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Towards a smart, sustainable and inclusive economy:
How to reform CAP to improve agriculture's contribution to the Europe 2020 Strategy?

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The CAP's Contribution to the Collective Well-Being: A Complex Assessment

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In view of the lively and frequent debate over the need for an agricultural policy, any discussion of the CAP calls for an introductory remark. Economic theory clearly spells out the grounds for public intervention: the latter is necessary in the event of market failures. Three forms appear on agricultural markets: the existence of public goods and the presence of external effects (externalities), a market power which enables some actors to manipulate prices, and the presence of unforeseen events against which economic actors cannot protect themselves because the corresponding markets do not exist.

Initially, the CAP had been formulated in part to counteract these market failures. It primarily reflected the States' desire to ensure self-supply, since decision-makers then considered food dependency to be a potential source of disaster. But rather than remaining a policy aimed at correcting market failures, the CAP soon evolved into an agricultural income support policy generating costly and distorting surpluses. Thus for almost twenty years reforms have been implemented to correct the CAP's excesses; *i.e.* the policy's shortcomings.

Public debate arguments for an overhaul of the CAP

According to detractors of the present CAP, twenty years of reform have proved insufficiency and the CAP's transformation should continue for the following reasons:

- The CAP is still having an overall negative impact on third country farmers;
- It is inadequate inasmuch as farmers' earnings are still less than the cost to consumers and taxpayers; it is therefore having a negative impact in terms of employment;
- It is inequitable because the public support distribution is based upon historic references;

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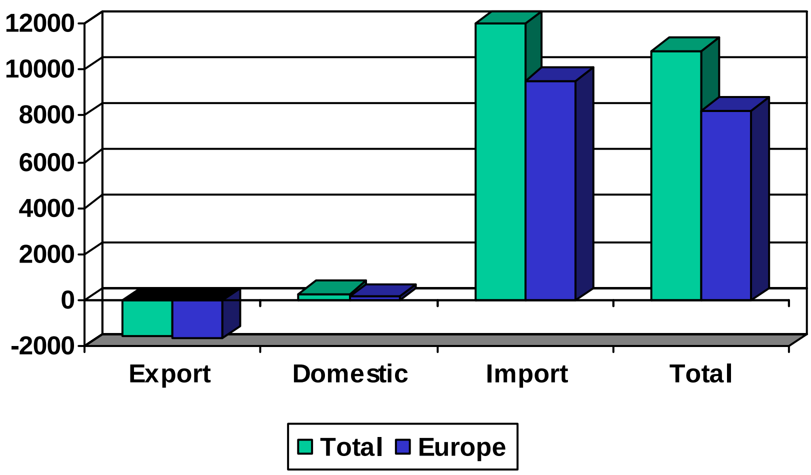
- It does not adequately promote positive externalities and inadequately penalizes negative externalities;
- It is not necessary to stabilize markets and agricultural income, considering the large number of private sector risk management tools available;
- Lastly, it is less effective than a food policy in managing product quality and health safety aspects.

Is the CAP creating major distortions in the global markets?

In the last few years, numerous assessments have been carried out to measure the impact that eliminating agricultural policies would have on developing countries. They generally show that the CAP is having considerably more negative impacts upon developing country agricultures and economies than the policies pursued in the United States and in Japan. This can be primarily attributed to the importing instruments used by the European Union, as shown by the following results obtained by the OECD and the World Bank.

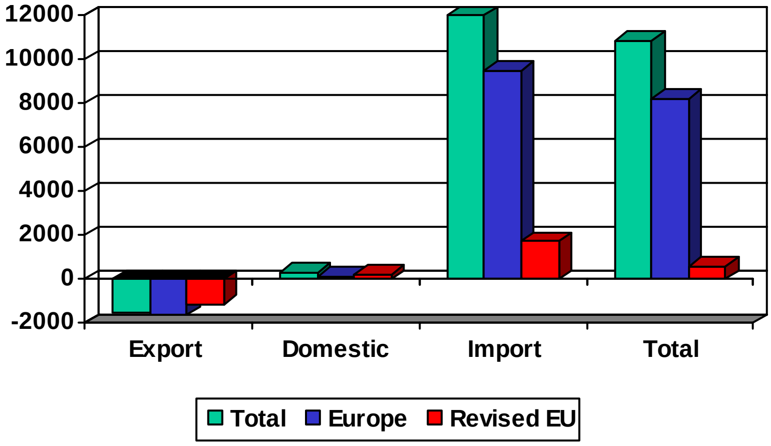
Graph 1. Gains realized by eliminating North agricultural policies for developing countries
(in millions of dollars - 2001)



