systems and correct the imbalances. Let us also reaffirm that farmers should be able to live on the price paid for their products and to absorb the costs arising from environmental requirements, food safety and food quality. Then let us reconcile farmers and society, a task that needs sufficient numbers of contented producers with confidence in the future to ensure the economic balance of all our territories and to maintain the diversity of our landscapes.

Last, let us put in place an ambitious policy for rural development and agri-environmental incentives that is less bureaucratic and more effective. Above all, let us be proud of building together an agricultural policy that meets our vision for our European civilisation. This is what we call our European model of agriculture, as validated in Berlin.

For us, agricultural products are more than marketable goods. They are the fruits of a love of the land that has developed over many generations. For us, Europe could never be a fortress isolated from the rest of the world. Europe should be proud of its model of rural civilisation, which it should do more to explain and share with others. It has been able to show the way through its "Everything but Arms" initiative, which other countries would do well to copy. Farmers must not become the "variable adjustment" of a dehumanised world. We see them as full participants in our society.

Yes, our ambition for Europe is a modern agriculture in which people and the land will play a part. Only by respecting these principles can we give tomorrow's enlarged Europe the agricultural policy it needs.

[Signed:] Fernand Boden, Miguel Arias Canete, Armando José Cordeiro Sevinante Pinto, Hervé Gaymard, José Happart, Wilhelm Molterer, Joe Walsh

The above are ministers of agriculture for, respectively, Luxembourg, Spain, Portugal, France, Wallonia (Belgium), Austria and the Republic of Ireland production functions of agriculture in an efficient manner and too often not at all. The Commission's biggest political challenge is to persuade the majority in the Council that protectionist policies which disrupt markets cannot eliminate the inevitable shrinkage of the importance of agriculture in developed country economies: it can only shift the burden of adjustment on to other countries.

37. A foretaste of the impending battle in the Council was provided by a letter to the press in September 2002 signed by the ministers of agriculture from seven EU Member States. It would require only one or two more to make up a majority of votes in the Council (see Box 4).

Implications of the Commission's Mid-term Review proposals for eastward enlargement of the European Union

38. Assessment of the impact of the Commission's proposals on the agriculture of the ten countries now due to join the European Union from 2004 has been complicated by the terms for application of the EU agriculture policy agreed by the EU heads of government at their meetings in Brussels and Copenhagen in October and December 2002 (see paragraphs 21–24). While it had originally been intended to apply only the market mechanisms of the CAP and to make substantial structural payments in place of the direct subsidies paid in the present 15 EU Member States ("EU15"), the final agreement has resulted in a commitment to pay direct subsidies on the same basis as the EU15, fully, by 2011.

39. As a result of this commitment, it is now difficult to see how the mid-term review proposals are going to ease the transition process; if anything they are likely to complicate matters. Certainly the subsidies as initially paid in the new Member States will serve to maintain people in agriculture and act as a stimulus to production. Subsidies are subsidies and if they are paid in the candidate countries their effect is unlikely to differ very much whether decoupled from production or not.

Attitudes to CAP reform in the Candidate Countries

40. Evidence and other information was received from four Candidate Countries—the Czech Republic, the Republic of Poland, the Slovak Republic and the Republic of Slovenia. From their evidence, and from other information available to the Committee, it is clear that a majority of the new member governments are keen that the subsidy system should act as a stimulus to production of the commodities where they believe they have an advantage in an enlarged common market.[20]

41. For this and other reasons, most notably the belief that acceptance of the mid-term review proposals would mean lower farm incomes than the application of an unreformed CAP based largely on producer subsidies, there is general opposition to the decoupling proposal among the new member countries. While it has been generally stated by their representatives in evidence to the Committee that the governments of these countries favour reform, their definition of reform is probably not the same as that held by the Commission. We suspect that a majority would tend to side with the conservative element in the Council of Ministers in their attitudes to the mid-term review. This is an important reason why the review process should be completed to meet the completion deadline set by the Commission of mid-2003. It was therefore a matter of regret for us to hear from the Slovenian Minister that his country had already set up what can only be described as a complete CAP in waiting.[21]

42. **It is essential that the Commission's recommendations on decoupling are agreed and applied in advance of the eastward enlargement from 2004 to ensure that any stimulation of production resulting from the application of EU agriculture policy is minimised.**

43. **In this same context, we would draw attention to the Commission's failure to recommend the abolition of market intervention and export subsidisation, which in our view should form the corollary to decoupling of subsidies from production. Change in emphasis from production and market support to the stimulation of structural change through modulation is even more essential in eastern Europe than in the EU15.**

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[20] See for example the non-paper by the Czech Republic at pp 53–56.

[21] Q 47.

The likely impact of the mid-term review proposals on the agricultural sector in the Candidate Countries

44. It has to be acknowledged that direct subsidies, whether decoupled or not, do have the advantage, in those countries with lower per capita incomes, that they are the means of avoiding any inflation of food prices and consequent depression of consumption which would result from the application of a market based support system.[22]

45. Despite the enthusiasm for stimulating production, it is also obvious that the new members will, in general, support the application of modulation and the gradual switch of policy emphasis and funding from market and production support (Pillar 1) to structural improvement (Pillar 2). There is a strong implication however that they expect this to involve not only a switch in emphasis between the two policy approaches, but also a switch of funding emphasis from west to east, with the money saved on production and market support in the EU15 being spent on re-structuring in the new Member States.[23]

46. **Agreement on modulation is essential to ensure that the emphasis on structural change is maximised where it is most needed and that the subsidising of increased production is minimised. We recommend that modulation should involve a larger proportion than the proposed 6 per cent to be removed from direct subsidies and transferred to structural measures. We also believe that this transfer should take place at a faster rate than the seven years (effectively ten, since the transfer would not start until 2007) recommended by the Commission.**

47. **Serious consideration should also be given to transferring funds to Pillar 2 policies in the new Member States at a greater rate than in the EU15, possibly by skimming off a percentage of the yield from modulation in the current Member States.**

48. **Early agreement and the application of the Commission's cross-compliance proposals is if anything more urgent in the new Member States than in the EU15. This is because there are many habitats and species still surviving in eastern Europe which are now rare in the west. Failure to apply effective cross-compliance measures could result in these being endangered by the intensification of agriculture in these regions.**

Implications of lack of reform proposals for dairy and sugar regimes

49. The lack of proposals for reform of the sugar market regime and the January 2003 recommendation to continue the dairy quota regime for another eleven years has particular importance for the new Member States. Unsurprisingly, all regard the limitations on production of these two commodities as too restricting for their industries.[24] They also represent considerable administrative problems in those countries with large numbers of small dairy farms, most notably in Poland. The danger of proceeding with enlargement without significant reform of the common market organisations for sugar and milk is that their highly beneficial price levels will stimulate constant political pressure for quota expansion and the consequent further growth in surplus and EU budgetary expenditure.

