
Reform and adjustment in the European Union: the 2003 reform of the Common Agricultural Policy and enlargement

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Abstract: This paper aims at presenting the main findings of an impact analysis of the reform of the Common Agricultural Policy on the agricultural markets and income of the current and the enlarged European Union over the 2004-2010 period, with specific investigation of the impact of the single farm payment. This policy changes towards significantly less-trade distorting instruments should reduce the risk of structural surpluses. The market projections indicate that adjustment of production would take part in key areas of agricultural production in Europe (cereal, beef and dairy production) while keeping agricultural income little affected.

Key words: Common Agricultural Policy, enlargement, decoupled payments, reform

Introduction and main hypotheses

Over the medium term agriculture in the EU will be exposed to significant adjustments and changes. The reform of the Common Agricultural Policy (CAP) in June 2003 brought about a major change in the agricultural policy by largely decoupling agricultural support from production. Moreover, the historical enlargement of the European Union (EU) will integrate the agricultural sectors of 10 new countries into a single market which will expand from 378 to 453 mio inhabitants.

This paper aims at presenting the main findings of an impact analysis of the reform of the CAP on the agricultural markets and income of the current and the enlarged European Union over the 2004-2010 period (European Commission 2003a). The paper also gives a view of the developments of agricultural markets in the EU-25 by taking into account the CAP reform as well as the specific conditions of entry for the new Member States.

The paper summarises the different scenarios for the EU-15 and the EU-25. This analysis has been undertaken on the basis of the statistical information available at the end of 2003 using the modelling toolsⁱⁱ currently available at the Directorate-General for Agriculture of the EU Commission. They have also been established under a specific set of assumptions, the most important of which concerns the Common Agricultural Policy where the projections based on the implementation of the latest decisions for CAP reformⁱⁱⁱ (i.e. the baseline) are compared with a *counterfactual* scenario, which corresponds to the continuation of the Agenda 2000 policy measures. The other important assumptions regard mainly the agricultural policy in the new Member States, other domestic policy measures, the trade policy framework, the macro-economic environment and the medium-term developments on world agricultural markets^{iv}:

Main characteristics of the CAP reform

The key elements of the reformed CAP can be summarised as follows (European Commission 2003b):

- The introduction of a single farm payment (SFP) for EU farmers, replacing most of the premia currently offered, independent from production with limited coupled elements maintained where Member States consider this necessary to avoid abandonment of production. The granting of the SFP is conditional to the respect of environmental, food safety, animal and plant health, and animal welfare standards, as well as to the requirements to keep farmland in good agricultural and environmental conditions;
- Strengthening of rural development with a significant extension of the scope of measures and funds through the implementation of modulation (reduction of the SFP for larger farms);
- Revisions to some common market organisations (cereals, dairy, rice, nuts etc.) with a significant reduction in price support;
- Financial discipline: introduction of strict budgetary ceilings for farm support (decreasing in real terms).

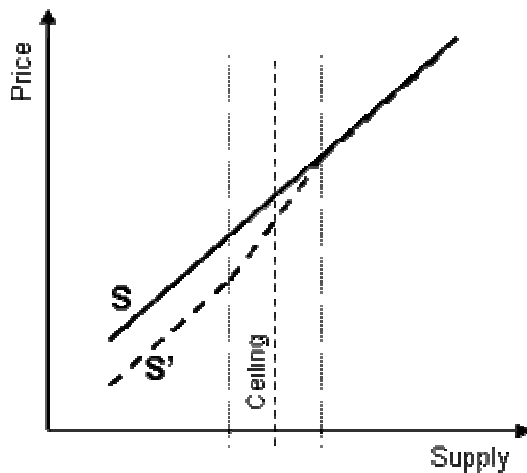
Introduction of decoupled payments

One of the key features of the latest CAP reform is the introduction of the single farm payment decoupled from production. From a theoretical point of view, decoupling refers to the idealized situation where policy measures do not affect production (and trade) as they do not distort decision making by producers

(or consumers) and markets adjusts as if there were no policy in place. Different concepts of decoupling have been put forward with varying degree of restrictions regarding the impact on production and trade (OECD 2001). Several studies have shown that decoupled payments without condition can still create distortions associated with risk and dynamics effects. This may occur by influencing the individual decision to stay in agriculture and to continue producing (Rude 2000, Benjamin 1992). There may also be an announcement effect whereby farmers anticipate on the information about future transfers being contingent on actual cultivation (Young and Westcott 2000). Finally, the impact on the collateral value of land (Phimister 1995), and the income and insurance effects (Hennessy 1998) may be significant. Nonetheless, such effects are seldom recognized as creating important distortions on international trade.

