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Competition, cooperation, solidarity

A Changing Global Context in Agricultural Policy

As a primer for its debate on CAP reform, Notre Europe is publishing a series of works to further our understanding of how European agriculture will look after 2013.

The original interaction of the Common Agricultural Policy (CAP) was based on protectionist and trade distorting measures. Interestingly, the CAP remained largely unchanged during three decades, and was then reformed three times in fifteen years. This article focuses on the interactions between the external constraint and successive CAP reforms.

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A Changing Global Context in Agricultural Policy

Isabelle GARZON

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CAP 2013 PROJECT

A changing global context in Agricultural Policy

By Isabelle GARZON

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Foreword

Since the launch of the Uruguay Round at Punta del Este in September 1986, international trade discipline has become an important background factor to agricultural policies. Agriculture long remained an exception in multilateral trade negotiations. And it still enjoys significant official support and tariff protections, particularly in the EU and the US.

However the acceleration of world trade is now impacting on agricultural policies that, since the 90s, have had to adjust to multilateral trade regulations. These upheavals fit into broader trends increasingly subjecting official policies to international necessities.

The increase in the number of countries involved in international negotiation has forced open the eyes of developed countries to the negative impact of their agricultural policy on their partners' trading balance. Today when debating the future of European farming, the Europeans can no longer ponder it without taking into account the impact of their policies on farming issues in the developing countries (UDCs) and the least developed countries (LDCs).

Policy makers must now review the agricultural policy's set of constraints in the light of this new parameter. But the trade-offs needed to keep to international obligations are particularly thorny where farming is concerned. Indeed, farming is an economic branch apart. In the LDCs, it holds the key to vital matters (famine and

poverty); in rich and emerging countries, it underwrites commercial, political and social stakes. Now the fall-outs of liberalization take their toll on the economic and social structures least able to compete whilst the benefits, ill-allocated as they are, remain elusive. Yet, opening the markets is an opportunity: it brings in a stimulating competition, advantageous in the long term.

Meanwhile, agricultural trade liberalization upsets social patterns. In ancient agrarian civilisations as are found in Europe or in India, farming underpins cultural identity. For millennia, the farmer's work played a crucial part in land use, food production and the environment. The new regulations for global farm trade cast these issues in a new light and bring about a reassessment of the role of farming in our societies. They force policy makers in a position where they must – laboriously – represent to their trading partners the cultural specificity of their own farming patterns.

In view of the CAP check-up due in 2008, and of the financial perspective running to 2013, Notre Europe proposes a set of long-range analyses aimed at understanding the issues at stake in farming in the mid-term. In this Policy Paper Isabelle Garzon scrutinises one of the CAP's major determinants today: farm trade liberalisation. She re-examines the genesis of farming's induction into GATT discipline then examines the impact of trade negotiations on the three major CAP reforms in 1992, 1999 and 2003.

Summary

The original interaction of the Common Agricultural Policy (CAP) was based on protectionist and trade distorting measures. Interestingly, the CAP remained largely unchanged during three decades, and was then reformed three times in fifteen years. This article focuses on the interactions between the external constraint and successive CAP reforms.

The international trade dimension has constantly expanded over the last two decades. World trade liberalisation is now a cyclical and recurrent item on the agricultural policy agenda. Until the Uruguay Round, agriculture remained characterised by exceptionalism, but the evolutions in world trade imposed to include agriculture in the negotiation agenda and making it one of the most contentious issues of the Uruguay Round.

The significance of the Uruguay Round Agreement on Agriculture (URAA) resides in that it brought agriculture more in line with world trade disciplines and ensured that the issue of liberalisation and policy reform would be kept on policy agendas by scheduling new negotiations. This led to the current Doha Development Agenda in which agricultural negotiations bear strong similarities with those of the Uruguay Round: agriculture continues to be one of the most contentious issues of multilateral trade negotiations; the nature of

the debate has not substantially changed, it concentrates on domestic support, export subsidies, and market access. What has changed is the configuration of actors. Developing countries now compose two thirds of the WTO membership and join those voices who expect strong agricultural policy reform out of the Doha Round.

The changes in the global environment stem also from other factors. First, concluding the URAA had strong systemic effects. By establishing the WTO dispute settlement system, it gave all members a powerful tool to ensure that commitments are abided by. The system has largely been used by developing countries and had a significant impact on the EU. Second, bilateral free trade agreements between the EU and other parts of the world also contribute to further re-shaping the international environment of agricultural policy. They increase the pressure on the EU market, at least for certain commodities and as far as certain suppliers are concerned. Third, EU external policies are changing: the EU development policy uses more and more trade policy as a tool to achieve its objectives; EU trade policy itself takes development considerations on board; this results in a new programme of policy coherence in which trade and agricultural policies are priority areas in which coherence with development policy is expected.

More generally, globalisation of the world economy challenges the particular structures of agricultural policy. Globalisation has affected patterns of trade, industry structures and farming practices. It has also contributed to transforming the policy space into a trans-national policy space where agricultural policy is being reappraised. One very significant evolution is a new sensitivity to developing countries and the entry of new participants in the debate, the development organisations. All this has the effect to reinforce the argument that agricultural policies should not be trade distorting.

As a consequence of these global evolutions, the CAP decision-making can no longer operate in isolation from international developments. The international dimension impacted significantly the process of the three successive reforms in 1992, 1999 and 2003. In two occurrences, in 1992 and 2003, the international trade dimension exerted a strong pressure for change on the CAP. This pressure shaped the content of reform through the interpretation by policy makers of what policies might successfully be enshrined in a

GATT or a WTO agreement. The objective was best achieved when the pressure was high and the public debate active, like in 1992 and 2003, when policy makers had to reach decisions simultaneously at the European and international level.

The outcome of these complex interactions is that a lot has been achieved in reforming the CAP under the spotlights of international debates. First, the international level increasingly shapes agricultural policy. One important factor is that trade policy is today considered as also promoting the role of the EU has an active global actor and serving the coherence of EU external policies, in particular as regards development policy. This suggests that the growing insertion of the agricultural policy debate into the international debates is there to remain and probably to further increase, combined with the effects of successive trade rounds.

Second, policy legacies provide for cumulative change through policy feedbacks. Each decision and policy mechanism influences future decisions. As regards the international dimension, a strategic decision was taken in 1992 in favour of progressive trade opening and policy reform. This triggered the constant necessity to bring domestic prices closer to international levels and to adapt policy instruments closer to the international paradigm of agricultural policy. Following the 2003 reform, it can be discussed whether new constraints will come from a new WTO environment, but it can be anticipated that given the almost universal WTO membership and the ensuing increased diversity of interests within the WTO, trends in negotiating patterns and expectations of various players are likely to continue targeting both domestic policies and market opening.

Third, evolving policy preferences changed the paradigm of agricultural policy. Insulation from world markets was replaced by the acceptance of inserting agriculture in the liberalisation of world trade. This had fundamental consequences for policy instruments, in particular a strong reduction of export subsidies, which are now expected to be eliminated in the context of the Doha round, and the transformation of direct payments into income support decoupled from production.

Fourth, and as a conclusion, a significant, yet implicit, choice has been made to turn the European agricultural model into a quality intensive one, withdrawing from the trade in commodities, unless

they are internationally competitive. Such strategy relies on the differentiation of EU products and therefore on global rules on quality and safety standards, as well as on a technological competitive edge of European agriculture. This may warrant a reflection on whether the parameters of the insertion of European agriculture into the world trading system may have to undergo yet another significant evolution.

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Introduction: The original sins of the CAP

From the origin, the Common Agricultural Policy (CAP) is part of the wider enterprise of European integration. The inception of the CAP served to reconcile the disparate national agricultural interests and differences in market organization schemes while the Common Market was progressively established. It enabled well-organised agricultural sectors such as France and the Netherlands to expand their markets into a unified market while maintaining mechanisms of support for their farmers and delegating the financial responsibility to the European level. By contrast, Germany had much less competitive agricultural structures and therefore relied on high domestic prices. German farmers feared increased competition from more competitive European farmers and wanted to retain high incomes. Nevertheless, because it was considered that the German economy as a whole was best served by open trade and a stable food supply, Germany eventually agreed to include agriculture in the package deal on the Common Market, which the Netherlands and France would not have accepted without agriculture.

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So, after intensive discussion, it was agreed that the new unified agricultural market would rely on remunerative prices based on German high levels and would be sheltered from international competition by a (high) common tariff in order to deliver the new market opportunities that the French were looking for. This initial political pact was reflected by what was subsequently described as the three fundamental principles of the CAP: market unity, financial solidarity and 'Community preference'. Market unity implied a common level of prices throughout the EU¹ which was based on the highest prices, German prices. Financial solidarity meant that the full budgetary impact of the CAP price support policies was to be borne by the EU budget. The principle of Community preference implied that third-country imports were only necessary if EU producers were unable to meet EU demand. It was translated into a common external tariff and threshold prices higher than internal target prices.

These principles had major consequences for the trade relations of the Community with the rest of the world. A policy based on price support could only resort to protectionist and trade distorting measures. Given that European prices were far higher than prices on the world market, the application of Community preference meant that the domestic market was insulated from imports by variable levies and any surplus was exported through the payment of export refunds. Such system of trade protection was inseparable from the price policy. To be effective in ensuring a high level of income, an agricultural policy based on price support had to prevent the importation of products coming from third countries at a lower price.