50. **Urgent consideration should be given to the formulation of proposals for the reform of the market regime for sugar and dairy products. We consider the Commission's recent proposals (January 2003) for the dairy sector to be completely inadequate; they leave the market unliberalised and the market distorting intervention and export subsidisation mechanisms intact. They also go against earlier understandings under Agenda 2000.**

51. **Proposals for these two sectors should involve, most essentially, plans for the rapid phasing out of the delivery and production quotas linked to stepped cuts in support prices with a view to rapid abolition of market support and export subsidisation. A short time limit should be set for the further operation of milk and sugar quotas. Compensation for the removal of support should be incorporated into the plans for the payment of decoupled income subsidies.**

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22 *Implications of CAP reforms for Poland*, Office of the Committee for European Integration, Republic of Poland, Warsaw 2002 (not printed—see Q 110).

23 Non-paper by the Czech Republic at p 55.

24 See, for example, the evidence of the Slovenian Minister for Agriculture, Forestry and Food at Q 48.

Relevance of the proposals to the European Union's position in the Doha Round of agricultural trade liberalisation negotiations

52. The Commission claimed in its July proposals that: "In addition to achieving major internal objectives, the approach also provides benefits in meeting external challenges. First, it will facilitate the integration of the new Member States into the common agricultural policy. Second, it will provide a major advantage within the WTO, since the Green Box[25] compatibility of the scheme will help secure these payments in an international context."[26]

53. If the Council of Ministers were to agree to the proposed conversion of current production related subsidies to flat-rate income supplements this would certainly put the bulk of EU subsidisation of agriculture into the WTO defined category of production-neutral, or "green box", and thus free it from reduction under any new agreement on domestic support. The important question is, however: would this change have the practical effect of reducing the level of subsidised production, most importantly in terms of export availability? Would it also eliminate the need for market intervention and export subsidisation?

54. Adoption of the Commission's proposals would allow the European Union to offer significant concessions in the trade round. Maintenance of an unreconstructed CAP, on the other hand, would mean the continuation of all the trade mechanisms which currently protect an over-subsidised agricultural sector. First and most important, continuation of the current direct subsidy system will not allow the EU to agree to any significant reduction in domestic support—with or without elimination of the "blue box" (see Box 5) category of temporarily permitted subsidy. Even with retention of the blue box, it cannot even reduce by any significant amount the significant proportion of its calculated total "aggregate measure of support" of over €35 billion, which is not covered by the blue box concession.

25 See Box 5.

26 COM (2002) 394, section 2.4, at page 19.

Box 5

WTO classification of subsidies and the Common Agricultural Policy

Under WTO terminology, the various degrees to which policies distort trade are classified into different groups or "boxes", which are subject to differing levels of acceptability. Completely unacceptable are "red light" policies which must be stopped or eliminated. "Amber light" policies are subject to limitations and eventual elimination, while "green light" (or "green box") policies are exempt from support-reduction requirements.

During the Uruguay Round this framework was simplified. Negotiators agreed to distinguish essentially between support that can significantly impact on trade, which should be subject to a reduction commitment (amber box measures) and support that can be considered as having no or at most minimally trade distorting effects (green box measures). The general assumption underlying the reduction commitment is that support based on price and/or the volume of output may lead to a significant trade impact. This is the case with amber box measures, while other measures, even if linked to a certain degree to production, are not subject to reduction commitments under the Uruguay Round Agriculture Agreement. A new category of support measures, the blue box, was introduced. This special "blue light" or "blue box" category was created to classify compensatory payments to producers linked to policies to limit production. Into this blue box fell the EU's (supposedly-transitional) compensatory direct payments to grain, oilseed, and some livestock producers, as well as the pre-1996 Farm Act US deficiency payments. These policies were (temporarily) excluded from reduction commitments.

The invention of the blue box allowed the EU to avoid any commitment to reduce what in 1992-3 became a large part of its support for agriculture: the direct subsidies to arable crops, beef and sheep production, now amounting to some €28 billion. Under the current WTO agreement the EU's total support of agriculture (budgetary expenditure plus so-called "consumer transfers"), the aggregate measure of support (AMS), must not exceed €65 billion. Without inclusion of the €28 billion, "blue box" direct subsidies in the sum, the EU's amber box subsidy payments and transfers amounts to only around €35 billion—well below the WTO limit.

Serious problems will arise for the EU if, in the current trade round, the blue box were to be abolished and the ceiling on total permitted support to be reduced. Were the blue box subsidy category to be abolished, the E28 billion currently spent each year on direct subsidies and the amber box subsidies included in the calculation, the EU's total AMS would rise to €61.4 billion.

If the EU's current domestic support level is recalculated with the blue box removed, then current levels of support as calculated by the AMS is shown to be just below the current limit. The margin is relatively small. Any new WTO agreement to be effective would have to include further large reductions in the level of domestic support. A not unlikely cut of 20 per cent in the AMS—in the EU's case to €52 billion—would be no problem if the blue box is retained; without it there would have to be a 15 per cent reduction in the overall level of support. This assumes of course that the current AMS system is used to calculate the levels of support for subsequent reduction.

It is probable however that the aggregation of support for reduction purposes would be abandoned and a more precise mechanism will be agreed which is specific to individual commodities. What is more likely is that something approximating to the US proposal of a reduction in support to no more than 30 per cent of the value of production of any commodity would be agreed. The adoption of such a formula, even without the abolition of the blue box, would put the EU into a difficult position for its mainstream livestock products and oilseeds. Combined with blue box abolition almost the whole of its support of all the major products would be under threat. Even in wheat, for example, the most notable example where EU exports are competing without subsidy, the level of subsidy represented by the so-called "compensatory payment" is between 35 and 40 per cent of the price of the product. Even with the retention of the blue box, the 30 per cent of value target would mean that dairy support would have to be cut by 44 per cent and beef support by 15 per cent.

55. Similarly, the continuation of an active intervention and export subsidy system in major commodity sectors such as dairy products, sugar, beef and coarse grains means that the Union cannot agree to any significant reductions in export subsidisation. At the same time, continuation of the present policy will necessitate the retention of tariff levels close to those currently in operation.

56. In contrast, if the Council of Ministers were to agree the Commission's July 2002 reform proposals, the EU would then have substantial scope for making concessions in the trade round. Decoupling of subsidy payments from production and conversion to income payments would allow the EU to achieve at least *de jure* if not *de facto* classification of its €28 billion a year expenditure on direct subsidies as green box rather than blue or amber box status. The implicit abandonment of the

principle of support of production in such an agreement would also allow it to make provisions for future intervention and export subsidy reduction which would allow it to make a meaningful offer on export subsidies and market access in the trade round. An agreement on "modulation"[27] on the degressive basis recommended by the Commission would allow the EU effectively to defend itself against charges from the Cairns Group[28] and other exporting countries that—even if decoupled—the subsidies would still be so large as to represent a competitive distortion. This would be further strengthened by agreement on the cross-compliance proposal, which would allow a strong case to be presented that a large part of the EU's subsidisation of farmers was being used to finance the provision of public goods.