The transition from a situation with direct payments limited to a certain area/number of animals towards a situation with support totally decoupled from production level can be synthesised in the following graph. Supply S' is influenced by direct payments until ceilings are reached. Then aggregated supply S' gradually moves to the left, to reflect the fact that, even when the overall average ceiling is reached, there are some individual farmers who have not yet reached their limit and continue to be influenced in their production decisions. After a certain quantity, any additional quantity produced depends entirely on price. Under total decoupling of direct payments the supply curve moves back to S .

Graph 1



The quantitative assessment of the impact of the decoupled payments is a difficult analytical task, in particular with the modelling tools currently available. The way in which the single farm payment is implemented and modelled may notably influence producer decisions and the projected production patterns. The single farm payments have been considered in our analysis to operate as lump sum transfers with no impact on production decisions of farmers. However, the cross-compliance requirements, the respect of good agricultural practices, the eligibility conditions attached to the decoupling scheme as well as agricultural legislation in Member States have been assumed to constrain the shift between activities, notably between grassland and arable land production and between agricultural activities and abandonment of production. Other studies (such as FAPRI, 2003, University of Bonn, 2003, and OECD, 2004) have all used different assumptions: whereas the single farm payments are considered as lump sum transfers retaining some production-inducing effects, assumed at some 30 % of the supply-inducing effect of the more coupled payments they replace in the FAPRI analysis and at 0.06 in the OECD analysis, the

University of Bonn treated the single farm payment as a uniform payment at national or regional level, i.e. a uniform non-crop-specific payment (entailing a redistribution of support between crops and farms, which would tend to overestimate the impact of the single farm payment based on historical references on land allocation – reflecting the implementing situation in some Member States). The analyses of the different ways of implementing the SFP confirm limited differences in terms of production impact. By contrast, the income impact would be more pronounced between farming groups (cereals, livestock and dairy) and regions.

The implementation of the single farm payment scheme as part of the CAP reform decisions^v allows Member States to choose among different options, which should influence the degree of decoupling of the payments. For the purpose of this impact analysis exercise, a series of assumptions has been made regarding the implementation option which could be adopted by each Member States for the sectors concerned. These working hypotheses have been defined on the basis of the information available, which at the time of the analysis were judged the most plausible. However, in order to limit the uncertainty attached to these assumptions, the main findings of alternative scenarios based on a “maximum” and “minimum” decoupling assumption are summarized in a box at the end of the paper.

Under decoupled support mechanisms, producers may be expected to increasingly base their production decisions on market signals (profitability expectations), thus potentially leading to significant changes in the allocation of production. However producers’ behaviour could also be influenced by other considerations, such as social inertia (arguably a short-term issue), the maintenance of some crops for agronomic purposes, the participation in agri-environmental programmes, the need to depreciate long-term investment, the eligibility to specific well-targeted support programmes addressed to less favoured area payments, etc., which could all be expected to mitigate the overall impact of decoupling on the farm sector.

Production may also be expected to adjust when market revenues do not cover variable cost on a structural basis (such as some crop production in marginal areas, in the beef and sheep sectors where the support system may create incentives to base production decisions on the maximisation of subsidy revenues rather than on the basis of what market prices would normally imply).

This adjustment could take several forms including:

- An adjustment in the production mix (including non-eligible production alternatives): this adjustment may be expected to be constrained between major production sectors -such as animal and arable crop sectors- as the conversion of pasture land to arable land is limited on a statutory basis. Any significant shift between arable crops and fresh fruit and vegetables production may also be reasonably assumed to be limited as a major increase in land allocation towards fruit and vegetables could create major economic disturbances in these sectors;
- An adjustment in the production intensity, notably in the beef and sheep sectors;
- Abandonment of production: this alternative may be expected to be constrained by cross-compliance conditions for the receipt of the single payment (it may, in some cases, be more profitable for some producers to simply reduce their production intensity than to stop producing);
- Adjustment in the farm structure with sale or lease of all or part of the land: this last alternative does not necessarily entail a reduction in the production potential.