Interestingly, the CAP remained largely unchanged during three decades, and was then reformed three times in fifteen years. The cause for starting to reform the CAP in the early 1990s was compelling: budgetary costs, structural adjustment, need to address new issues such as environment protection and rural development.

¹ The term EU is used for simplification purposes even though the EU was only established in 1990s.

International reasons were also very strong and penetrated the European agricultural policy debate for the first time. This has not ceased from then on.

This article focuses on the interactions between the external constraint and successive CAP reforms. It describes how the international trade dimension has expanded over the last two decades, through a succession of cyclical agendas leading from the Uruguay Round to the Doha Development Agenda, systemic innovations such as the WTO dispute settlement system and bilateral trade agreements, and the penetration of the globalisation debate in the agricultural arena. This impacted significantly the process of the **three successive reforms in 1992, 1999 and 2003. These events are analysed to highlight how the international level of decision making influenced the European policy debate.** Not only did the external pressure have an impact on how and what decisions were taken, but reforms themselves influenced the European position on the international level through important policy feedbacks. The outcome of these complex interactions between the CAP and the international level is also examined to highlight the varying degree of influence of the external pressure in shaping agricultural policy, the decisive role of policy feedbacks in provide the ground for cumulative change, and the eventual change of agricultural paradigm resulting in the now almost full integration of agriculture in a broad policy context.

I - External constraints: cyclical agendas and recurring issues

1.1 - A challenged model from the 1980s - Intellectual and legal challenges

The CAP remained largely unreformed until the early 1990s, although the situation started to be challenged already in the 1980s. There were a number of internal challenges. The institutional price guarantees attracted capital into the farm sector and accelerated its modernisation. This led to an overall intensification of production processes. Moreover, the increasing budgetary cost of market and price policy started to become unbearable. In the 1980s, guaranteed prices to farmers and productivity gains produced such an increase of production that surplus stocks accumulated.

At the same time, the international context and the trade consequences of the policy became a problem. During the 1970s and 1980s, the world trading system evolved in a trilateral game comprising the United States, the EU and Japan, but saw lower trade growth and increasing non tariff barriers². The 1980s recession increased trade tensions and protectionist tendencies, thus leading to a perceived agricultural trade crisis: this crisis was due to a fall in commodity prices and a major shift in export patterns resulting from the emergence of the EU as a net exporter (Ingersent *et al.* 1999). **Facing increasing production and static domestic demand, the EU had to dispose of its surpluses on the world market through the export subsidies mechanism³.** This took place in a global context of falling demand due to world recession – notably in Communist countries and developing countries – and static demand in industrialised countries.

Simultaneously, the agricultural policy debate at international level was profoundly renewed. The OECD played a major role in the analysis and the diffusion of new norms. A discussion was launched in 1982 to examine agricultural domestic policies and their impact on trade. After some years, the work arrived at a common concept, the production subsidy equivalent, which facilitated the comparison of agricultural policies. The process involved intense interaction with the international scientific community, which had the effect of a major pedagogical exercise also for national policy makers. The discussion was indeed based on the thus far unknown concept that domestic policies had an impact on trade. This laid the ground for a re-definition of the scope and method of public policy intervention.

These rather academic developments would not have had a major impact if new international discussions did not develop at the same time in the GATT (General Agreement on Tariffs and Trade). The debate in the OECD forum was transformed into a political

² It has been estimated that from 40 per cent, the share of world trade subject to export controls raised to 48% (Ingersent *et al.* 1999).

³ In 1973-74, European self-sufficiency ratios for cereals, sugar and beef and veal were 91, 91 and 96 respectively. In 1990, they were 120, 128 and 108 respectively (McCalla 1993).

negotiation as the OECD discussions gave further arguments to open negotiations on agriculture for the first time. This represented a major quality shift for the OECD work : from producing analysis and evaluation tools, OECD work was used to agree on rules and to bring arguments to the negotiators. The OECD itself was closely involved in the negotiation and behaved as an active mediator and influenced directly the end result (Fouilleux, 2003).

At the same time, the imbalances of the CAP system were provoking trade tensions that exacerbated into GATT disputes. One specific issue warranted attention early on. This was the oilseeds dispute between the EU and the United States. The origin of the dispute stems from a European concern about the growth of imports of cereal substitutes under very low rates of tariff duties, and the subsequent enactment of a specific oilseeds support regime to re-balance imports by domestic production. As a result of the scheme, EU production of oilseeds rose from 600,000 tons in 1966 to over 12 million tons in 1990 (Kay 1998).

This growth of European production created American resentment in the form of GATT panel in 1985 which in December 1989 found the EU subsidy regime to be in violation of GATT rules. The processor subsidy scheme favoured domestically produced oilseeds over imported ones and contravened a 1962 commitment by the EU to charge zero duty on imported oilseeds. In order to come into compliance with the ruling, the EU first envisaged settling the issue as part of the GATT negotiations but had eventually to adopt a new regime in 1991. The new scheme was aimed at being a compensatory payment system with per hectare aids paid directly to producers, thus replacing the processor subsidy of the old regime and removing the guaranteed price level. It did not, however, meet US demands. The US again referred the oilseeds regime to the GATT. Once more, in April 1992, the EU oilseeds regime was found to be in violation of GATT rules because producers were being directly compensated for any price advantage that imported products might enjoy and therefore continued to contravene the 1962 import concession.

Although the oilseeds regime was a specific issue, it highlighted the various interactions and causal links between international trade rules and EU domestic policy, and in many ways was considered as

showing the way for the cereals sector at a moment when the EU was under direct international pressure to reform the CAP (Kay 1998).

1.2 - From the Uruguay Round to the Doha Development Agenda

THE EVOLUTIONS IN WORLD TRADE AND THE INCREASING NUMBER OF TRADE DISPUTES CHANGED THE CONTEXT INTO MAKING AGRICULTURE ONE OF THE MOST CONTENTIOUS ISSUES IN THE NEW ROUND OF GATT NEGOTIATIONS LAUNCHED IN 1986 IN PUNTA DEL ESTE, THE URUGUAY ROUND.

World trade liberalisation is a cyclical and recurrent item on policy agenda. Agriculture has never been formally excluded from it. It was already subject, although in a very limited manner, to the 1948 GATT and was discussed in the Kennedy, Dillon and Tokyo rounds in the 1960s and 1970s.

Until the Uruguay Round, however, agriculture remained characterised by exceptionalism. Although the GATT had established the principles governing international trade - non discrimination, open markets and fair trade -, agriculture remained for decades exempt from most of the GATT disciplines. In particular, the use of subsidies was not prohibited and was only subject to notification for those which directly or indirectly reduced imports or increased exports. In addition, quantitative restrictions on exports and imports were allowed and used. The US was itself, during that period, an important user of quantitative restrictions (Swinbank *et al.* 1996).

But the evolutions in world trade and the increasing number of trade disputes changed the context into making agriculture one of the most contentious issues in the new round of GATT negotiations launched in 1986 in Punta del Este, the Uruguay Round.

In the first half of the 1980s, preparations for a new round of multilateral trade negotiations within the GATT had been underway, with strong support of the US, Australia and Japan. After US President Reagan persuaded the G7 summit in 1987 to give more market oriented agriculture high priority, there was disagreement about how radical the reforms should be enshrined in a new GATT agreement (Greer, 2005). Although the EU was determined that the mechanisms

of the CAP should not be put into question, Europeans eventually agreed to negotiating objectives that would ultimately force changes to the CAP4, namely that farm support should for the first time be discussed in a trade context and that significant trade opening should also apply to agriculture. Ultimately, it was agreed to reduce tariffs by 36%, to limit export subsidies and to reduce trade-distorting domestic support by 20%, while establishing a new classification of domestic subsidies whereby a distinction is made between trade-distorting support and non trade-distorting support, exempting the latter from reduction commitments through the so-called 'green box', and exempting also support which is basically trade-distorting but which is linked to production-limiting mechanisms, the 'blue box' subsidies.

The significance of the Uruguay Round Agreement on Agriculture (URAA) resides in that it brought agriculture more in line with world trade disciplines and kept the issue of liberalisation and policy reform on policy agendas (Greer, 2005). The cyclical nature of agricultural trade negotiations was enshrined into the URAA itself: the key clause was Article XX which explicitly recognised the long-term objective of a fair and market-oriented trading system and "built-in" the resumption of negotiations on the liberalisation of agricultural trade by January 2000.

Accordingly, negotiations on agriculture started in special sessions of the WTO Agriculture Committee in early 2000, despite the fact that a new round of negotiations was still not launched after the failure of the Seattle Conference in 1999. The EU was one of the most active proponents of this new round, for various reasons amongst which the need to enshrine agricultural negotiations within a broader package (the "single undertaking") in order to re-balance the future talks in

⁴ With regard to agriculture, the Punta del Este declaration said that 'the Contracting Parties agree that there is an urgent need to bring more discipline and predictability to world agricultural trade by correcting and preventing restrictions and distortions (...). Negotiations shall aim to achieve greater liberalisation of trade in agriculture and bring all measures affecting import access and export competition (...), by : (i) improving market access through, inter alia, the reduction of import barriers; (ii) improving the competitive environment by increasing discipline on the use of all direct and indirect subsidies and other measures affecting directly or indirectly agricultural trade (...); (iii) minimising the adverse effects that sanitary and phytosanitary regulations and barriers can have on trade in agriculture (...)'.

favour of EU offensive industrial and services interests and thus alleviate pressure on agriculture. The “built-in agenda” on agriculture focused on issues identified as core concerns during the previous round: export subsidies, market access and trade-distorting domestic subsidies. These talks were fully integrated into the negotiating mandate of the new round of negotiations eventually launched at the WTO in Doha in 2001. Because of the path dependency of the recurrent agricultural trade agenda, the agricultural agenda of the Doha Round bears strong similarities with that of the Uruguay Round⁵.