57. **It is essential that the EU adopts the proposals for the decoupling of subsidies from production. This is the only way that the EU can present a credible proposal to what is intended to be a "Development Round"—in other words providing real agricultural trade advantages to less developed countries. We do not regard the current minimal EU proposal to the WTO[29] as a valid contribution to progress, since it is based on the assumption that present methods of agricultural support will be maintained and that the EU will continue to support markets, subsidise exports and maintain prohibitive import barriers.**

58. Overall, while it can be strongly argued that the Commission's mid-term review proposals do not make any direct contribution to improving the external aspect of the Union's agriculture policy, it has to be conceded that they would, if accepted by the Council, lay the groundwork for a substantial shift away from export subsidisation and import obstruction as well as from the basic and massive market distortion created by the heavy subsidisation of agricultural production. If the Fischler plan were agreed as now proposed, the EU would have the basis for making important concessions on the three main pillars of agricultural support and protection in any new agreement on farm trade likely to emerge from the Doha Round.

59. **In order to make real concessions in the trade round the Commission should propose and the Council of Ministers agree to the abolition of market intervention and export subsidisation in all commodity sectors—including dairy products and sugar. Only in this way would it be able to offer effective reductions in import tariffs. An important part of this process must therefore be, in fulfilment of expectations created by Agenda 2000, the dismantling of the dairy and sugar market regimes by 2008, as recommended in paragraphs 50–51 above.**

IMPACT OF THE PROPOSED MID-TERM REVIEW REFORMS ON THE LESS DEVELOPED COUNTRIES

60. Since the publication of the Commission's proposals in July 2002, there has been considerable criticism from the major aid agencies that the proposals will do nothing to improve trading conditions for agricultural exporters in the less developed countries—whether inside or outside the EU. The Commission's response is that while the mid-term review proposals do not overtly deal with the external trade aspects of the agriculture policy, benefits in terms of reduced subsidising of EU exports and improved market access will automatically follow indirectly from reform of the internal market regime. There are also the beneficial effects of the "Everything but Arms" agreement[30] to be taken into account, which will allow access to the EU market for farm exports from the world's least developed countries.

61. It is argued that the decoupling of subsidies from production and the "modulation" or gradual reduction of total subsidy levels will have the effect of reducing production of those commodities currently in substantial surplus and therefore being dumped on world markets to the detriment of less developed country exporters. At the same time, the need for EU import barriers to protect EU market prices will be reduced.

62. The major non-governmental organisations concerned with development in the less developed countries are not convinced. They argue that a reduction in the level of direct subsidisation of EU

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[27] See Box 2.

[28] The Cairns Group of 17 agricultural exporting countries (named after its inaugural meeting in Cairns, Northern Queensland, Australia) was formed in 1986 with the objective of ensuring that agricultural trade issues would be given a high priority in multilateral trade negotiations. The members are Argentina, Australia, Bolivia, Brazil, Canada, Chile, Colombia, Costa Rica, Guatemala, Indonesia, Malaysia, New Zealand, Paraguay, Philippines, South Africa, Thailand and Uruguay.

[29] European Commission Statement "WTO and agriculture: European Commission proposes more market opening, less trade distorting support and a radically better deal for developing countries" IP/02/1892 Brussels, 16 December 2002.

[30] On 26 February 2001 the General Affairs Council adopted the Everything but Arms (EBA) amendment to the EU's Generalised Scheme of Preferences (Regulation 416/2001, OJ no. L 60, 1.3.2001). With effect from March 2001 EBA extended duty and quota-free access to all products originating in Less Developed Countries, with the exception of arms and ammunition. Only fresh bananas, rice and sugar were not liberalised immediately.

farmers by less than ten per cent and the change in the mode of subsidisation will not have any significant effect on the level of EU production and therefore of subsidised surplus to be shipped on to world markets, however indirect the subsidies might be.[31] The net EU surplus of wheat, other cereals and beef will remain largely unchanged and the price at which these commodities will be sold on world markets will still reflect the substantial subsidy to EU producers still present in the reformed system. More specifically, for those products where both developed and less developed country producers are most seriously affected, sugar and dairy products, the Commission has not presented any proposals for change.

63. It is argued, with considerable justification, that the Commission's proposals lack the logical extension of the philosophy on which they are based: if the decoupling of subsidies from production means that the support of agricultural markets is no longer necessary, logically the package ought to contain recommendations for the abolition of intervention and export subsidisation The political reality is that such measures would be highly unpopular with most European farmers—which is why reform of the CAP has been such a painfully slow process. A consequence of this logical gap in the proposals is the assumption that if it is still considered necessary to maintain a high EU internal price then there can be no reduction in the level of import tariff (or only so far, as with cereals, where there is a specific recommendation for a price reduction).

64. An important aspect of the argument about the effectiveness or otherwise of developed country agricultural policy reform is that in global terms reform has only a relatively small effect in terms of overall benefit to the poorer agricultural exporting countries. Recent studies by OECD,[32] for example, indicate that a reduction of support levels by the developed countries by 10 per cent would lead to an average increase in export prices of major commodities of 2.2 per cent. Such figures however are virtually meaningless unless applied to specific examples.

65. Specific examples show much more graphically the damaging effects of EU policies on less developed country producers and exporters. Not surprisingly, the worst examples are in those products where the level of EU subsidisation and protection is at its highest: dairy products, sugar, beef and cereals. As evidence from the African, Caribbean and Pacific Group of States (ACP) showed, the effects can vary capriciously between different countries.[33]

66. A good example of the harmful effect of subsidised EU dairy exports on developing country producers is that of skim milk powder exports to Jamaica. According to a report by the aid agency CAFOD, rising imports of cheap milk powder—mainly from the EU but also from the United States—have steadily undermined the market for fresh milk from Jamaican dairy farmers.[34] Over a period of ten years these imports have progressively destroyed the milk marketing and processing structure for the local product and thus the market for fresh milk from small local farmers.

67. Jamaica's skim milk powder imports from the EU have almost quadrupled during the past 10 years. In 1992, the amount of milk solids imported from the EU was 1,200 tonnes, rising to an average of 4,600 tonnes over the last 3 years, peaking at 6,300 tonnes in 2000. Imports from the EU account for 67 per cent of these imports which carry an annual subsidy from the EU taxpayer of €4 million. These imports have been used largely to replace fresh milk originally supplied from local farms.

68. Similar examples of short term market and longer term structural damage to developing country producers can be found in other regions: Kenyan grain growers whose prices are regularly depressed by indirect subsidised EU flour imports via Egypt; beef producers in west Africa; cane sugar producers in non-ACP developing countries.

69. What there is little doubt about is the role of the current arable area payments[35] in substituting for export subsidies in maintaining the competitiveness of EU wheat and other cereals on international markets. According to a recent report by ActionAid, the impact of the CAP on developing countries is much the same whether subsidies on export are paid direct at the port or indirectly in the form of producer subsidies. EU prices for its exported wheat were, thanks to export subsidies, equal to the world price in 1992 before the introduction of arable area payments and similarly at the world price

[31] Such criticisms have been challenged in what the Commons Committee has described as "the (in)famous letter from the French Minister of Agriculture and others" (see paragraph 37 and box 4).