The pressure for (structural) adjustment in the farm sector consecutive to the introduction of the SFP is expected to be particularly important in the beef and sheep sectors, notably in countries of Northern Europe. For example, more than a third of farms specialised in suckler cow activity in the EU had negative gross margins (without direct payments), with figures even significantly higher in some European regions. A similar picture can be found in the sheep meat sector. The lack of competitiveness of specific sectors is particularly acute in regions subject to environmental constraints and/or classified as less favoured as more than three quarters of the farms not covering variable costs in the animal sector come from these regions.

Enlargement of the European Union

The implementation of the CAP would generally improve the situation of agriculture in the new Member States compared to the situation without membership and under domestic policies. The CAP in combination with the size of the Single Market provides more stable and on average slightly higher prices than domestic policies of the individual Accession Countries could secure for the years to come.

The new Member States will add about 38 mio ha of utilised agricultural area to the 130 mio ha of the current Member States representing an increase of 30 %, whereas production in the EU will increase by about 10 % to 20 % for most products. Gross value added of agriculture in the EU-25 will be 6 % higher than that of the EU-15 and employment in agriculture will increase by 60 %. These differences illustrate an important lower intensity of production in the new Member States and a significantly lower labour productivity than in the EU-15.

Despite all the positive achievements in the preparation for EU membership a considerable task of restructuring agriculture and food industries, most notably in animal production, remains in the new Member States in order to increase competitiveness on the Single Market. Subsistence farming is an important new farm type in the EU-25. The emphasis on rural development measures until 2013 will put the new Member States into a position to ease and support the necessary structural change. However, the structural change in the agriculture sectors of the new Member States certainly will be more dependent on economic and social developments than on agricultural policies.

The increase in total agricultural area in the EU-25 shows the significant production potential in the new Member States. The ongoing restructuring process suggests however that it will be gradually exploited and fully used only in the longer term. Agricultural production in the ten new Member States would expand slightly over the medium term thanks to slightly higher and significantly more stable producer prices, increasingly favourable perspectives on the Single Market, and rural development measures. Accession should also result in some trade creation and diversion effects between regions of the enlarged EU. However, these effects would be comparably small as most of the bilateral trade in agri-food products has already been liberalised under the Europe Agreements (including the double-zero and double-profit agreements). Nevertheless, accession would significantly change some of the dynamics of agricultural markets in the EU-25 as compared to the current situation in the EU-15 (without enlargement).

The main trade creation effects would result from growing demand for agri-food products in the new Member States. Amongst the products covered by the this analysis, fresh dairy products, cheese, poultry and pork would benefit most. These developments would be supported by the high level of income growth -which stood on average at approximately double the rate recorded in the current Member States over the last ten years. This trend is projected to be strengthened by the accession process^{vi}.

The EU-25 would exhibit an increased degree of competitiveness across production regions and thus lead to different patterns of production. The new Member States would find growing markets, e.g. for poultry products and feed grains, in the current Member States, and expand production accordingly. By contrast, current Member States would benefit from the expansion of the markets for fresh dairy products, cheese and pork in the new Member States.

Impacts of the CAP reform on EU markets and income

Arable crops

The introduction of the single farm payment, the changes in the durum wheat and rye sectors and the reduction in the monthly increments for cereals are all expected to have a significant impact on land allocation and on the structural balance of the EU cereal market.