Since 2001, the Doha Development Agenda is ongoing. Agriculture continues being one of the most contentious issues. The nature of the debate has not substantially changed insofar as it remains centred around both trade opening and domestic policies. What has changed is the configuration of actors. During the Uruguay Round, 34 developing countries joined the WTO and developing countries now compose two thirds of the WTO membership. Logically, from an opposition between those in favour of free trade – the USA and the Cairns Group of agricultural exporters (i.a. Australia, Canada, Argentina) – and those who consider agriculture as a special case – the EU and Japan -, a range of new positions has emerged, following the emergence of new actors in the WTO.

Although the EU and the US remain the main exporters of agricultural products and challenge each other for the place of first world exporter, they are facing more and more competition from other industrialised countries, namely Australia, New Zealand and Canada. But the most important development is the increasing share taken by emerging countries such as Brazil and Argentina, and the changing

⁵ The part of the Doha declaration related to agriculture states : ‘We recall the long-term objective referred to in the Agreement to establish a fair and market-oriented trading system through a programme of fundamental reform encompassing strengthened rules and specific commitments on support and protection in order to correct and prevent restrictions and distortions in world agricultural markets. We reconfirm our commitment to this programme. Building on the work carried out to date and without prejudging the outcome of the negotiations we commit ourselves to comprehensive negotiations aimed at: substantial improvements in market access; reductions of, with a view to phasing out, all forms of export subsidies; and substantial reductions in trade-distorting domestic support. (...) We take note of the non-trade concerns reflected in the negotiating proposals submitted by Members and confirm that non-trade concerns will be taken into account in the negotiations as provided for in the Agreement on Agriculture’.

patterns of agricultural world trade. Brazil realises impressive export performances due to its low costs of production and dominates trade in sugar, soya and cotton. India has become a net exporter, although its still plays a marginal role. China, a net importer, attracts the lion share of imports in commodities, thus driving prices up, but also has comparative advantages in certain products such as pork, poultry and fruits and vegetable. By contrast, the share of least developed countries (LDCs), in particular in Africa, is continuously declining and their marginalisation increases.

These new patterns in world trade are reflected in the positions taken in the WTO negotiations, with four distinct groups of countries with very disparate interests (Lamy, 2004). **The first group, the Cairns Group**, which includes thirteen of the world’s twenty biggest exporters, considers opening of markets and abolition of agricultural support as a priority of multilateral trade negotiations. Because their natural advantages make them the most competitive producers in the world, they feel that agriculture should be governed by the same rules as any other sector.

At the opposite, **the LDCs** are concerned about their ability to cope with multilateral opening and rules. They have been confronted with many challenges, including putting in place the necessary administrative, institutional and legal machinery, to implement the Uruguay Round commitments. Some of them did not fully appreciate these challenges at the time of the negotiations and had thus limited impact on the design of the new rules. This particular applied to the URAA, which was largely negotiated between the EU and the US (see below). As a consequence of this experience, LDCs and low income countries have consistently expressed their reluctance to agreeing on new significant tariff cuts, mainly for concerns about preference erosion, loss of tariff revenue and perceived lack of capacity to capture the market access opportunities supposedly ensuing from trade opening in northern markets. More assertively, these developing countries are also demanding new rights or security under the principle of special and differential treatment, such as the right to meet their farming and food needs and

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the prior requirement that developed countries reduce or eliminate their agricultural subsidies.

THE EU NOW ACCEPTS MORE EASILY THAN THE US A TIGHTENING OF RULES ON DOMESTIC SUPPORT THANKS TO THE SUCCESSIVE CAP REFORMS, BUT DEFENDS A HIGHER DEGREE OF TRADE PROTECTION AS SOME OF ITS COMMODITIES ARE NOT INTERNATIONALLY COMPETITIVE.

The third and fourth players are the US and the EU. American agriculture is very export oriented, and it is therefore logical that the US place high price on opening third markets and demanding elimination of EU export subsidies. But like in the EU, many farmers in the US need government support. The US attitude towards domestic support is therefore less ambitious and defends the continuation of existing categories of domestic support. Finally, the EU now accepts more easily than the US a tightening of rules on domestic support thanks to the successive CAP reforms, but defends a higher degree of trade protection as some of its commodities are not internationally competitive.

1.3 - The strength of the trade dispute settlement system

Concluding the URAA had strong systemic effects, and not only through the recurrent character of negotiation rounds. By establishing the WTO dispute settlement system, it gave to all members a powerful tool to ensure that commitments are respected. And also in this regard, patterns of the actors involved have changed along with the increasing assertiveness of developing countries.

Indeed, **over the ten years following the Uruguay Round agreement (1995-2005), the use of the dispute settlement system has not completely been dominated by developed countries: developing countries have participated in one third of cases and 40% of cases have been generated by developing countries** (Abbott, 2007). Most significantly, seven out of the most top eleven most active members in dispute settlement are developing countries, with a very strong role of five of them, Brazil, India, Thailand, Chile and Argentina. These five countries are at the origin of 60% of all complaints from developing countries, reflecting their more advanced and diversified economies,

the absence for them of difficulty to use the system as well as a strong interest to redress any problem of principle affecting their trade interests.

A number of panels brought by third countries have had significant impact on the EU. The most famous one is the banana dispute brought by latin-american countries allied with the US against the EU import regime, in particular the preferential arrangements granted to African, Caribbean and Pacific (ACP) countries. This dispute provoked three panels which found the EU regime illegal. As a consequence, from a quota system based on a restrictive import licences regime, the EU had to establish a tariff only regime based on a more liberal import licences system. But most recently, Ecuador has requested a new panel, directly putting into question the preferential treatment for ACP countries. This case illustrates not only the strength of the WTO dispute settlement for imposing change, but also the new competition between developing countries to access the EU market, which is further illustrated by a panel launched, and won, by India against preferences granted to Pakistan under the general system of preferences.

Other cases, sugar and cotton, show the constant pressure on developed countries' domestic support. On both sugar and cotton, panels launched by Brazil and Thailand with Australia against respectively the EU and the US found their domestic policies in breach with their commitments to limit and reduce export subsidies. The two panels argued that domestic production support can lead to disguised export subsidisation that is incompatible with WTO rules if it is not declared as such and if it exceeds the limits allowed under the URAA. The panel on sugar against the EU was, together with the prospect of full market opening in favour of LDCs (see below), a direct cause for reforming the EU sugar regime in 2005.

Finally, **WTO panels also limit the use of protectionist measures disguised behind regulatory standards.** The most significant case for the EU was the hormone case launched by the US and Canada against the ban of growth hormones in the EU. The panel found that the EU

THE BANANA DISPUTE ILLUSTRATES NOT ONLY THE STRENGTH OF THE WTO DISPUTE SETTLEMENT FOR IMPOSING CHANGE, BUT ALSO THE NEW COMPETITION BETWEEN DEVELOPING COUNTRIES TO ACCESS THE EU MARKET.

had not demonstrated the risks for health as a reason to ban beef imported from the US and forced the EU to carry out substantial risk assessment to justify its decision. The EU confirmed its decision on the basis of a scientific risk assessment, but the dispute is still ongoing because US and Canada do not recognise this latest decision and have imposed retaliatory duties.

1.4 - A new agenda of bilateral trade agreements

THE EU DEVELOPMENT POLICY USES MORE AND MORE TRADE POLICY AS A TOOL TO ACHIEVE ONE OF ITS MAIN OBJECTIVES, A BETTER INTEGRATION OF DEVELOPING COUNTRIES INTO THE WORLD ECONOMY.

The international dimension does not only penetrate agriculture through the multilateral trading system. Bilateral free trade agreements between the EU and other parts of the world also contribute to further re-shaping the international environment of agricultural policy.

Since the late 1990s, the EU has embarked into a range of bilateral free trade agreements with a significant number of emerging countries. Agreements were signed with the Mediterranean countries⁶ as part of the Barcelona process, South Africa (1999), Mexico (2000) and Chile (2002), and are being – or will be – negotiated with Mercosur, Central America, the Andean Community, India, South Korea and the ASEAN. Not all of these

countries are significant agricultural producers or exporters, but as bilateral agreements offer preferential conditions in comparison to multilateral commitments, they increase the pressure on the EU market, at least for certain commodities and as far as certain suppliers are concerned.