[32] *Agricultural policies in OECD countries: monitoring and evaluation*, OECD, 2002.

[33] QQ 58, 68.

[34] Duncan Green and Matthew Griffith, *Dumping on the Poor: The Common Agricultural Policy, the WTO and International Development*, CAFOD, London, October 2002 (provided in support of written evidence to the inquiry by CAFOD, ActionAid, Christian Aid and Oxfam); available on the internet at http://www.cafod.org.uk.

[35] Arable area payments are direct subsidies equal to the difference in market support level before and after the application of the 1992 reforms of the CAP—most importantly the 34% reduction in the cereal intervention price. Paid on the basis of regional historical yields, they were initially equal to 34% of the 1991 intervention price.

level in 2001 with no export subsidies. The cost of production was much the same in both periods, but over the ten year period the internal price had fallen by 34 per cent, due to the replacement of market support with direct producer subsidies.[36]

70. The important question is: will conversion of the compensatory subsidy into an income payment, on the basis recommended by the Commission, make any difference to either the level of production or the volume and price of EU exports? To the large and efficient producers responsible for the bulk of EU production it is difficult to see that the translation of the payment will make any significant difference—even with degressive modulation. Because farmers are receiving an income payment—more or less equal to their "historical" drawings of arable area payments—instead of a subsidy directly related to planted area, will they leave their land uncultivated and their machinery idle? The likelihood is that they will not.

71. Seen from the perspective of the third country exporter therefore, the effect of the Commission's mid-term review proposals may well be to diminish slightly the Union's level of exports of wheat, beef and dairy products, but these exports will still be at a volume and price level that will continue to weaken international prices. This is likely to be the external reality of maintaining an annual subvention to agriculture in excess of €40 billion.

72. There is little doubt that the degree of protection provided by the present system is excessive and that quite substantial concessions could be made before there would be any appreciable effect on the level of imports.

73. While the OECD average for agricultural tariffs is 36 per cent (against only 14 per cent for industrial products), among the most important developed economies the EU has the highest. But what matters are the specific tariffs on the major agricultural commodities and the EU has prominent so-called tariff "peaks", or tariff "spikes", on most basic agricultural products. What is particularly damaging for less developed countries is that the real situation is effectively worse than the figures suggest because of the higher tariffs on processed products. Both the WTO and the OECD report a marked escalation of tariffs on processed products in the 1990s. We were told by the Department for International Development (DFID) that although the mid-term review proposals would not directly address the question of tariff escalation and tariff peaks, there was a commitment to do so in the Doha development agenda.[37]

74. Even if and when reform of European agricultural policy results in improved market access and international market reform, less developed country exporters still face the problem of EU health, safety and quality standards—a point stressed to the Committee by DFID representatives.[38] Product standards are more often than not a bigger barrier to the European market than tariffs and too often these are perceived by third countries as a protectionist barrier. Development programmes need to be directed towards encouraging the establishment of facilities in the less developed countries which allow them to meet EU import standards. As we pointed out in our 2000 Report on the Commission's proposals for the European Food Authority, enlargement of the EU also poses challenges in this field.[39] The approach needs to be one of capacity-building in third countries and the new Member States, without compromising over standards.

75. There is also the problem of the inequality of benefit to different groups of less developed countries arising from EU reform (and from import tariff dismantling under the "Everything but Arms" arrangements). As the evidence from the ACP Secretariat demonstrated, the more developed less developed countries with multi-faceted economies are able to gain from these changes.[40] Those that are dependent on single commodities, such as sugar or bananas, exported to the EU under current preferential arrangements will lose. It is likely therefore that important ancillary to CAP reform should be revision of the Union's development programmes to deal with the problems created by these changes.

[36] *Farmgate: The developmental impact of agricultural subsidies*, ActionAid, London, August 2002 (provided in support of written evidence by CAFOD and others); available on the internet at http://www.actionaid.org.

[37] Q 32.

[38] Q 26.

[39] EUC 7th Report, 1999–2000, *A European Food Authority*, HL 66.

[40] Q 58.

Globalisation

76. Although the majority of the issues considered by the Select Committee on Economic Affairs, in its recent Report on Globalisation[41], fell outside the scope of our inquiry, we are pleased to find ourselves in full agreement with the Committee's observations on the effects of developed country protectionism on developing countries, including the perverse effects of the US Farm Security and Rural Investment Act 2002 ("the US Farm Act"). In particular we endorse the following recommendation:

> "We consider that developed countries' protectionism (mainly in the United States and the European Union) with regard to agricultural and textile products in particular is wholly objectionable and unjustifiable. . . . Developed country protectionism places an unfair burden on developing countries and is in stark contrast to the protestations of the leaders of rich nations that they are committed to helping the world's poor. We urge the Government, within the European Union and the WTO, to take stronger steps to ensure that it is brought to an end".[42]

Conclusions on Less Developed Countries

77. **The EU has a responsibility towards the world community, particularly towards less prosperous members, which it has yet to address properly. We share DFID's disappointment**[43] **that the Commission has not looked in more detail at the impact of its proposals on developing countries. If there is to be any gain for the less developed countries in the mid-term review process it has to come from a significant reduction in the level of EU subsidisation of production. Only in this way can subsidised competition in the domestic markets of these countries and on the international market be reduced. For this reason it is not only necessary that the EU's subsidies be detached from production, but also that the level of subsidy payment to the individual producer be reduced. It is clear that large subsidies to large farms are a positive incentive to low cost production which will continue to undercut international markets—whatever form the subsidy may take. We deplore the complacent attitude of a number of Member States' governments to this problem, as revealed in the seven ministers' open letter of 23 September**.[44]

78. **We therefore recommend that in order to act as intended, as an income subsidy only, the level of subsidy receipts allowed to individual holdings should be capped. We regret the Commission's decision to remove the capping proposal from its January 2003 modification of the mid-term review proposals. The converted subsidy should be utilised only as a transitional income supplement, to be used only where hardship is created by elimination of EU support to production or in economically disfavoured areas.**

79. **Developing country trade is particularly affected by the EU's subsidised exports of wheat, dairy products and sugar. It is therefore all the more essential that the EU abandons its direct subsidisation of these exports and takes early steps to reform its dairy and sugar market regimes, which remain the two outstanding examples of unreconstructed common market organisations. The Commission's January 2003 proposal to continue dairy quotas is therefore a step in the wrong direction.**

80. **Where reform of European agriculture policy and the introduction of the "Everything but Arms" agreement harms the incomes of countries which are dependent on the high prices maintained in the EU market through long-standing preferential access agreements, the EU's development effort to diversify the economies of these countries should be intensified.**

81. **An important conclusion to be drawn from the evidence presented by less developed country and development agency representatives is that reduction of subsidised competition and the lowering of import barriers is only part of the solution to the problem of increasing the agricultural trade of developing countries. As important is the removal of health, technical and quality obstacles. We therefore recommend that more emphasis should urgently be given to development projects which will assist less developed countries to meet EU health, safety, quality and labelling requirements.**

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41 House of Lords Select Committee on Economic Affairs, 1st Report, 2002–03, *Globalisation*, 17 January 2003, HL Paper 5–I.