In a more detailed assessment of the continuation of the Agenda 2000 in the EU-15, the main impacts of the CAP reform decisions can be summarised as follows:

- The total area grown with cereals would display a slight decline (by around 1 % or 0.3 mio ha) over the medium term, with rye and durum wheat areas exhibiting the strongest falls (10 % and 6 %, or 0.1 and 0.25 mio ha respectively) in line with the overall reduction in the level of support in these two sectors. Most of the fall in cereal area would come from these market measures and the introduction of decoupling;
- Oilseed area is projected to decline by 1.0 % on average, whereas energy crops would develop on an area estimated at approximately 0.1 mio ha^{vii}. Oilseed production would be higher under the CAP reform scenario in the new Member States because of the increased competitiveness of these crops as compared to coarse grains and potatoes;
- The projected decline in beef production and increased competition from other fodder crops area resulting from the decoupling of direct payments would lead to a fall in silage area of some 5 % in the EU-15. In contrast, decoupling would generate an increase in voluntary set-aside (i.e. abandonment of production) by approximately 20 % (or 0.5 mio ha) as land with low profitability would move out of production;
- Total EU-15 cereal production would decline by 0.6 % on average by the end of the decade as lower planted area would be partially compensated by an increase in average yield on account of the removal of low quality land, slightly higher price perspectives and the relative expansion in high-yielding cereals (i.e. common wheat). Rye and durum wheat production would display the most significant strongest falls (approximately 10 % and 5 % respectively) in line with area developments. Rye production in the new Member States would not increase as projected under the Agenda 2000 production.

Table 1. Impact on EU-15 land allocation, 2004/05 – 2010/11 (mio ha)

(% deviation from Agenda 2000)

| | 2004/05 | 2005/06 | 2006/07 | 2007/08 | 2008/09 | 2009/10 | 2010/11 |
|----------------------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| Total cereals | 38,2 | 35,9 | 36,2 | 36,0 | 36,0 | 35,9 | 35,9 |
| | -0,2% | -1,8% | -1,2% | -1,0% | -0,8% | -1,0% | -0,9% |
| Soft wheat | 14,5 | 14,0 | 14,3 | 13,9 | 14,0 | 14,0 | 14,1 |
| | -0,1% | 1,3% | 1,5% | -0,2% | 0,3% | 0,3% | 0,4% |
| Durum wheat | 3,9 | 3,5 | 3,6 | 3,9 | 3,8 | 3,9 | 3,9 |
| | -0,2% | -13,0% | -9,4% | -6,6% | -5,3% | -6,3% | -5,5% |
| Barley | 11,1 | 10,4 | 10,2 | 10,2 | 10,0 | 9,9 | 9,7 |
| | -1,0% | 0,7% | 0,4% | 1,7% | 1,1% | 1,4% | 1,2% |
| Maize | 4,6 | 4,1 | 4,1 | 4,1 | 4,2 | 4,2 | 4,2 |
| | 0,8% | 0,4% | -4,8% | -0,4% | -2,4% | -0,9% | -2,1% |
| Rye | 0,8 | 0,8 | 0,9 | 0,9 | 0,9 | 0,9 | 0,9 |
| | 0,2% | -20,0% | -11,8% | -9,4% | -9,6% | -10,7% | -10,3% |
| Total oilseeds | 4,5 | 4,7 | 4,6 | 4,7 | 4,7 | 4,8 | 4,8 |
| | 0,6% | 0,4% | -0,7% | -1,3% | -1,6% | -1,1% | -1,0% |
| Voluntary set-aside | 2,7 | 2,9 | 2,8 | 2,9 | 2,8 | 2,9 | 2,9 |
| | 1,2% | 28,6% | 22,7% | 21,8% | 19,8% | 21,3% | 19,7% |

For the EU-15 total cereal consumption and exports would decline slightly over the medium term as compared to the Agenda 2000 scenario (-0.1 % and -2.5 % by 2010 respectively) owing to lower cereal availability and lower demand from the livestock sector (-0.3 % on average, linked mainly to the fall in beef production). The overall reduction in the production level would enable the balance of EU cereal markets to be improved –but not fully restored- with total (public) stocks dropping by some 4 mio t by 2010. The EU rye market would display the greatest improvement. After a short-term fall (-0.6 %) linked to the reduction in the overall cereal price support, cereal prices in the EU would gradually recover over the medium term to develop some 0.1 % on average above Agenda 2000 levels.

The drastic cut in the rice support price towards world market price levels, partially compensated by the granting of direct payments, would entail a decline in EU rice production of 14 % by 2010 (with a 10 % fall in planted area and a 4 % drop in average yield). Lower domestic prices would in turn boost domestic consumption –notably in the short-term- and lower the EU attractiveness as an import market by the end of the decade, allowing a swift and significant improvement in the overall balance of the EU rice market.