In addition, the EU development policy uses more and more trade policy as a tool to achieve one of its main objectives, a better integration of developing countries into the World economy. A very

⁶ Egypt (2001), Israel (1995), Jordan (1997), Lebanon (2002), Morocco (1996), Palestinian Authority (1997), Tunisia (1995)

significant step was taken in 2001 with the “Everything but Arms” (EBA) initiative, which granted to the 50 least developed countries of the world full access to the EU market, that is duty free and quota free access with immediate effect, except for bananas, sugar and rice for which duty would be phased out gradually (by 2006 for bananas, and 2009 for sugar and rice). This had significant repercussions for the domestic regimes of these very sensitive products (see below).

Similarly, the EU is currently engaged in the negotiation of Economic Partnership Agreements (EPAs) with the ACP, which will replace the current preferences granted under the Cotonou convention. The EPAs will be WTO compatible free trade arrangements but with strong asymmetries, which means further opening concessions to those ACP countries which do not already benefit from EBA. This further opening will align EU imports on the EBA regime, with only a few exceptions on a transitory basis. Here again, this will put more pressure on the most sensitive agricultural products.

THE URUGAY ROUND AND MOST SIGNIFICANTLY THE DOHA DEVELOPMENT AGENDA PUT DEVELOPING COUNTRIES CONCERNS AT THE HEART OF THEIR AGENDA.

1.5 - A new policy agenda: trade and development

Trade policy itself has gone through significant evolutions with the penetration of development considerations in the policy debate, both internationally and in the EU. This occurred through a change of paradigm in development policy itself, which more and more considers trade and economic growth as an essential condition to development, as manifested in the UN Millenium Development Goals and various UN conferences in the last decade: the Monterrey conference on financing called for an increase in trade related assistance; the Brussels UN conference on LDCs called for granting free access to developed markets for imports from these countries, which was further confirmed by the WTO conference in Hong Kong in 2005. As a result, the Uruguay Round and most significantly the Doha Development Agenda put developing countries concerns at the heart

of their agenda, including by trying to help developing countries to overcome their capacity needs through a new “aid for trade” agenda.

These international commitments have been translated in 2006 in the EU development policy through a new programme of policy coherence. **Trade and agricultural policies are priority areas in which coherence with development policy is expected.** This means that the EU trade and agricultural policies have to ensure that their impacts are as positive as possible on developing countries. In particular, the accent is put on increasing EU market access through the generalised system of preferences, simplification and relaxation of rules of origin and reduction on trade-distorting agricultural subsidies. New tools such as an annual review of policy coherence by the European Commission have been put in place to that effect.

IN EUROPE, AGRICULTURAL PRODUCTION SYSTEMS HAVE BEEN EVOLVING TOWARDS A DUAL STRUCTURE COMPOSED OF INTERNATIONALLY COMPETITIVE PRODUCERS OF COMMODITIES AND PROTECTED SMALL SCALE FARMERS SPECIALIZED IN QUALITY PRODUCTS.

1.6 - Globalisation enters the agricultural policy debate

More generally, globalisation of the world economy affects agriculture and challenges the particular structures of agricultural policy. This takes place on different levels.

In its economic dimension, globalisation in agriculture has affected patterns of trade, industry structures and farming practices. Largely as a result of a relatively slow growth of trade in commodities and a much more rapid growth in processed foods, agriculture underwent a twin evolution of specialisation of production and concentration on quality and speciality commodities. This is accompanied by a change in agricultural structures leading to horizontal or vertical integration and high concentration levels, which leads to new commercial alliances, mergers and contractual arrangements. In Europe, agricultural

production systems have thus been evolving towards a dual structure composed of internationally competitive producers of commodities and protected small scale farmers specialized in quality products.

Globalisation has also a political and cultural dimension. It has contributed to open national policy debates, which until then

remained largely closed and were transformed into a largely trans-national policy space (Coleman *et al.* 2004). Many issues have contributed to this opening, but the latest multilateral trade negotiations provided the main impulse. New sections of civil society became involved in the debate over trade liberalisation, development or the economic benefits of global market economy. New concerns have emerged such as impact on the poorest countries, environment or local and national traditions. These concerns developed some times into ‘resistance identities’ and a globalised policy debate. Competing ideas and policy paradigms have been developed and discussed on the global scene, with the EU model of agricultural policy being one of the main topics of debate.

As a consequence, **agricultural policy is being reappraised.** The concern for natural resources calls for sustainable agriculture not only in Europe but also in the rest of the world. The rise of consumer concerns in Europe, starting with concerns about food prices and turning to increasing demands for new regulations ensuring food safety and consumer information also applies to goods traded internationally. The debate on globalisation brings contestation that world markets and the productive model built on technological inputs favour standardised commodities to the detriment of food products as identity markers.

One very significant evolution is a new sensitivity to developing countries which emerged in the late 1990s at the occasion of the WTO endeavour to launch a new round in Seattle. At that time, new stakeholders broke into the agricultural policy debate much more forcefully than before. Protests against globalisation and the WTO, including mobilisation around agriculture, brought organisations with different concerns to cooperate. For the first time, alliances between environmental, consumer and development organisations were formed. Some put the emphasis on rural development, the need for less intensive practices and the CAP’s impact on trade accusing Europe of ‘dumping’ food through export subsidies. Others argued in terms of taxpayers’ interests, asking for safe food, safe environment and a vibrant countryside. All were conscious that their previous positions had been contradictory at times and tried to reconcile environment, consumer and development concerns.

The newcomers were development organisations, drawn into the debate from their participation in the debate on agricultural trade negotiations. Their main targets are an increase market access to the EU for goods from developing countries and the elimination of any subsidies that impact on trade, including income support. They also focus on export subsidies and on certain commodities (milk and sugar) to demonstrate the need for substantial domestic policy reforms.

All in all, the opening of the policy debate to all parts of society has the effect to reinforce the argument that domestic policies should not be trade distorting, not only as regards other competitive exporters but also developing countries' concerns such as food security and poverty alleviation.

II – CAP reforms under external pressure

As showed above, the CAP decision-making can no longer operate in isolation from international developments. It is widely acknowledged that it is a three level game where bargaining and decisions are made at Member State, European and international level and where the international dimension is key (Patterson 1997, Colemand *et al* 1999, Knodt 2004). The various processes are neither linear nor conducted in isolation; they occur most of the time simultaneously and reverberate with each other. In addition to these vertical inter-connections, there is also a horizontal dimension, which connects issues and decision processes. These issues often can be identified with policy areas and the struggle to ensure their coherence. In the case of agriculture, it is difficult to look at it in isolation from international trade and budgetary considerations.

In addition, agricultural policy reform is affected by policy legacies, including policy changes themselves. The CAP has a long history. It is not possible to fully comprehend one particular reform without examining the legacies of previous decisions, because the latter may have reduced the options of current decision makers or prepared the ground for additional changes. In the case of the successive CAP changes, it is argued that there were strong policy feedback effects which reverberated from one episode through the other and that external pressure had a very powerful role in this process.

In a decade, the CAP went through three significant reforms, in 1992, 1999 and 2003. The importance of the international agenda on the domestic decisions and their feedback effects on the next steps will be further examined below.

2.1 - External pressure and policy feedbacks in the MacSharry reform

2.1.1 - The 1992 reform and the Uruguay Round

The 1992 CAP reform took place in a context of crisis of domestic agricultural markets, the EU budget and the international trade arena.

The post war objective of self sufficiency was achieved in the late 1970s for a number of core products. Since then, the policy of high prices generated an excess of production (excessive stocks and export subsidisation) which created a series of negative trends: the fall of farm income and soaring budget expenditure, while consumption was increasing at a slower pace than production. However, in this context of strong market imbalances, not all factors had the same weight to push for reform. Significantly, although a new budgetary crisis was looming, the reform did not bring about any budgetary savings. By contrast, at international level, in the GATT negotiations of the Uruguay Round, the sense of crisis was at its utmost.

The first period of the GATT negotiations until 1990 was characterised by the absence of overlap between the EU and United States

positions. The US put forward the elimination of all farm support, sharp tariff reduction (-75%), and strong reduction of domestic support (-75%) as well as of export subsidies (-90%). By contrast, the initial EU position was to pursue first stabilisation of world markets and as a second step to reduce support for agriculture until it was bound to present concrete proposals in view of the Ministerial Conference at the Heysel in December 1990. However, these proposals (a 30% cut in support, but no quantified offer on export subsidies) remained unacceptable to others.

Not surprisingly, the Heysel Conference collapsed. The EU was unable to agree to specific quantitative commitments that would have implied changes to the CAP as a direct result of external pressure. By then, however, it became evident that the European position based on the existing CAP would not allow a conclusion of the agricultural negotiations and was an impediment for the conclusion of the whole negotiation (Legras 1993, Patterson 1997, Moyer *et al.* 2002). The principal target was export subsidies and domestic support encouraging production. Pressure was actually concentrated on the grain sector, where the Cairns Group and the US had most interest in expanding trade.

This situation of blockage had two major consequences. On the one hand, political leaders realised that farming interests were putting at risk the benefits that other sectors of the economy would reap from a new global trade agreement. On the other hand, decisive developments occurred with strong general policy effects: largely as a consequence of the debate in the OECD, non trade distorting social and environmental policies became more attractive as a way to answer external pressures; the post-war belief that protectionism was a necessary shield to improve agricultural productivity was put into question. It was therefore necessary to admit that agriculture could be supported through different means (Coleman *et al.* 2002).