42 *Op cit*, paragraphs 25/208.

43 Q 26.

44 See paragraph 37 and Box 4.

EFFECT OF PROPOSALS ON SUSTAINABILITY OF EUROPEAN AGRICULTURE

82. Sustainability has been defined as "development which meets the needs of the present without compromising the ability of future generations to meet their own needs". According to the Rio Declaration, this should have three aspects: ecological, social and economic. [45] Environmentalist opinion would generally have it that modern European agriculture, as encouraged by the CAP, has not fulfilled desired ecological standards, has been instrumental in disrupting the social structure of the countryside by reducing employment and has certainly not achieved economic efficiency, since it has distorted domestic and international markets, harmed consumers and absorbed huge subventions from the taxpayer. The question which the Committee asked itself was: how far would the application of the Commission's proposals eliminate these shortcomings of current agriculture policy?

83. It is claimed that the new subsidy system, as proposed by the Commission, would both relate production more closely to the market and reduce the intensity of agricultural production. While some may argue that there is a clear conflict here, the effect of removal of production related subsidies is expected to outweigh any compensatory intensification which may result from the reduction in support. The major benefit arising from the change is likely to be in reducing the high cost structure which has been a major stimulant of intensification particularly of arable cropping.[46]

84. The mid-term review proposals, through decoupling and cross-compliance, provide the opportunity to repair some of the damage to the rural environment caused by the production related subsidy structure of the current policy. The Environment Agency has argued that the CAP has stimulated arable production on marginal land, the elimination of hedges and other field boundaries and encouraged often unsuitable crops—all with harmful environmental side effects, principally erosion and the leaching of fertilisers and pesticides into water courses. The headage payment systems for livestock have also provoked overstocking of both upland and lowland pastures. This latter development has been responsible for the loss of important wildlife habitats, particularly in upland areas.[47] The mid-term review proposals can be expected to provide the incentives and opportunities for better stewardship of the rural environment. They are consistent with the proposals (which the UK Government has endorsed) by the Policy Commission on the Future of Farming and Food (the Curry Commission) for a "broad and shallow" entry-level agri-environment scheme.[48]

85. It is essential however that the Commission's cross-compliance proposals are effective in preventing what may prove to be the short term harmful effect of decoupling and the extension of permanent set-aside—the desertification of some areas and increased intensification in others.

86. The changes in the modulation arrangements recommended by the Commission can be expected to play an important part in switching the emphasis in funding and policy from market and production support (Pillar 1) to structural improvement (Pillar 2). It has been stressed by most bodies which have given evidence to our inquiry that the proportion of funds to be switched from Pillar 1 to Pillar 2 is not high enough and the rate at which this change is to take place is too slow. It should be noted, however, that pessimistic assessments of the impact of modulation on farm incomes have generally not taken account of the benefits to the farming industry resulting from the potential increase in income resulting from increased structural spending.[49]

87. There is a widespread view among witnesses (not shared by the National Farmers' Union of England and Wales) that the amount of funding to be switched to Pillar 2 under the Commission's proposals will not be enough to counteract the harmful effect that intensification of agriculture across Europe has had on the rural environment.[50] Adoption of the decoupling and cross-compliance proposals has particular importance for the European environment as whole in its application to the new Member States. Due to "under-development" in parts of eastern Europe, biological diversity and valued landscapes have survived unaffected by intensive agriculture. The survival of species in eastern Europe which have become close to extinction in the west of the continent will depend upon the operation of sympathetic agricultural and environmental policies. Urgent measures are needed to

[45] Written evidence from Defra, p 5, at paragraph 30.

[46] Written evidence from the Tenant Farmers Association, pp 108–109, at paragraphs 2–3.

[47] Memorandum by the Environment Agency to the House of Commons Environment, Food and Rural Affairs Committee, printed in the Committee's 3rd Report, 2002–03, *The Mid-term Review of the Common Agricultural Policy*, HC 151, p Ev 129, at 1.2.

[48] Response to the Report of the Policy Commission on the Future of Farming and Food by HM Government, Cm 5709, December 2002, recommendation 71.

[49] Environment Agency memorandum to House of Commons Environment, Food and Rural Affairs Committee, *op cit*, p Ev 130, at 2.2.

[50] Written evidence from the RSPB, p 104, at paragraph 5.1.

prevent the conflict between intensive agriculture and the rural environment which has already occurred in the EU15 being repeated in the new Member States.[51]

88. We are concerned, however, that these measures, however well-intentioned, may fail unless they are backed by a determined effort to reduce bureaucracy and to simplify procedures. At the same time, we agree with the House of Commons Environment, Food and Rural Affairs Committee that implementation of the Commission's modulation proposals will require careful monitoring and rigorous assessment of value for money.[52]

89. In our recent Report on the impact of EU environmental regulation on UK agriculture[53] we drew attention to the need for a risk-based approach to environmental regulation which relied more on self-regulation and less on formal regulation by enforcement agencies, citing with approval the recommendations of the Better Regulation Task Force and the Policy Commission on the Future of Farming and Food.[54] We suggested that this more flexible approach should be built around whole-farm planning, environmental management systems and effective delivery of advice on best practice. We believe that what is good for the UK environment and farming industry is good for Europe as a whole, and would want to see it better reflected in the Commission's proposals.

Conclusions on sustainability

90. **It is essential that the cross-compliance measures and the closely allied Farm Advisory System recommended in the mid-term review proposals are sufficiently effective to ensure that possible intensification stimulated by the reduction of support to production is discouraged**.

91. **The switching of funds from support of production to structural, environmental and other Pillar 2 considerations proposed by the Commission amounts to only a possible total of €1.5 billion for the EU15 by the end of a seven year period. We consider that this is inadequate to have any noticeable effect. We therefore recommend that—subject to careful monitoring and assessment of value for money—the modulation percentage should be considerably more than the maximum of 19 per cent proposed under the Commission's "degressive modulation" proposal of 21 January 2003 and that the time allotted to reach the full figure should be considerably less than what has now effectively become ten years. We deplore the delay in the application of this measure until 2007, as recommended in the January modification of the Commission's proposals.**

92. **A revised CAP should be less complicated, less bureaucratic and less centralised. It should offer farmers more choice about how to run their businesses. In this respect these proposals fall far short of the Commission's commendable intentions to deliver such reforms.**

93. **If environmental measures are to be effective it is important that, rather than being of an essentially prescriptive nature, the new policies envisaged within the mid-term review proposals should be designed to encourage and reward good land management. We recommend that the type of subsidised "best practice" measures being developed in the UK, for instance in response to the Curry Report, and in some other EU Member States should be adopted at the general European level.**

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51 The Committee is grateful to the Royal Commission on Environmental Pollution for drawing its attention to a statement (then in draft) by the network of European Environmental Advisory Councils (EEAC). The statement, *A sustainable agricultural policy for Europe*, was adopted by the EEAC network at its annual conference in Kilkenny, Ireland, in October 2002 and is available at http://www.eeac-network.org.