Animal sector

In the animal sector, the introduction of the single farm payment together with partially decoupled animal premia is projected to have a significant impact on the livestock sector. Combined with a slight increase in cereal feed prices, it is projected to reduce the incentives towards intensive beef production systems and generate a fall in EU beef production. After a short-term increase linked to the reduction in herd size, beef output would decline progressively to stand some 1.9 % below Agenda 2000 levels by 2010 (i.e. a fall of approximately 140 000 t).

Decoupling would also remove some of the pressure on markets in the new Member States because farmers would invest more in the extension of other production with more attractive market conditions such as pork and poultry. Enlargement under CAP reform conditions would lead to a lower average price

decline of merely 50-70 €/t than around 100 – 120 €/t under Agenda 2000. Most of the adjustments will take place in the EU-15, because beef production in the new Member States is relatively more dependent on milk production than in the EU-15.

The suckler cow sector would be most affected with a projected fall in herd size of around 7 % over the medium term in the face of its high dependence on direct payments and the large proportion of output not covering variable costs. The total cow herd in the EU-15 would display a 2.2 % drop by 2010.

Supported by lower domestic availability, beef producer prices would exhibit a strong rise. After a short-term decrease, beef prices would start rising to stand some 6 % above Agenda 2000 levels by 2010, despite the slight pressure of enlargement. This would in turn generate a fall in domestic consumption of some 1 % in the EU-15 and a more significant decline of consumption in the new Member States. Lower supply and higher domestic prices would also reduce EU beef exports which would fall by more than 6% (or 30 000 t) by 2010. Beef meat imports, on the other hand are expected to be further attracted by the relatively high price environment and increase by more than 7%.

The impact of the CAP reform proposals on the pig and poultry sectors is projected to be dominated by demand-side effects from the beef sector as well as slightly higher production capacities in the new Member States, which would largely outweigh changes in cereal feed prices. While the greater availability of beef at lower prices over the short term is foreseen to exert some downwards pressure on pig and poultry prices, over the medium term the pork and poultry meat sectors should display a moderate expansion in production and consumption of less than 1 % compared to the continuation of Agenda 2000.

These developments would result from the significant rise in beef prices which is expected to generate a swift improvement in the relative competitiveness of pork and poultry meat against beef.

Dairy sector

Milk production in the EU-25 would stand at around 145 mio t over the medium term. In the dairy sector, the quota increases foreseen by the Agenda 2000 were confirmed by the Luxembourg Agreement on CAP reform, though postponed by one year (plus some upwards adjustment for Greece and Portugal). The main impact of this reform derives from the additional 10% butter support price cut on top of Agenda 2000, and its earlier implementation (price cuts for both butter and skimmed milk powder (SMP) are due to start already in 2004). These asymmetric cuts in support prices for butter and skimmed milk powder over the period 2004/05-2008/09 are projected to lead to a significant fall in milk prices (some 8.8% below Agenda 2000 levels by the end of the period^{viii}). Subsistence production in the 10 new Member States still represents a significant share in total milk production, accounting for about 20 % of total production. Over the projection period, subsistence production would gradually decline primarily due to the expected positive development of rural economies and social security systems after enlargement. These positive developments should provide viable economic alternatives to subsistence farmers. These developments would offset the foreseen milk quota increases in the new Member States. For the 10 new Member States total milk production, i.e. subsistence and market production, would remain relatively stable at approximately 22 to 23 mio t. Market production in the new Member States, however, would increase according to the quota increases agreed upon at the Copenhagen Summit.

The rise in fat production resulting from the foreseen quota increase in the period 2006/07-2008/09 and the cut in the support price of butter are expected to result into a corresponding fall in butter market price (-22.5 % against the 2001 level and 10.7 % lower than under the continuation of Agenda 2000 policy by

2010). With a lower price incentive, butter production is projected to fall over the medium term (by around 2.5 % compared to Agenda 2000). Due to its low price responsiveness, EU domestic use would display a very limited rise, reaching some 0.4 % above Agenda 2000 levels by 2010. Lower availability and slightly higher internal use would entail a marked decline in EU exports which would exhibit a fall of some 23 % (i.e. around 50 000 t) (cf. Table 2).