The reform, proposed by the European Commission (Mr MacSharry was the Commissioner for Agriculture) immediately after the failure of the Heysel conference, was eventually agreed upon mainly to allow the conclusion of the GATT Uruguay Round. The core of the reform was to substantially reduce cereal and beef prices and to compensate farmers with direct support based on area payments and a historic basis, thus partially decoupling income support from current

production. Such reduction in domestic prices had the double effect to allow for new market opening and for a reduced need of export subsidies.

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The decision was possible because trade considerations reverberated through the EU decision making process in two ways. First, the international trade dimension was fully integrated in national and European decisions under the pressure of the short term constraint to conclude the Uruguay Round. Second, trade considerations guided political choices among a range of possibilities. As the GATT negotiations had reached a very mature stage, they were able to orient the content of the reform through the assessment of what would be acceptable by trading partners. In short, by threatening the collapse of the entire Uruguay Round, stalemate in agricultural negotiations created pressures in the EU to reform the CAP in such a way that a GATT agreement could be reached. In addition, without an agreement on agriculture, the Uruguay Round would collapse, hurting more important sectors of the economy than agriculture. Both timing and substance of the reform were therefore directly influenced by the state of the GATT negotiations. This explains why the 1992 reform went much beyond previous attempts at amending

the CAP during the 1980s.

2.1.2 - Policy feedbacks of the 1992 CAP reform

The agreement on the CAP directly contributed to unblock the process of GATT negotiations. The main provisions of the CAP reform came closer to the possible area of compromise that had emerged from the last two years of GATT negotiations, notably by decreasing domestic prices and therefore allowing for some decrease in the custom tariffs protection, and by shifting support to compensatory payments related to a period preceding the reform, thereby enabling the EU to claim that they were decoupled and hence exempt from the GATT disciplines.

Indeed, with the CAP reform, EU negotiating objectives could be adjusted. From preserving an unchanged CAP, the objective was to secure the legal situation of the reformed CAP in the GATT (Cloos *et al.*

1994). This paved the way for a bilateral agreement between the US authorities and the European Commission, known as the Blair House Agreement, in November 1992. The accord settled the long standing oilseeds dispute and provided a common understanding on how the draft final GATT agreement should be amended as compared to the one considered until then. The GATT agreement itself was then concluded on the basis of the reformed CAP. Indeed, once an internal decision was taken, especially by consensus, it became clear to all EU trading partners what the new European red lines would be. This experience would have a lasting learning effect on policy makers in the EU.

In particular, the lesson was that too much time was spent in defending an indefensible CAP (Moyer *et al.* 2002). Had the EU been able to change its policy in anticipation, before being constrained to it by a crisis in the negotiation, the price to pay would perhaps be less. This would be remembered by the successors of Mr MacSharry. In particular, in 2002, Agriculture Commissioner Fischler emphasised the need not to reproduce the Uruguay Round scenario in 2002 by anticipating reform before external pressure became too strong, and the Council itself confirmed that the 2003 reform served to get credits in the WTO negotiation, notably to obtain similar commitments from other trading partners.

The URAA had structural effects on European agricultural policy. First, it introduced limitations on future policy developments.

Transfers to producers through domestic support programmes were limited and had to be reduced by 20% and a set of criteria for minimally trade distorting subsidies had to be respected. Therefore, the agreement forbade any new policy increasing the link between price support and production, which means trade distortion. With a cap on export subsidies and their mandatory reduction, the agreement also introduced a potential limitation to the life expectancy of export subsidies. It notably introduced immediate constraints for the period 1995-2000 that would dictate further domestic reform in 1999 even before the end of the period of implementation of the URAA.

Second, because the debate on the reform was directly connected to the need to find an agreement in the GATT, this led to the general recognition of the importance to bring commodity prices closer to

world market levels. This contributed to the elaboration of new values forging a more market oriented paradigm. From then on, the policy community - policy makers and interest groups - would be influenced by WTO considerations when discussing agricultural policy reform.

2.2 - External pressure and policy feedbacks in the Agenda 2000 reform

2.2.1 - Agenda 2000 and the WTO

The Agenda 2000 reform, decided in 1999, contrasts with the 1992 reform in that it aimed at anticipating future challenges more than at responding to immediate pressing needs.

The situation of agricultural markets did not provoke the same sense of urgency as in 1992, although they were still unbalanced. Production of cereals and beef was still excessive, despite the short term cut in beef production due to the BSE crisis that broke in 1996, and the Commission projected huge increases after the turn of the century. Despite fifteen years of quotas, the EU was still producing too much milk in relation to demand. Agricultural spending was still rising as an inevitable consequence of replacing support based on consumer prices by tax payer support⁷ and there was a real risk of breaching the 'guideline', the ceiling for agricultural spending, in 1991 and 1992. As a consequence of the continuing excess in production, stocks were mounting and surpluses had to be exported with export subsidies. The exportable surplus of cereals was expected to increase in the following two or three years, nearly doubling the cost of export subsidies from the 1988/89 level. The probability that the amounts and quantities authorised by the URAA would be exceeded was very high. Without a new step in the

reduction of prices, a new budgetary crisis was anticipated while the EU would be unable to fulfil its international obligations.

However, **the main external constraint was the perspective of enlargement to the former communist countries of Central and Eastern Europe**, whose agriculture lagged behind and would necessitate a considerable increase of funding and a re-orientation of CAP priorities if the CAP was to be successfully applied in these countries. Partly as a consequence of preparing for enlargement, a new CAP reform would have to be part of a broader package of financial planning and policy reforms for the period 2000-06 (the "financial perspectives"). This resulted into the main topic of discussion being the budget.

In this context of such an historic development for the EU, the international trade dimension was almost absent from the 1999 decisions. It was rather connected with the evolution of the European markets and their ability to respect WTO constraints. This operated only as a static, passive legal constraint – respecting existing commitments – and was therefore qualitatively different from the necessity to adjust a bargaining position in the context of ongoing negotiations.

Such a dynamic pressure was, however, not totally absent in 1999. The EU was among the active proponents of the launch of a new round of WTO negotiations, scheduled in Seattle for the end of 1999. This would be a source of pressure which the Europeans had an interest in anticipating through a new CAP reform, because the pressure was expected to target export subsidies again, as well as a new reduction of the most trade distorting domestic subsidies, and an incentive to further decouple direct support from production and to re-orient it toward environmental subsidies, which were better recognized by the WTO.

⁷ EAGGF Guarantee spending increased from ECU 10.4 billion in 1992 to ECU 17.5 billion in 1997 (Ackrill 2000). In 1998, approximately half of the EU budget in 1998 went to the CAP, of which 88 per cent went to the EAGGF Guarantee section (Hennis 2005).

However, **in the absence of a short term constraint, anticipating future challenges was not a strong enough incentive to enact an ambitious reform.** The final outcome did not go beyond ensuring respect for existing commitments with further price cuts in the cereal and beef sectors and making a cursive reference to future WTO negotiations⁸. In particular, in the absence of an immediate pressure on the sector least exposed to international competition, the dairy sector, budgetary concerns prevailed over preparation of new market opening (less price decrease meant less compensatory payments, and therefore budget savings). Although the wheat sector was reformed, the price cut aimed only at fulfilling existing obligations and was soon recognised as insufficient to negotiate future reductions of trade protection. Similarly, despite some concerns over the future of the WTO blue box in which direct payments are classified, no decision to reduce them or to further decouple them from production was made in 1999. Had there been real external pressure over the blue box, the main objective of the CAP reform would not have been to stabilise overall expenditure but to guarantee the future of direct payments by their complete decoupling from production and/or their reduction.

Overall, as new WTO talks had not been entered into yet, it was not clear whether and which reforms undertaken for domestic reasons would get full 'credit' at the international bargaining table. In the absence of reform, Europe's ability to respect its legal obligations would be put in jeopardy, but there was no immediate cost to a limited overhaul. Even if the new round of WTO negotiations was launched at the end of the same year, the EU would still have a negotiating position to start with; but there was no immediate or targeted international pressure on specific points.

⁸ '24. The European Council acknowledges the scale of the efforts being made to curb the budget and exercise rigour in implementing the Common Agricultural Policy decided within the framework of Agenda 2000. The efforts made, notably in terms of reducing support prices, represent an essential contribution by the European Community in stabilising the world's agricultural markets. The European Council considers that the decisions adopted regarding the reform of the CAP within the framework of Agenda 2000 will constitute essential elements in defining the Commission's negotiating mandate for the future multilateral trade negotiations at the WTO.' (European Council 1999)

2.2.2 - Policy feedbacks of the Agenda 2000 reform

In comparison with the 1992 reform, the policy feedbacks of the Agenda 2000 reform as far as the international level is concerned were less immediate and more difficult to manage. **The now accepted connection of domestic policies with the WTO and world markets would have required a reform going further for the EU to be in a strong position ahead of the new round of trade negotiations.** In concrete terms, the less than complete overhaul of EU domestic support would have uneasy consequences for the EU negotiating position in future WTO talks: the price decrease would be insufficient to envisage a substantial reduction, and therefore the elimination, of export subsidies; the stabilisation of direct support expenditure, rather than its decrease, would make further reduction commitments of the overall domestic support difficult; and the absence of decoupling while the future of the blue box was put into question was a matter of preoccupation (Blanchet *et al.* 1999).