52 Although the Commission's original proposals on modulation have been overtaken by the revised proposals of January 2003 (see paragraph 25 and Box 2), we agree with the House of Commons Environment, Food and Rural Affairs Committee when they say: "We believe that there should be a very rigorous analysis of the scope and purpose of rural development measures and a procedure put in place to assess value for money. Rural development programmes should not be regarded as virtuous simply because they are not production aids. Funding from Pillar 1 should only go to well-founded schemes: if, as a result, there are total savings in expenditure so much the better. Equally, funding required under Pillar 2 to deliver measures which really will deliver clear measurable benefits should be provided. A proper assessment of the measures required would form a more intellectually-sustainable basis for funding." (*The Mid-Term Review of the CAP*, page 35, recommendation 6.)

53 EU Committee 36th Report 2001–02, *Environmental Regulation and Agriculture*, December 2002, HL Paper 186.

54 Better Regulation Task Force, *Environmental Regulations and Farmers*, Cabinet Office, London, November 2000; Report of the Policy Commission on the Future of Farming and Food, *Farming & Food: A Sustainable Future*, Cabinet Office, London, January 2002. See also footnote 48.

PART 4: SUMMARY OF CONCLUSIONS AND RECOMMENDATIONS

INTRODUCTION

94. In this final part of the Report we bring together some general observations on the mid-term review of the CAP, with our conclusions and recommendations from Part 3. They are arranged, as before, under the key headings of Enlargement, the WTO Doha Round, Impact on Less Developed Countries, and Sustainability of European Agriculture.

95. Viewed against the background of previous attempts at reform, the European Commission's proposals for the reform of European Union agriculture policy of July 2002 (even in their modified and weakened form of January 2003) in the scheduled mid-term review of the common agricultural policy provide the basis for a major advance in the liberalisation of the EU's external trading relationships, if applied soon enough. They would provide the basis for economically and ecologically sound application of European agriculture policy in eastern Europe. They would provide the framework for a strong EU position in the Doha Round of trade negotiations and would significantly aid the long term sustainability of European agriculture. Nevertheless in some respects the modified proposals go against previous understandings in Agenda 2000. We think this is regrettable.

96. The most important feature of the plan is the Commission's recommendation that the subsidising of farm incomes should be separated from the subsidising of production. If accepted by the Council of Ministers, this proposal would allow the EU to eventually dismantle its "traditional" market intervention and export subsidisation mechanisms which currently distort both internal markets and force the EU to maintain largely prohibitive import barriers and to subsidise agricultural commodity exports. As well as improving the operation of the internal agricultural market, the implementation of this measure would allow the Union justifiably to present almost all of its agricultural support as production neutral and therefore as being acceptable under World Trade Organisation rules. It would also allow agricultural markets to respond effectively to normal supply and demand movements and diminish the damage to the trade of developing and developed country markets, as well as the domestic markets of less developed markets, resulting from the current operation of EU agricultural market manipulation.

97. The proposals to ensure that subsidy recipients comply with environmental, food safety, employment, animal welfare and land management conditions are likely to result in a marked improvement in the long term sustainability of European agriculture.

98. The implications of the mid-term review proposals for the eastward enlargement of the European Union are more difficult to judge. This is because the likely impact is likely to be confused by the agreement of EU heads of government to apply the CAP on the same basis as in the EU15 from 2004. The (unjustified) payment of direct production subsidies in the eight central and east European countries is likely to lead to development of agriculture in these countries contrary to the principles laid by the Commission in its current proposals. The failure of the Commission to table proposals for the rapid removal of dairy and sugar quotas is also likely to prevent efficient working of the market in these commodities in the new Member States.

99. It should be noted that the weakening of the modulation proposal and the abandonment of the subsidy capping proposal in the January 2003 modification has important budgetary implications. Whereas the July 2002 plan would have left a margin of *c* €2 billion in the agricultural support budget (1a) for EU25 by 2013, the latest version will leave little more than €300 million. This will mean that there will be little leeway for any contingencies which may occur in the next ten years. It is to be regretted that in its January 2003 proposals the Commission has seen fit to deduct the bulk of the yield from modulation, some €2 billion in 2012, from potential transfer to Pillar 2 and to pass it back into Pillar 1 for the funding of traditional market support measures.

Time is not on the reformers' side

100. Without an early commitment to the principles of the Commission's July mid-term review proposals, an unreformed CAP applied in the ten and possibly twelve new Member States will mean almost certain bureaucratic chaos and increasing production which will not be able to be encompassed within the new budget limits. The alternative to reform now is the slow attrition of long drawn out budget wrangles to force incremental and disrupting change, rather than the clear signals to the agriculture industry in both east and west which would have been given by a unequivocal commitment to the July mid-term review package. For example, the probable additional €3-4 billion of operating a largely unchanged common market organisation for milk products and higher than estimated costs for direct payments in the new member countries post-2006 could seriously threaten the budget limit. Further intervention price cuts and reductions of direct payments will be inevitable.

101. If a majority of EU governments continue to obstruct the Commission's plan and opt for a merely cosmetic conclusion to the mid-term review, any substantive, effective reform of European agricultural policy will now become increasingly difficult and could be put off for another decade. The danger is that the Agriculture Council will drag its feet on agreement on the mid-term review to the point where any measures agreed will have little immediate effect and very little by 2006-07. By the time the Commission and the supporters of reform are able to mount a new reform campaign in the EU25 they will be in a very much smaller minority than at present.

ENLARGEMENT

102. Assessment of the effect of the mid-term review proposals on the new Member States is complicated by the EU's commitment to apply the current producer subsidy system in these countries. What is certain is that a majority of the governments of the new Member States favour the application of the current production linked subsidies in order to stimulate their production of major agricultural products. These governments are not enthusiastic supporters of decoupling. There is little doubt however that the transfer of funds from market support (Pillar 1) to rural development measures (Pillar 2) would be of substantial benefit to the rural structure and environment in these countries, where the need for such measures is considerably greater than in the EU15. The scheduled delay in applying the modulation measure to the new members until the end of the transition period will unfortunately delay the development of the new Pillar 2 measures; this should however not prevent the development of the new measures in the east through the transfer of funds saved through application of modulation in the EU15.

103. The introduction of cross-compliance should also be particularly important in the new Member States. It is unfortunate that the governments of the new Member States have already been encouraged to establish the major mechanisms—market intervention, high import tariffs and export subsidisation—of an unreformed CAP. This is most notable in Slovenia, Poland and Hungary. The minimalist proposals for adjustment of the common market organisation for dairy products and the lack of any proposals to reform the common market organisation for sugar will reinforce this process.