Table 2 Impact on the butter sector in the EU-15, 2004 – 2010

(% deviation from Agenda 2000)

| | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 |
|------------------------------|-------|--------|--------|--------|--------|--------|--------|
| Production | -0,6% | -3,5% | -4,4% | -3,4% | -2,6% | -2,6% | -2,4% |
| Consumption | 0,3% | 0,6% | 0,8% | 0,5% | 0,6% | 0,4% | 0,4% |
| Exports | -5,3% | -26,4% | -34,0% | -27,1% | -23,8% | -24,3% | -23,1% |
| Butter Prices | -2,5% | -7,5% | -9,6% | -10,4% | -12,6% | -10,7% | -10,7% |
| Milk Farm Gate Prices | -2,2% | -6,0% | -7,4% | -8,3% | -9,4% | -8,9% | -8,8% |

The lower attractiveness of the butter market would in contrast favour the production of high value added dairy products. Fresh dairy products (yoghurts, other fermented milks, etc.) would benefit from lower milk prices to satisfy a steadily growing demand. However, cheese production and consumption are expected to be slightly negatively affected by the CAP reform, as cheaper fat matter would be channelled, together with scarce protein, towards other dairy products. As a consequence cheese production is expected to be around 0.4% lower than with Agenda 2000 by 2010, and price would slightly increase.

Following the combined effect of the higher quantities of milk proteins being channelled into fresh dairy products and the smaller quantities of SMP being produced as a co-product of the butter production process, SMP production would fall significantly (by up to 5.5 % in the short-term and 4.5 % at the end of the period). In spite of lower internal prices, the lower availability of SMP and the assumed reduction in internal consumption aid would entail a further decline in domestic use and exports (2.6 % and 11.4 % respectively by 2010 compared to the continuation of Agenda 2000). SMP prices would fall by 2.1 % by 2010 against Agenda 2000 levels, even if the price cut is the same in both scenarios.

Demand trends in the new Member States would result in an increase of more than 20% of per capita consumption of cheese and fresh milk products. This would strengthen the shift of production from bulk to high value added dairy products. However, the relative specialisation of dairies in the new Member States in the production of bulk dairy products would lead to increasing market opportunities for dairies in the current Member States.

Impact of alternative scenarios of implementation of the SFP

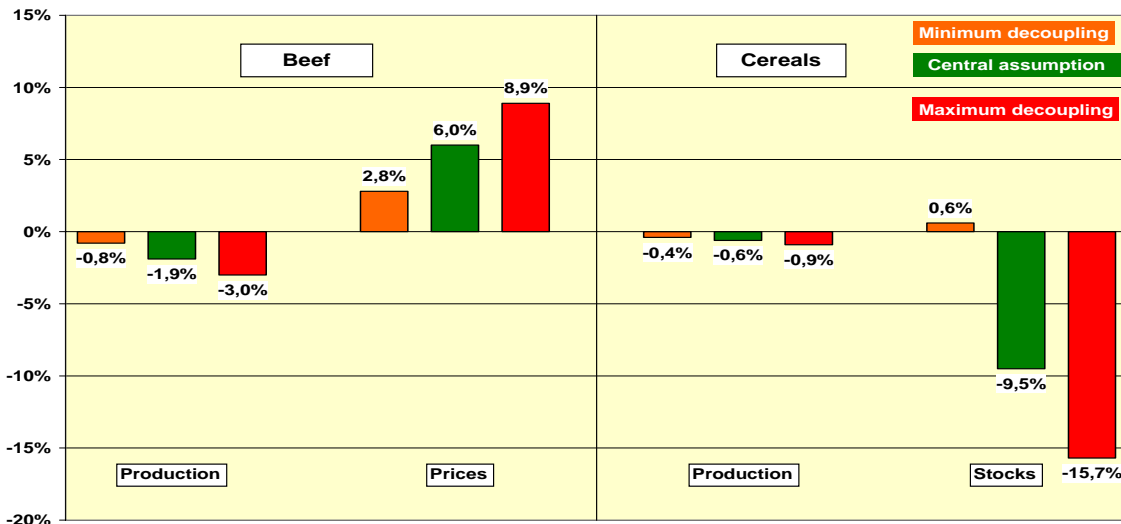
The flexibility left to Member States in the implementation of the single farm payment has introduced a further degree of uncertainty when assessing the future market developments and the impact of the CAP reform decisions changes. The medium-term projections and impact analyses presented in this document have all been based on an implementation scenario which at the time of the analysis was considered as the most plausible according to the information available. The main objective of this section is to examine the