Source: Féméni and Gohin, INRA

It appears, however, that the tools used to measure the impact of the CAP do not adequately take into account the policy's complexity, particularly with respect to its production quotas, preferential arrangements, direct support systems restricting land or livestock sizes, etc. Such instruments nonetheless exert a constraint on European agriculture in terms of quantities produced, which should be considered in assessing its impact. We have therefore supplemented this research with a clearer representation of the CAP's instruments and have produced new simulations of this policy's impact which show a marked reduction of its effects, as seen by the red bars in our graphs.

Graph 2. REVISED gains the elimination of the CAP would produce for developing countries
(in millions of dollars - 2001)



Source: Féménia and Gohin, INRA

This means that the CAP obviously does not yet play a totally neutral role in the global markets. However, thanks to the reforms implemented over the last twenty years or so, the situation has vastly improved.

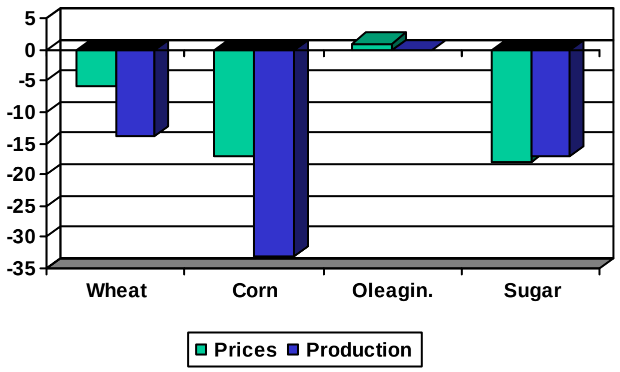
Is the CAP really that ineffective from a domestic point of view?

With respect to the second criticism concerning the CAP's ineffectiveness, estimates made in the 1980s and in the early 1990s showed that eliminating the CAP would have resulted in an approximate 3% GDP growth rate inside the EU, and produced similar employment gains. What would the results be today?

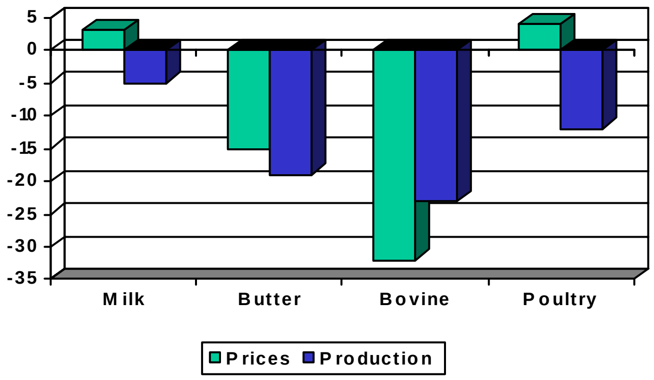
To assess the impact an elimination of the CAP would have on the economy, we must first grasp what the impact would be on field crop prices and production levels. The graph below indicates that it would mainly affect the corn sector, so we need to look into the reasons for this sector's lack of competitiveness. Is it related to the fact that factor or technology endowments differ from those used by competing countries? Similarly, analysis of the elimination of the CAP in the animal markets indicates that the bovine sector, and more specifically suckling-cow production, would be particularly affected. In order to be comprehensive, the assessment of such an elimination must be examined in terms of the role played by this industry in the development of certain territories.

Graphs 3 and 4: The impact an elimination of the CAP would have on European prices and production in 2015 (impacts in %)