104. **It is essential that the Commission's recommendations on decoupling are agreed and applied in advance of the eastward enlargement from 2004 to ensure that any stimulation of production resulting from the application of EU agriculture policy is minimised (paragraph 42).**

105. **A necessary corollary to decoupling of subsidies from production is the abolition of market intervention and export subsidisation. Change in emphasis from production and market support to the stimulation of structural change through modulation is even more essential in eastern Europe than in the EU15 (paragraph 43).**

106. **As we recommend in paragraph 91, modulation should involve a larger proportion than the maximum of 6 per cent to be removed from direct subsidies and transferred to structural measures, and this should take place at a faster rate than the seven years (effectively ten, since the transfer would not start until 2007) recommended by the Commission (paragraph 46).**

107. **Serious consideration should also be given to transferring funds to Pillar 2 policies in the new Member States at a greater rate than in the EU15, possibly by skimming off a percentage of the yield from modulation in the current Member States (paragraph 47).**

108. **Urgent consideration should be given to the formulation of proposals for the reform of the market regime for sugar and dairy products, which have particularly important implications for the new Member States. We consider the Commission's recent proposals (January 2003) for the dairy sector to be completely inadequate; they leave the market unliberalised and the market distorting intervention and export subsidisation mechanisms intact. They also go against earlier understandings under Agenda 2000 (paragraph 50).**

109. **Proposals for these two sectors should involve, most essentially, plans for the rapid phasing out of the delivery and production quotas linked to stepped cuts in support prices with a view to rapid abolition of market support and export subsidisation. A short time limit should be set for the further operation of milk and sugar quotas. Compensation for the removal of support should be incorporated into the plans for the payment of decoupled income subsidies (paragraph 51).**

THE WTO DOHA ROUND

110. The European Union will significantly strengthen its negotiating position in the current trade liberalisation negotiations if it agrees the Commission's proposals. Adoption of the decoupling proposal will allow it to present almost three quarters of its current €42 billion expenditure on

agricultural support as non production positive and therefore not subject to reduction under any current or future World Trade Organisation agreement. It will also provide the basis for eventual dismantling of market intervention, the elimination of the need to subsidise exports and scope for significant reduction of the EU's import tariffs. Agreement of the cross-compliance measures will ensure protection against charges by other exporting nations that the substantial resulting expenditure on income subsidies is still production-positive.

111. **It is essential that the Union agrees the proposals for the decoupling of subsidies from production. This is the only way that the EU can present a credible proposal to what is intended to be a "Development Round"—in other words providing real agricultural trade advantages to less developed countries—and strengthen its own negotiating position. We do not regard the Commission's draft current minimal EU proposal to Geneva as a valid contribution to progress, since it is based on the assumption that present methods of agricultural support will be maintained and that the EU will continue to support markets, subsidise exports and maintain prohibitive import barriers (paragraph 57).**

112. **Urgent consideration should be given to the formulation of proposals for the reform of the market regimes for dairy products and sugar. We do not regard the latest proposals for modification of the dairy common market organisation as a valid contribution to trade liberalisation. These should involve, most essentially, plans for the rapid phasing out of the delivery and production quotas in both sectors, linked to stepped cuts in support prices with a view to rapid abolition of market support and export subsidisation (paragraph 59).**

Impact on Less Developed Countries

113. A major shortcoming of the mid-term review recommendations from the point of view of the less developed countries is that they make no proposals for the dismantling of the "traditional" EU support and protection mechanisms and that therefore access to the EU market for agricultural exports from the less developed countries will still be obstructed and their domestic markets disturbed by subsidised dumping of EU surpluses of dairy products, sugar and meat. While the first problem should to a great extent be overcome by the "Everything but Arms" concession, there is considerable validity in the argument that the sheer volume of the subsidies which will still be paid to EU farmers after application of the mid-term review proposal will still represent a hidden subsidy to production which will allow the EU to dump its products in less developed markets. In the dairy product and sugar markets, the unreconstructed common market organisations which will remain after application of the mid-term review proposals will in any case ensure that this market distortion continues. EU health, safety and quality standards are likely to remain a substantial barrier to the access of less developed country agricultural exports to the European market.

114. **The EU has a responsibility towards the world community, particularly towards less prosperous members, which it has yet to address properly. We share DFID's disappointment that the Commission has not looked in more detail at the impact of its proposals on developing countries. If there is to be any gain for the less developed countries in the mid-term review process it has to come from a significant reduction in the level of EU subsidisation of production. Only in this way can subsidised competition in the domestic markets of these countries and on the international market be reduced. For this reason it is not only necessary that the EU's subsidies be detached from production, but also that the level of subsidy payment to the individual producer be reduced. It is clear that large subsidies to large farms are a positive incentive to low cost production which will continue to undercut international markets—whatever form the subsidy may take. We deplore the complacent attitude of a number of Member States' governments to this problem, as revealed in the seven ministers' open letter of 23 September (paragraph 77).**

115. **We therefore recommend that in order to act as intended, as an income subsidy only, the level of subsidy receipts allowed to individual holdings should be capped, as originally proposed, but at a much lower rate than that recommended by the Commission. The converted subsidy should be utilised only as a transitional income supplement, to be used only where hardship is created by elimination of EU support to production or in economically disfavoured areas (paragraph 78).**

116. **As part of the mid-term review the EU must abandon its direct subsidisation of exports and scale down its import tariffs. Developing country trade is particularly affected by the EU's subsidised exports of wheat, dairy products and sugar. It is therefore all the more essential that the EU abandons its direct subsidisation of these exports and takes early steps to reform its dairy and sugar market regimes which remain the two outstanding examples of unreconstructed**

common market organisations. The Commission's January 2003 proposal to continue dairy quotas is a step in the wrong direction (paragraph 79).

117. **Where reform of European agriculture policy and the introduction of the "Everything but Arms" agreement harms the incomes of countries which are dependent on the high prices maintained in the EU market through long-standing preferential access agreements, the EU's development effort to diversify the economies of these countries should be intensified (paragraph 80).**

118. **An important conclusion to be drawn from the evidence presented by less developed country and development agency representatives is that reduction of subsidised competition and the lowering of import barriers is only part of the solution to the problem of increasing the agricultural trade of developing countries. As important is the removal of health, technical and quality obstacles. We therefore recommend that more emphasis should urgently be given to development projects which will assist less developed countries to meet EU health, safety, quality and labelling requirements (paragraph 81).**

SUSTAINABILITY OF EUROPEAN AGRICULTURE

119. The three main features of the Commission's proposals—decoupling, cross-compliance and modulation—can be expected to make a significant contribution to the sustainability of European agriculture. The measures envisaged could on balance be expected to reduce the pressure of intensification of agriculture on the rural environment, to force farmers to have more respect for EU environmental, food safety and animal welfare regulations and provide funding for new measures to foster these desirable objectives. The degree of switch in importance from market support to these measures to improve the quality and safety of food and food production will however be seriously hampered by the relatively small amount of money likely to be transferred from Pillar 1 to Pillar 2. On the basis of the Commission's January 2003 modification of the mid-term review proposals, the total annual amount of money to be transferred to Pillar 2 in this way will be only €1.48 billion for EU25 by 2013.