influence of alternative scenarios on medium-term market developments in the EU. For that purpose, alternative scenarios based on a “maximum” and “minimum” decoupling assumption have been considered.

In the “maximum decoupling” scenario, Member States are assumed to convert 100 % of all relevant direct payments into the single farm payment from 2005 onwards. On the contrary, in the “minimum decoupling”, Member States would maintain payments coupled as far as possible (which in the case of the beef sector concerns the premia representing the largest budgetary expenditure) and would delay the introduction of the decoupled payment until 2007.

The beef sector will probably be the most affected by the introduction of the single farm payment together with partially decoupled animal premia. Under a “maximum decoupling” scenario, production is expected to drop by up to 3.0 % while prices rise by up to 9 % (as compared to 1.9 % and 6.0 % in the central decoupling assumption). In the case of “minimum decoupling”, beef production, which is expected to react with a certain time lag, declines by just 0.8 % by 2010, while prices rise by 2.8 % compared to the Agenda 2000 baseline. By contrast, alternative options for implementing the single farm payments would have little impact on production in the arable crop sector as shown in graph 2.

Graph 2 Impact of alternative decoupling scenarios for EU-15 markets, 2010 (% deviation from Agenda 2000)



Agricultural income

Compared to the continuation of the Agenda 2000 policy measures, the CAP reform decisions are projected to show a rather moderate impact on the income situation of the agricultural sector. Agricultural income, expressed per labour unit and in real terms, is expected to increase by 2.8 % between 2003 and 2010 in a non-enlargement scenario, i.e. a small decline (-0.5 %) against Agenda 2000^{ix}.

After a short-term increase, agricultural income is projected to exhibit a relative decline linked to the fall in meat, cereal and milk prices. It would then slowly recover as cereal and meat prices start rising. However, by the end of the decade, these more favourable developments in the arable crop and meat sectors would remain slightly outweighed at farm sector level by the impact of the fall in milk prices.

The CAP reform would have diverging impacts across regions and commodity sectors. By 2010 and compared to the projected Agenda 2000 levels, total receipts (i.e. market revenues and single farm payment) in the milk sector are foreseen to decline by slightly less than 5 %. In contrast, total receipts in the cereal sector would broadly stagnate, while the meat sector –beef, pork and poultry- would display significant gains (estimated at between 1 % and 3 %) as meat price increases would more than compensate the combined impact of the fall in production and modulation. These trends however remain conditional on the option adopted for the implementation of the single farm payment. The full decoupling option would for example generate a very slight increase in sector income against Agenda 2000 thanks to more sustained price developments.

The prospects for agriculture in the new Member States would develop very positively over the medium term as the real gross value added including the direct payments and the effects of rural development would increase sector income by 35 % as compared to 2002. This strong development in farm income in the new Member States is largely related to the phasing-in of direct payments, the effect of rural development measures (about 80% of these measures are directed towards farms and should materialise into farm income) as well as improved efficiency of production. The decoupled nature of direct payments reduces the incentives to invest in those production areas characterised by weaker markets and high direct payments (which would have been the case under Agenda 2000).

For the current Member States sector income including direct payments would be little affected by the CAP reform. From 2010 onwards, income levels would be slightly superior to those under Agenda 2000. This outlook is slightly more positive for the current Member States than in the EU-15 analysis without enlargement. The main difference lays in the more positive market dynamics of the EU-25, which would be more pronounced under the CAP reform.