On the other hand, the increased international exposure of agriculture was discussed extensively during the Agenda 2000 debates, as they were later during the WTO Seattle meeting. This would fuel the debate on the role of agricultural policies in a global economy. From their impact on developing countries to the protection of the environment, new issues penetrated the policy debate and highlighted the necessity to re-build a consensus, a new paradigm, for agricultural policy (Hervieu *et al.* 2001). This debate was no longer held in closed policy networks. It interested a series of civil society groups and increasingly the general public.

2.3 - External pressure and policy feedbacks in the 2003 reform

2.3.1 - The 2003 reform and the Doha Development Agenda

The 2003 reform took place in response not to a crisis or a budgetary need like in 1992 or 1999 but to a political need to address the internal inconsistencies of the CAP system which were less and less acceptable to public opinion.

Indeed, for most commodities, the balance was going to be reached in the medium term⁹, with successive reductions of institutional prices starting to reach their objective of transforming them into a safety net, and some sectors (wheat) having begun to export without export subsidies. Imbalances remained, however, for minor crops (rye, rice) which were witnessing very worrying levels of intervention stocks, while the dairy sector had to face substantial decisions on whether to maintain production quotas, and many commodities were still dependent on export subsidies.

THE MOST IMPORTANT ISSUE WAS NO LONGER THE IMBALANCES OF THE EUROPEAN AGRICULTURAL MARKETS. IT HAD BEEN REPLACED BY MORE SYSTEMIC AND POLITICAL QUESTIONS.

So, the most important issue was no longer the imbalances of the European agricultural markets. It had been replaced by more systemic and political questions. On the one hand, even if successive price cuts had reinforced the market orientation of European agriculture, the take-over by direct payments had generated a high dependence of farmers on income support and weakened the effect of price cuts by maintaining incentives to produce or to use certain production factors. On the other hand, the social distribution of income support had remained concentrated on some sectors and regions, mostly the most

competitive ones, without tackling effectively the pressures on traditional and mixed production systems.

Although domestic considerations were the main reason for the reform, the extent of the reform could not be entirely explained without the existence of external pressures. Initially envisaged as a “mid-term review” of the previous Agenda 2000 decisions, the review turned into a very substantive overhaul of the CAP. This is largely explained by the importance WTO talks had gained both at international level and also in the European policy agenda.

After the failure of the Seattle meeting in November 1999, a new round of WTO negotiations had eventually been launched in Doha in November 2001. Like the Uruguay Round, agriculture was considered as the key to progress, and ultimately to the success of the negotiations. Unlike the Uruguay Round, however, the task was more clear-cut because of the transparency introduced by the Uruguay Round in the measurement of border protection and domestic support. The stakes were also different: it was no longer so much about agreeing ways to bring agriculture under the constraints of GATT rules, but to secure prospects for further reforms of agricultural policies, in particular in the US and in Europe. Moreover, actors had diversified and the negotiating landscape had changed. The Cairns group, supported by the US, gave priority to the ‘core’ agenda (market access, domestic support, export subsidies). **The EU, together with other European countries, Japan and some developing countries wanted to enlarge the discussions to non-trade concerns and the multifunctionality of agriculture.** More assertive developing countries wanted to ensure that developed countries would take more stringent commitments than developing countries and that other issues such as special and differential treatment for developing countries, food security and trade preferences were also part of the agenda.

⁹ Self-sufficiency ratios had become more balanced: 109 per cent for coarse grains, 107 per cent for meat, 101 per cent for butter and 105 per cent for skimmed milk powder in 1999 (European Commission 2002).

BY 2003, IT BECAME CLEAR THAT WITHOUT REFORMING THE CAP, THE EU COULD NOT TAKE PART IN A WTO AGREEMENT ON THE BASIS OF THE AGENDA 2000 PACKAGE, IN PARTICULAR THE CAPPING OR REDUCTION OF BLUE BOX SUBSIDIES.

Following the agreement in Doha, the next phase was to agree on more precise modalities by March 2003. The EU made an offer in January 2003 which included significant reductions in tariffs, domestic support and export subsidies (European Community 2003), but was greeted with less than enthusiasm by WTO partners. Despite its efforts, the EU had again been called to abandon export subsidies and to reduce substantially its domestic support, including the direct payments classified in the blue box. By 2003, it became clear that without reforming the CAP, the EU could not take part in a WTO agreement on the basis of the Agenda 2000 package, in particular the capping or reduction of blue box subsidies.

The experience of the Uruguay round had taught Europeans to avoid being blamed for the failure of the next Ministerial conference scheduled in Cancun in

September 2003 which aimed at deciding on an interim agreement for the Doha Round. The issue of income support, which joined export subsidies as the target of the WTO members, had therefore to be addressed. The mid-term review offered the opportunity to improve the negotiating position of the EU.

The link with international trade and the ongoing WTO negotiation bears strong similarity with 1992. The sectors most concerned by change were those for which international pressure was strongest. The first was domestic support, notably the reduction, or elimination, of the blue box. Developing countries were particularly vociferous on domestic support, putting forward the argument of the inequity of rich countries paying for their rich farmers. In these circumstances, the conservative position of the EU had become a potential impediment to reaching an agreement. The flagship proposals of the reform - decoupling of direct payments and increase in the financing of rural development through degressivity and modulation - were assessed according to their ability to improve the EU's negotiating position in the trade talks and to safeguard within the WTO the legitimacy of the CAP.

Similarly, the reduction, and possibly the elimination, of export subsidies was the second sector under pressure from a majority of

the WTO membership. Here also, developing countries were adamant that export subsidies were remains of the past, at a time when two major actors, the US and the EU, dominated agricultural world trade. They were noisily supported by NGOs who called for more "trade justice" and the end of "food dumping". But contrary to the 1990s, the main commodity concerned was no longer cereals but dairy products. While dairy reform had been postponed in 1999 when international pressure was weaker, now dairy prices were to be reduced more substantially and at an earlier date. Another sector directly concerned was rice, whose excess of production due to high domestic prices would make further market opening extremely difficult without substantial reform, in particular in view of the planned full market opening to least developed countries in accordance with EBA. This reform, long postponed, was indeed adopted.

The role played by the WTO dimension was confirmed by the Council itself. In its final conclusions, half of the political declaration introducing the final compromise was devoted to explain the relationship between the newly adopted reform and the ongoing WTO negotiations¹⁰. **The contrast with the concerns prevailing in 1999, where only a cursory reference was made to the WTO, or with the defensive position adopted in 1992, was remarkable.**

This is because the cost of no agreement on the reform was quite high. The WTO negotiations were not in a comparable situation of

¹⁰ 'The Council stresses that the reform allows to reduce the remaining trade distortions of CAP measures, and that overall CAP expenditure will stay within the agreed ceilings, despite an increase in the number of farmers of 50% following the EU enlargement. The CAP reform is Europe's important contribution to the Doha Development Agenda (DDA), and constitutes the limits for the Commission's negotiating brief in the WTO round. Its substance and timing are aimed at avoiding that reform will be designed and imposed in Cancun and/or Geneva - which could happen if we went there empty handed. The Council stresses that the margin of manoeuvre provided by this reform in the DDA can only be used on condition of equivalent agricultural concession from our WTO partners. While the European Union has been moving throughout the 1990s towards less trade distorting support and has taken the initiative to very substantially move further and early in the DDA, it does not intend to, and will not pay twice in order to conclude the round. Europe has done its part. It is now up to others to do theirs. [...] Every country or Union has the right to an agricultural policy of its own, provided it is sustainable and avoids or limits trade distortion. The support of the EU (just like others) offers to its farmers is a policy choice, based on an objective of ensuring a sustainable agriculture, in its social, economic and environmental aspects. The reform confirms and acts on that choice, and aims at securing the future of farmers in a changing world in the light of societal demands and international requirements' (Council of the European Union 2003).

crisis to that of 1990: they were actively ongoing and heading towards the Cancun conference. However, partly for lack of a new EU position, the date for agreeing on agricultural modalities in March 2003 had already been missed and a resulting sense of urgency and looming crisis was prevailing.

Indeed, a failure to agree on the CAP reform would have two consequences. First, the EU would be locked in defending a position which would not respond to the targeted pressure against export subsidies and domestic support and therefore make an agreement in Cancun impossible. Second, NGOs targeted agriculture as a symbol of the imbalances caused by globalisation. The more discussions on agriculture continued, the less support public opinion would lend to trade opening and agricultural policy. As a result, not only the EU would be in a similar position to 1992 of being held responsible for blocking the WTO negotiations, but this would have an impact on public opinion' confidence in the EU as a global actor.

Overall, **the particularity of the 2003 situation is that the interaction with the WTO negotiation was less dramatic and controversial than in 1992.** The policy learning effect affected all actors, who all shared the concern of avoiding a repetition of the EU isolation of the early 1990s. Indeed the reform aimed at improving the chances of success of an intermediate deal in the WTO and not to conclude, like in 1992, the entire round of negotiations. As the timing of the reform was essentially the result of earlier decisions on the CAP – a mid-term review – one can say that the interaction between the European and international levels of decision making was a more conscious, proactive choice made by EU policy-makers and less of a constraint imposed by international events. The risk taken by policy makers in reforming the CAP for domestic reasons but also in order to get some 'credit' in the international bargaining existed but appeared less important than in 1999.