120. **It is essential that the cross-compliance measures and the closely allied Farm Advisory system recommended in the mid-term review proposals are sufficiently effective to ensure that possible intensification stimulated by the reduction of support to production is discouraged (paragraph 90).**

121. **The switching of funds from support of production to structural, environmental and other Pillar 2 considerations proposed by the Commission amounts to only a possible total of €1.5 billion for the EU15 by the end of a seven year period. We consider that this is inadequate to have any noticeable effect. We therefore recommend that—subject to careful monitoring and assessment of value for money—the modulation percentage should be considerably more than the maximum of 19 per cent proposed under the Commission's "degressive modulation" proposal of 21 January 2003 and that the time allotted to reach the full figure should be considerably less than what has now effectively become ten years. We deplore the delay in the application of this measure until 2007, as recommended in the January modification of the Commission's proposals (paragraph 91).**

122. **A revised CAP should be less complicated, less bureaucratic and less centralised. It should offer farmers more choice about how to run their businesses. In this respect these proposals fall far short of the Commission's commendable intentions to deliver such reforms (paragraph 92).**

123. **If environmental measures are to be effective it is important that, rather than being of an essentially prescriptive nature, the new policies envisaged within the mid-term review proposals should be designed to encourage and reward good land management. We recommend that the type of subsidised "best practice" measures being developed in the UK and in some other EU Member States should be adopted at the general European level (paragraph 93).**

124. **Early agreement and the application of the Commission's cross-compliance proposals is if anything more urgent in the new Member States than in the EU15. This is because there are many habitats and species still surviving in eastern Europe which are now rare in the west. Failure to apply effective cross-compliance measures could result in these being endangered by the intensification of agriculture in these regions (paragraph 48).**

RECOMMENDATION TO THE HOUSE

125. This Report is made for debate.

APPENDIX 1

Sub-Committee D
(Environment, Agriculture, Public Health and Consumer Protection)

Members of the Sub-Committee

Baroness Billingham
Lord Carter (2002-2003)
Rt Hon the Lord Crickhowell
Lord Christopher (2001-2002)
Lord Dubs (2001-2002)
Lord Fyfe of Fairfield
Lord Haskins (2002-2003)
Lord Livsey of Talgarth (2002-2003)
Baroness Maddock
The Countess of Mar
Baroness Miller of Chilthorne Domer (2001-2002)
Lord Palmer
Lord Renton of Mount Harry (2002-2003)
Earl of Selborne (Chairman)
Lord Walpole

The Specialist Adviser was Mr Brian Gardner

Members of the Sub-Committee declared the following interests in relation to this inquiry:

Lord Carter
President, The Institute of Agricultural Management
Retired farmer
Retired agricultural consultant

Lord Fyfe of Fairfield
Former Chairman, Co-operative Wholesale Society 1989-2000

The Countess of Mar
Farmer
Cheese Maker

Lord Palmer
Arable Farmer
Member of NFU for Scotland
President of The British Association of Biofuels
Member of the Advisory Board of "Farm Business" magazine
Residual beneficiary of banana plantations in the West Indies

Lord Renton of Mount Harry
Chair, Sussex Downs Conservative Board

The Earl of Selborne
Director, Blackmoor Estate Ltd (a farming company)
Trustee, The Lawes Trust (Rothamsted Experimental Station)
Member, The Commercial Farmers Group
Member, Country Land and Business Association
Member, The Institute of Agricultural Management
Member, National Farmers' Union (England and Wales)
Vice President, Royal Society for the Protection of Birds (RSPB)

Lord Walpole
Landowner, retired Farmer, Gardener. Active in countryside conservation since 1982.
Vice-President, Council for National Parks
Director, Peter Beales Roses
Member, Country Land and Business Association, National Trust

APPENDIX 2

The following witnesses gave evidence. Those marked * gave oral evidence.

* ActionAid
* African, Caribbean and Pacific Group of States (ACP), Brussels
* The Biscuit, Cake, Chocolate & Confectionery Alliance (BCCCA)
* The Catholic Agency for Overseas Development (CAFOD)
* Christian Aid
Consumers' Association
* Country Land and Business Association (CLA)
* Czech Republic
* Department for Environment, Food & Rural Affairs (Defra)
* Department for International Development (DFID)
Environment Agency
European Landowners Organisation (ELO)
The Federal Trust
Food and Drink Federation
* National Farmers' Union of England and Wales (NFU)
* Organisation for Economic Co-operation & Development (OECD)
* Oxfam
* Republic of Poland
Royal Society for the Protection of Birds (RSPB)
Royal Society for the Prevention of Cruelty to Animals (RSPCA)
Slovak Republic
* Republic of Slovenia
Tenant Farmers Association
UK Industrial Sugar Users Group (UKISUG)

In addition the Sub-Committee received relevant information from the Family Farmers' Association and the Royal Commission on Environmental Pollution.

GLOSSARY

References are to fuller explanations in the Report

Agenda 2000	Agenda 2000, published in July 1997, was a blueprint for the future of European Union policy, with enlargement in view. Within this blueprint the European Commission proposed reform of the CAP. Negotiations on Agenda 2000, and thus on CAP reform, were concluded at the Berlin European Council in March 1999 *(paragraphs 13–14)*.
Amber box	WTO designation of domestic financial support to agriculture linked to production support, which must be reduced under the Uruguay Round Agreement on Agriculture *(Box 5)*.
Blue box	WTO designation of domestic acreage and headage support, based on fixed areas, yields and number of head, which limits production *(Box 5)*.
Cross-compliance	Making subsidy payments conditional on compliance with environmental and other non-production requirements *(Box 2)*.
Decoupling	The separation of subsidies to supplement farm incomes from subsidies to production, so that they no longer support or stimulate production *(Box 2)*.
Doha Round	WTO trade liberalisation negotiations initiated at the Fourth WTO Ministerial Conference in Doha in November 2001. Agricultural trade liberalisation talks, which had already begun under the 1993 Uruguay Round Agreement on Agriculture, were subsumed by the Doha Round negotiations.
EU 15	The present (2003) 15 Member States of the European Union.
EU 25	The EU 15 with the 10 countries due to become Member States in 2004 (Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovak Republic and Slovenia).
Everything but Arms	*See paragraph 60 and footnote.*
Green box	WTO designation of domestic support to agriculture which has no significant effect on levels of commodity consumption, production and trade *(Box 5)*.
Mid-term review (of the CAP)	So called because it is mid-way through the 2001-06 budgetary period set by the European Council at Berlin in March 1999, when Agenda 2000 was agreed. It was the only concession won by the reformers at Berlin and committed the Council to reviewing and rectifying the shortcomings of Agenda 2000 *(paragraphs 16, 21–25)*.
Modulation	The term has evolved since it first entered the agricultural policy vocabulary with the proposals for the 1992 CAP reform. Then it meant staged reductions in subsidy entitlement. In the Agenda 2000 agreement modulation was taken to refer to permission given to Member States to reduce direct production support to farmers and transfer those funds to spending covered by the rural development regulation. The mid-term review introduced the term "dynamic modulation". It refers to the phasing of modulation *(Box 2)*.
OECD	Organisation for Economic Co-operation and Development.
Pillar 1	Production subsidies and direct market support within the CAP.
Pillar 2	Support for rural development, environmental protection and structural measures within the CAP.
WTO	World Trade Organisation.