Conclusions

The agricultural sector in the EU would have to adjust significantly over the medium term. Enlargement of the EU is certainly one of the factors which would create significant adjustments within EU agriculture and food industries, largely independent of agricultural policies. New market opportunities would arise for agriculture throughout the EU, but the relative competitiveness of production will decide in which region the additional supply would actually be realised. The integration into the single market as well as the rural development funds made available to the new Member States would speed the structural adjustment process in the market-oriented part of agriculture. The important part of subsistence agriculture, which is in some countries a significant provider of livelihood in rural areas, would on the other hand be more dependent on the economic and social development than on agricultural policies. The analyses however show that the CAP reform would positively contribute to the development of agriculture in the new Member States.

The CAP reform is another important contributor to adjustment in agriculture and food industries in the EU. The CAP reform decouples a large part of the agricultural support, thus enhancing income transfer efficiency. This policy move towards significantly less-trade distorting instruments provides stable policy conditions until 2013, reduces the risk of structural surpluses and encourages farmers to base their production and investment decisions on markets developments rather than on product specific support. The market projections indicate that adjustment of production would take part in key areas of agricultural production in Europe: cereal, beef and dairy production. Farmers would have to gain efficiency of production which would affect farm structures as well. In order to support and accompany these structural changes, rural development policies provide for targeted instruments to help farmers to retire, young

farmers to enter the sector, to adapt and meet higher cross-compliance standards, to diversify income sources and to support investments.

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NOTES

ⁱ Pierre Bascou, Pierluigi Londero and Wolfgang Münch are agricultural economists with the Directorate-General for Agriculture of the European Commission in Brussels. Paper presented at the International Agricultural Trade Research Consortium Symposium entitled “Adjusting to Domestic and International Agricultural Policy Reform in Industrial Countries” held in Philadelphia, June 6-7, 2004.

ⁱⁱ These projections have been undertaken on the basis of two modelling tools. The EU-15 projections have been conducted with a set of partial equilibrium, dynamic models covering the most important arable crops, animal and dairy products. The ESIM model, which is a price driven, world, multi-country non-linear, agricultural sector model has been used to develop the EU-25 projections. For more information on the modelling and methodological framework, cf. “*Prospects for agricultural markets 2002-2009*”, published in June 2002, EC Commission.

ⁱⁱⁱ A summary of the main decisions is given in European Commission (2003a), in comparison with the continuation of the Agenda 2000 policy, the initial proposals from the Mid-Term Review Communication (July 2002) and the draft legislative proposals presented in January 2003.

^{iv} These other assumptions are kept identical in the impact analysis for both the baseline and *counterfactual* scenarios. All the specific conditions of accession of the ten new Member States are expected to operate under the rules decided by the end of 2003 for the 2003-2010 period (in particular the phasing-in of direct payments, the top-up possibility and the production quotas). It is also assumed that the URAA commitments remain unchanged over the 2003-2010 period. The macro-economic environment in the EU is expected to remain sluggish in the short-term and stabilise around 2.5% from 2005 onwards. By contrast, economic growth in the new Member States should remain solid reaching more than 4 % over the medium-term. After a recent strengthening, the \$/€ exchange rate is expected to gradually stabilise around 1.1 as the impact of the short-term factors contributing to the recent weakness of the US dollar may be expected to weaken over the medium-term. Finally, the medium-term outlook for world agricultural markets is projected to remain essentially supported by rising food demand driven by a recovery in the global macro-economic environment, higher population, urbanisation and changes in dietary patterns, particularly in many emerging economies.

^v It should be mentioned that the proposals to extend the scope of currently available instruments for rural development to promote food quality, meet higher standards and foster animal welfare and those relative to some specific sectors such as the nuts, dried fodder and starch potato sectors have not been incorporated in these analyses.

^{vi} For more details see Network of Independent Experts of the Accession and Candidate Countries (2004), “Consumption trends for dairy and livestock products and the use of feeds in production in the CEE Accession and Candidate Countries”.
http://europa.eu.int/comm/agriculture/publi/reports/ccconsumption/index_en.htm

^{vii} These projections for energy crops have been established on the assumption that the tax incentives currently existing in EU Member States would prevail over the simulation period.

^{viii} Under Agenda 2000 policy, milk prices were projected to stand well above support price towards the end of the decade.

^{ix} The savings generated each year by the modulation scheme destined for the rural development measures have been taken into account in the income calculation for approximately 80 % (estimated to amount to 930 mio EUR in 2010).