The other particularity of the 2003 talks was the extension of the constraints resulting from the WTO negotiations. From the constraint on domestic prices through additional market opening and reduction of export subsidies, pressure now applied to domestic support, and decoupling would allow further commitments in the reduction of the WTO constrained categories of public support.

2.3.2 - Policy feedbacks of the 2003 CAP reform

The agreement on the CAP in June 2003 was immediately used by the EU as a new, more offensive negotiating position in the DDA. Following the missed deadline for agreeing on a set of modalities in March 2003, the negotiations had effectively slowed down before the agreement on the CAP reform, as other countries were waiting for the results of the European internal debates. As in 1992, Europeans made it immediately clear that the new CAP would be the basis of a WTO agreement and expressed new objectives, like 'buying two reforms for the price of one', namely forcing a change of the American agricultural policy by requesting equivalent concessions in the area of domestic support and export subsidisation.

This more offensive positioning was demonstrated by a bilateral agreement concluded between the European Commission and US authorities in August 2003, just as it had been done in 1992. However, this agreement was not sufficient to avoid the failure of the Cancun Ministerial meeting in September 2003. Many reasons can be found to explain the failure of Cancun, notably the fact that countries could not agree on the inclusion of 'new' issues (investment, competition, public procurement and trade facilitation) in the WTO rules book. Those reasons related to agriculture are, first, the late approval of the CAP reform, and second, more importantly, the new configuration of assertive developing countries. Indeed, positions within the "South" became polarised. On the one side, the G20 of emerging countries was born out of their political and agricultural interests and their desire to assert themselves on the international scene. Their objective was to bring down US and EU farm support. On the other side, the LDCs saw this new stage in market opening as a threat, which would eventually erode their trade preferences on developed markets (Lamy, 2004). Their fear crystallised in an alliance of a group of African countries against cotton subsidies in the north.

MANY REASONS CAN BE FOUND TO EXPLAIN THE FAILURE OF CUNCUN, NOTABLY THE FACT THAT COUNTRIES COULD NOT AGREE ON THE INCLUSION OF 'NEW' ISSUES IN THE WTO RULES BOOK.

Eventually, the new CAP did lay the ground, after the recovery from the Cancun failure, to two intermediate agreements in the WTO.

Indeed, in July 2004 in Geneva, the EU could sign up to a 'framework' deal that contained the objective of a substantial reduction of domestic support including, for the first time, the blue box category which was capped at 5% of domestic production, and most symbolically, the elimination of export subsidies. This last move was a significant development in the CAP history and a direct result of the 2003 reform, but also of the EU willingness to consider requests from developing countries: after having offered to eliminate export subsidies on products benefiting developing countries, the EU agreed to full elimination in return of the reciprocity from the US.

Later in December 2005 at the Hong Kong Ministerial meeting, further commitments could be taken by the EU: within three bands of reduction in domestic support, the EU was able to commit to the highest reduction; a date for the elimination of export subsidies (2013) could be agreed, with parallel elimination of other forms of export subsidisation; and thanks to cotton reform in 2004, the EU could easily accept special efforts for this commodity, an issue of particular concern of some African countries.

An additional effect of the 2003 reform was further changes brought to specific commodity regimes. Significant reforms took place in 2004 notably for cotton, and in 2005 as regards sugar. These commodities had long been insulated from international competition. The new role of developing countries in trade negotiations, and mobilisation of civil society, brought them into the light of trade controversies, and then agricultural reforms, which aligned largely their schemes onto the main commodities.

III- Achievements and prospects

A lot has been achieved in reforming the CAP under the spotlights of international debates. While agriculture remains a hot topic in trade negotiations, especially in relation to the North-South relation and the new South-South divide, the CAP reform process has substantially evolved. The impact of external pressures and prospects for further evolutions are analysed below.

3.1 - The international level increasingly shapes agricultural policy

In the EU system of governance, problems facing policy makers and their decisions are vertically connected across three different levels of policy-making (national, European, international), and horizontally connected with other policy areas. In the case of agriculture and trade, the relationship has constantly become tighter, influenced both by trade negotiations and by new considerations.

In two occurrences, in 1992 and 2003, the international trade dimension exerted a strong pressure for change on the CAP. This pressure shaped the content of reform through the interpretation by policy makers of what policies might successfully be enshrined in a GATT or a WTO agreement. This happened in all three episodes of reform, but the objective was best achieved when the pressure was high and the public debate active, namely when the political horizon was shortest, like in 1992 and 2003, when policy makers had to take decisions simultaneously at European and international level.

It is clear that the higher the cost of no agreement, the more likely substantive reforms are to happen. The international dimension is particularly strong in this respect, because it increases the cost of no agreement. This cost of failure was not strong enough in 1999 against the prevailing connected issue, namely the budget agreement in view of enlargement. The cost of no agreement was higher in 1992 and in 2003, and the highest in 1992 when the entire Uruguay Round was at stake and had already failed once because of agriculture. This does not mean that the 2003 reform was not a substantive one. There were simply other factors at work adding to the external pressure, one of which was the new collective expectation that trade policy should serve other purposes that simply defending EU commercial interests.

Indeed, trade policy is today considered as also promoting **the role of the EU has an active global actor. It is clear that trade policy has evolved into an instrument that should serve the coherence of EU external policies, as manifested at three levels.**

First, this is expressed in the demand for coherence between the EU development, trade and agricultural policies. To the extent that trade can lead to export generated growth in developing countries, the EU consensus requests further market opening with preferential treatment of developing countries, some of which are strong competitors for European farmers. Similarly, it is now accepted that EU internal policies should minimise their impacts on developing countries. This clearly concerns the CAP, which is expected to constantly search for minimal trade distortion of its domestic support and to eliminate export subsidies.

TRADE POLICY IS TODAY CONSIDERED AS ALSO PROMOTING THE ROLE OF THE EU HAS AN ACTIVE GLOBAL ACTOR.

Second, the EU trade policy is more and more embedded in the of bilateral relations of the EU with third countries with the aim strengthening the political, economic and cooperation relations with these countries. All recent bilateral agreements concluded by the EU have a trade component which includes sometimes far reaching commitments, not only to satisfy requirements of WTO compatibility, but also to serve the purpose of strengthening the bilateral relationship with the countries concerned. The most striking example is the current negotiations of Economic Partnership Agreements with ACP countries. Whether these agreements have had strong impacts on European agriculture is still a matter for discussion. However, it is clear that their conclusion contributes to further embedding the external aspects of agricultural policy in a wider context of EU external relations.

Third, the EU trade policy is considered as a reflection of the European commitment to multilateralism. Not only does this make the EU a strong supporter of multilateral trade negotiations, this also entails responsibilities in ensuring that the multilateral system of trade rules functions effectively. Contrary to some other players, the EU therefore places a high value in respecting established rules, even if it is sometimes to its detriment. Concretely, this means that the WTO dispute settlement system may have had some painful effects on the EU agricultural system, such as in the case of the sugar and cotton regimes which had to be reformed under the scrutiny of WTO challengers. But for reasons of consistency with the defence of multilateralism, it is largely accepted that this should be the case.

CONTRARY TO SOME OTHER PLAYERS, THE EU THEREFORE PLACES A HIGH VALUE IN RESPECTING ESTABLISHED RULES, EVEN IF IT IS SOMETIMES TO ITS DETRIMENT.

All this suggests that the growing insertion of the agricultural policy debate into the international debates is there to remain and probably to further increase, combined with the effects of successive trade rounds.

3.2 - Policy legacies provide for cumulative change through policy feedbacks

Policy legacies play a crucial role in policy change. Each decision and policy mechanism influences future decisions. The apparently strong incrementalism in the successive CAP changes may lead to the conclusion that it may not have fundamentally changed either in its objectives or in its policy instruments. On the contrary, there were strong policy feedback effects at work.

As regards the international dimension, a strategic decision was taken in 1992 in favour of progressive trade opening and policy reform. In order to maintain and improve the competitiveness of European products, this triggered the constant necessity to bring domestic prices closer to international levels and to adapt policy instruments closer to the international paradigm of agricultural policy.

When looking at the future, long term assessments on the inter-relation between the reformed CAP and the WTO rules and negotiations are difficult. Following the 2003 reform, some analysts have already pointed to some of the pressures that will come from the new WTO environment. On the one hand, some consider that it is not certain that the EU will be able to implement its commitment to eliminate export subsidies without further reform (price decrease) before the end of the current CAP period 2005-13, notably for the main commodities receiving export support, dairy and sugar (Butault *et al.* 2004). On the other hand, the compatibility of the new decoupled single farm payment with recent WTO jurisprudence has raised some concerns (Swinbank *et al.* 2005). More fundamentally, when export subsidies are outlawed, no safety valve will allow high priced EU surpluses to be exported, thus depriving also farm incomes from a safety net. As markets further liberalise, farm incomes will face increased instability which may trigger calls for new forms of income stabilisation. Such concerns have already been expressed and have led public authorities, both national and European, to consider the merits of farm insurance as a method of market fluctuations and crisis management (see for example European Commission 2005c).