By field crop



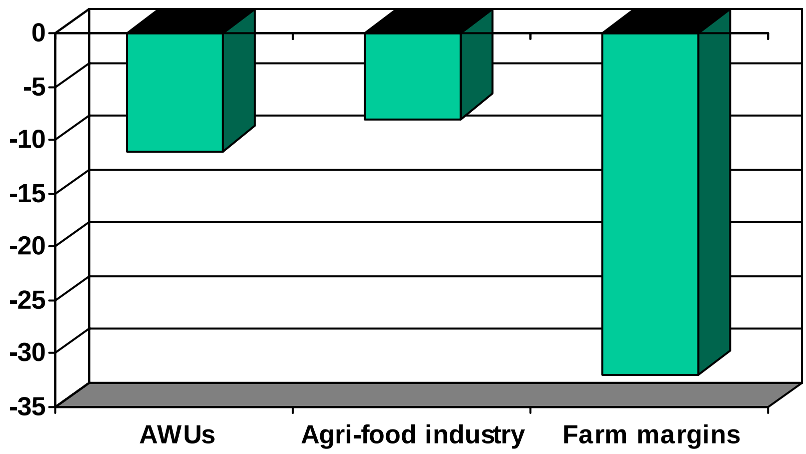
By animal sector



Source : A. Gohin, INRA

Overall, eliminating the CAP would result in a sharp drop in agricultural employment of up to 11% and in an even more significant decrease in agricultural income of more than 30%, as indicated by the last bar in Graph 5.

Graph 5. The impact an elimination of the CAP in 2015 would have on farm jobs (Agricultural Work Units - AWU), agri-food industry jobs, and farm margins (impacts in %)

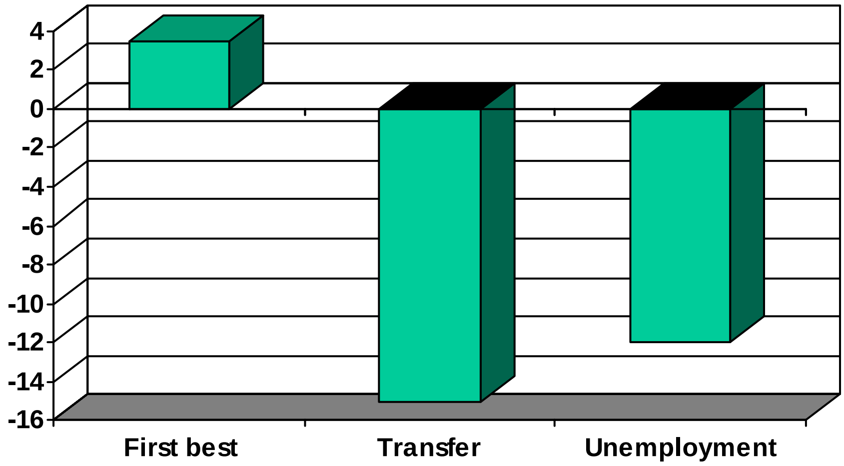


Source: A. Gohin, INRA

What would be the macro-economic implications of eliminating the CAP?

As is the case in many other assessments, our reasoning initially did not take into consideration the many market failures which may exist. In the so-called “first best world” case, the implicit hypothesis is that farmers leaving the sector have opportunities to find jobs elsewhere and that price transfers are perfect throughout the food chain. In such a framework, the market’s welfare − a measure similar to the GDP – increases by just over EUR 3 billion (scarcely 0.05% of the GDP), which is very slight. This gain is therefore considerably lower than estimates made prior to the reforms, which means that eliminating the CAP would result in a better allocation of existing resources.

Graph 6. Impact of eliminating the CAP on welfare (in billions of euros)



Source: A. Gohin, INRA

The other two bars show that these macro-economic gain estimates should be considered with some caution. Indeed, if we consider the possibility that the downstream sectors (food processing and distribution) may not fully pass onto consumers the price drop experienced by farmers in the absence of any agricultural policy, we obtain a significant loss of such welfare or GDP. The hypothetical imperfect price reduction transfer represented by the second bar is far from unrealistic. As shown by the European Commission’s conclusions with regard to the recent “milk crisis,” although dairy product prices increased along with milk prices, consumer prices for dairy products did not decrease despite the drop in consumer milk prices. Similarly, if we assume that job opportunities are limited due to involuntary unemployment, here too, the macro-economic impact can be reversed (third bar in Graph 6).

These assumptions lead to two conclusions. First, although the CAP’s much-criticised ineffectiveness is a reality, it remains quite limited. Next, this ineffectiveness in terms of supports also depends upon the capacity of the States to promote competition at all sector levels, as well as to spearhead economic growth. This analysis does not, however, call for a status quo in terms of an agricultural policy, but rather for European agriculture and its policy to be repositioned within a highly complex global context.

For more information:

Fémenia F., Gohin A. (2009). “On the European responsibility in the agricultural multilateral trade negotiations: Modelling the impacts of the Common Agricultural Policy,” *World Economy,* 32(10), pp. 1434–1460.

Gohin A. (2009), “Quelles conséquences d’une suppression de la Politique Agricole Commune pour l’après 2013?” *Revue d’Economie Politique,* 119(4), pp. 633–651.