Whatever the evolutions in these particular areas will be, experience of the internationalisation of agricultural policies and globalisation of agricultural trade tell us that pressures will continue to come from international markets and will continue to affect domestic policies like the CAP. The place taken by the WTO dimension in many aspects of the 2003 reform discussions also shows the extent of the policy learning since 1992. This seems to indicate that policy makers have integrated this dimension into the shaping of agricultural domestic policies. The experience of the reform of specific regimes in 2004 and 2005, some of which – cotton and sugar – had a strong international dimension, confirms this trend.

More precisely, given the almost universal WTO membership and the ensuing increased diversity of interests within the WTO, trends in negotiating patterns and expectations of various players are likely to continue targeting both domestic subsidies and market access.

The first such trend is the continuing debate on domestic subsidies and their impact on trade. The classification in three categories seems to more and more actors and commentators to date back to the Blair House agreement, in other words to a time when such arrangement aimed largely at accommodating EU defensive interests. Following the latest CAP reform, the main user of the amber box category is the US. This will largely be true also for the blue box in so far as the reformed CAP still entails some elements of coupled support which may one day be removed following further reforms. In such case, the future issue for the EU domestic system of income support may become the current green box, and its adaptation to new realities. Current WTO negotiations do not discuss the criteria of green box subsidies in depth, only as far as they need to be adapted to developing countries needs in respect of food security or rural livelihood. It could however be anticipated that future debates turn their attention to this issue.

The second trend concerns market access and the debate between developing and developed countries as well as between developing

EXPERIENCE OF THE INTERNATIONALISATION OF AGRICULTURAL POLICIES AND GLOBALISATION OF AGRICULTURAL TRADE TELL US THAT PRESSURES WILL CONTINUE TO COME FROM INTERNATIONAL MARKETS AND WILL CONTINUE TO AFFECT DOMESTIC POLICIES LIKE THE CAP.

countries. One of the key principles put forward by developing countries in the WTO, especially LDCs, is special and differential treatment. An illustration of this debate is the current discussion over “special products” that developing countries would be entitled to protect from further market opening. It reflects the change of paradigm whereby much tighter rules should apply to developed countries than to developing countries, thus no longer enabling developed countries to fully exclude any product from market opening as could be the case during the Uruguay round. Another more and more prominent debate is the differentiated treatment amongst developing countries. This debate results from the increased competition between developing countries to access developed markets, in particular the EU market, and the ensuing preference erosion for those, the least developed ones, which until now benefited from unilateral trade preferences. New multilateral trade opening brings additional export opportunities for the most competitive developing countries exporters. It also generates calls from the least competitive ones to redress lost opportunities through alternatives trade arrangements such as bilateral agreements. The result is an even stronger expectation from of further market opening.

3.3 - Evolving policy preferences changed the paradigm of agricultural policy

In a decade, the CAP underwent three reforms. Looking beyond each episode, one can say that the successive reforms led to a real paradigm change. This is illustrated by four key elements.

First, the overall financial solidarity that presided over the institution of the common agricultural market progressively gave way to a socio-economic solidarity aimed at compensating structural handicaps in certain regions. Indeed, the recognition that structural problems had to be addressed at the right geographic level displaced the centre of gravity from market unity and underwriting of its costs solely by the EU budget. This notably justified co-financing adjustment and rural policies designed by Member States and their local authorities.

Second, insulation from world markets – the so-called Community preference – was replaced by the acceptance of inserting agriculture in the liberalisation of world trade. That meant accepting some assumptions of market liberalism, that is that world markets can be stabilized by putting international constraints on domestic policies and establishing rules governing the food chain such as sanitary and phyto-sanitary standards.

Third, from a production intensive model, the model turned into a more quality intensive one, with high content of technology, and environment and health protection. This represents a strategy of withdrawing from the production of basic commodities, unless they are competitive globally, and re-orienting European production to high valued added products that can compete on world markets.

Fourth, although the principle of income stabilisation remains, it is now conditioned to the provision of public goods. The combination of the objectives of income support, environment protection and widespread presence of agriculture on the EU territory highlights the policy objective to continue supporting farm businesses as an essential component of the vitality of rural areas and the provision of public goods. The most recent evolution lies in society’s expectation that government support should do more than provide incentives and rewards to the production of public goods but also sanction failure to provide them.

Some uncertainties remain, however. **One component of market liberalism is acceptance of territorial specialisation, which leads to dual structure of farms which are internationally competitive and those which are not. The actual trend of farm structures evolutions points in this direction, and yet, policy discourse and objectives claim the need to maintain a widespread and diversified presence of agriculture on the entire European territory.** How far will specialisation go or how strongly will it be resisted? How long can the discrepancy between discourse and reality last?

This evolution in the vision of European agricultural had practical application in the adaptation of policy instruments. Reforms followed a particularly consistent path in focusing on the budgetary and economic insufficiencies of the CAP, with a significant attention being given to international aspects. The decision in 1992 to liberalise the agricultural market by opening it to imports and by bringing market’s

functioning closer to other economic sectors had fundamental consequences for policy instruments.

On the one hand, the high guaranteed price policy has been abandoned by reducing institutional prices to bring them closer to international levels and to transform them into safety nets. From the sectors most concerned with international competition (cereals and beef in 1992 and 1999), the change has been extended to almost all commodities (dairy in 1999 and 2003, olive oil, cotton and tobacco in 2004, sugar in 2005). This had the consequence to also allow for a strong reduction of export subsidies, which are now expected to be eliminated in the context of the Doha round.

On the other hand, to ensure political acceptability, direct payments have been introduced as compensatory benefits for price cuts. This followed the rhythm of price reductions: from cereals and beef in 1992, direct payments now benefit almost all crops and commodities after the last reforms in 2004 and 2005. Moreover, direct payments have gone through significant changes too, the most significant being the transformation of direct payments into income support decoupled from production.

The triggering factor for decoupling was enlargement of the ten new Member States. Initially, EU institutions maintained the position that direct payments were introduced to compensate farmers for price cuts and implicitly admitted that they could be of a temporary nature. This was unacceptable to candidate countries and EU institutions had to admit that direct payments had to be granted to all EU farmers. The rationale was no longer compensation for price cuts, but stabilisation of farm incomes. This intellectually very significant evolution was immediately complemented by a conclusion drawn from the WTO negotiations. As shown previously, the call from WTO partners to reduce all kinds of domestic subsidies applied most significantly to the blue box, therefore to the partially decoupled direct payments. The EU had no choice, in 2003, but to proactively fully decouple its income support in order to accept a strong limitation of blue box payments.

There is some uncertainty on the future of policy instruments. **The current instrument setting is a combination of new policy tools reflecting directly the new paradigm (decoupled support, cross-compliance, modulation, rural development payments) and**

instruments inherited from the previous model (quotas, set aside, intervention). A debate is ongoing as to whether this coexistence will be replaced by yet totally new instruments, as advocated by the supporters of bond schemes (Daugbjerg *et al.* 2004) or income insurance (Blanchet *et al.* 1999). From an international perspective, the question is whether this would allow the EU to base entirely its support schemes on non coupled support qualifying for the WTO green box and whether the latter is appropriately designed to that effect.

3.4 - A “normalised” or renewed agricultural policy debate?

Today's public policies develop in the context of globalisation of the economy, and the agricultural policy debate has indeed been integrated into this broader context. Globalisation led to a restructuring of the European agricultural sector which has strengthened the differentiation among farmers and changed the role of public policies. As a consequence, the policy debate has been opened to the wider public and now addresses the place of agriculture in a globalised economy as it never has previously.

A significant, yet implicit, choice has been made to turn the European agricultural model into a quality intensive one, with high content of technology, and environment and health protection. This entails also a choice of withdrawing from the production of basic commodities, unless they are competitive globally and therefore to exploit the comparative advantage of European food production on the global scene. Such strategy relies on the differentiation of EU products and therefore on the establishment of global rules on quality and safety standards, as well as on the establishment of a technological competitive edge in the case where technology science.

To benefit from such a new globalised production chain, the parameters of the insertion of European agriculture into the world

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trading system may well have to undergo yet another significant evolution. What would seem to matter in such situation would be less the “quantitative” debate on subsidies and tariffs (how much they need to be reduced), as has been the case since the URAA, but more the “qualitative” discussion on the rules, economic structures and investments necessary for European agriculture to be globally competitive.

Three issues come, tentatively, to mind in this respect. The first is the protection of the identity markers of European food products, the so called geographic indications, to which less attention is given in WTO negotiations than to other agricultural matters¹¹, whilst there is some potential for renewed efforts including through bilateral agreements and an alliance with some developing countries which also would benefit from a protection of their own products (coffees, teas, rice). **The second issue is the trade and economic structures governing trade in food products.** Little attention is given to the efficiency of the production and distribution chains, despite a context of increasing vertical integration and strong concentration of operators. There may be efficiency gains to look for, including through appropriate competition, but further research would be needed to ascertain the potential of a policy in this area. **The last issue is ensuring that appropriate investments in research and development of new technologies are secured in order to safely and efficiently develop new uses of agricultural production, such as biotechnology and bio-energy.**

¹¹ Since the URAA, geographic indications are recognised by the WTO, but to a limited extent. Only wines and spirits are concerned, not other food products; there are significant problems of enforcement, starting with the absence of any international system of registration; and registered trademarks use the names of EU protected appellations.

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