Economic aspects of the EU agricultural sector: New challenges both at home and away

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Abstract
The Common Agriculture Policy has been modified for the period 2014-2020. The main change relates to environmental protection, more market orientation, ensuring rural development and quality of food. Within the given period the agriculture sector faces new internal and external challenges and will also encounter opportunities. The paper analyses both internal and external factors ahead. Among the internal factors, it encounters issues such as market situation, especially in the dairy and sugar sectors in relation to the end of the quota regime, simplification of rules for farmers and public authorities, competitiveness, rural development, job creation, functioning of the food chain and the situation of young farmers. Among external factors the paper deals with trade agreements under negotiation, the link between agriculture and climate and global food security.

Key words: CAP, market support, regulatory simplification, greening, trade relations, climate change

JEL Classification: Q18, P42

1. Introduction
The Common Agricultural Policy (CAP) belongs to most mature policies of the EU. Since its introduction in the beginning of the 60s, it has been one of the major achievements of the European integration. It has been successful for having provided the European Union with constant food supply, stability in prices, development of the rural areas and fairer life conditions for farmers. The CAP undertook fast pace changes recently experienced by European Union, such as the EU enlargement, new international agreements or market disruptions. Therefore, several reforms have been carried out in order to face the new challenges but, the CAP has proven to be an especially resilient, hard-to-modify policy.

The CAP is managed, and funded from the resources of the EU annual budget, of which the CAP constitutes almost 40% of the total budget. Its objective is manifold: to provide food security, to face global competition, economic and financial crises, climate change and to ensure sustainable management of the natural resources or food security, amongst others.

In 2013, the CAP has faced its last reform. This reform is composed of four regulations which cover issues such as Direct Payment, Market Management mechanisms or Rural Development, amongst others. This reform aims at strengthening the economic basis of the CAP and addressing the environmental and social aspects of farming. The EU has thus reinforced its agricultural position in order to face new challenges ahead, both at internal and at external level. This paper will analyse which are these challenges, what the EU has done in order to confront them and what is the outcome so-far.

The objective of this article is to analyse both internal and external factors ahead which are influencing the CAP. Among the internal factors, it encounters issues like market situation, especially in the dairy and sugar sectors in relation to the end of the quota regime - but, also in other sectors like pig meat, simplification of rules for farmers and public authorities, competiveness, rural development, job creation, functioning of the food chain and the situation
of young farmers. Among the external factors the paper deals with trade agreements under negotiation, the link between agriculture and climate and food security globally.

2. Internal challenges of the EU farming sector
The EU is facing numerous challenges in the agriculture sector at an internal level. These challenges have a wide scope, it could not be otherwise when dealing with a transversal topic such as agriculture. Below is the non-exhaustive list of internal challenges facing the CAP.

a) The Russian Embargo
Following the Ukraine conflict, and subsequent to the economic sanctions imposed by the EU, the Russian Federation in August 2014 decided to prohibit the importation of food and agricultural products from the EU for a year. In July 2015, the Russian Federation announced the extension of the import embargo by another year (until August 2016). The affected categories are beef, pork and poultry meat, dairy products, fruits and vegetables. The Russian Federation was the second biggest destination of EU agri-food products: 12% of exports in the fruit and vegetable sector and 10% of dairy exports previously went to Russia. This situation has been specially hard for the pig meat sector, which already suffered an embargo following an African swine fever outbreak in the east of the EU.

Figure 1: EU-Russian Federation trade relations (2005 - 2015)

Right after the announcement of the embargo, the European Commission (EC) adopted under the urgency procedure different measures, extended and reinforced because of the prorogation of the import ban. They were aimed at helping the most affected sectors, and included, among others: support for producers of certain fruits and vegetables; extension of the public intervention period for butter and skimmed milk powder; an exceptional private storage aid scheme for certain cheeses, butter and skimmed milk powder; and compensation for producers in the dairy sector in the most affected Member States (MS). In order to implement these measures, the EC has allocated an aid package of more than 500M€.

The EU has also increased the exports to third countries in order to curb the effects of the embargo. According to DG Agriculture and Rural Development (2016), over the 12 month of the Russian ban being in force (August 2014-July 2015), total EU agri-food exports to third countries increased in value by 5.7% compared to one year ago. After a very positive performance during the first half of the year 2015, with a record month in March (at almost €12
billion), the second half of the year has also started off with a positive trend: July 2015 exports recorded +8% compared to July 2014.

It still remains to be seen how much longer the EU can continue these measures if the Russian market keeps closed. What is clear is that this enhanced emergency mechanism, introduced in the 2013 reform, has proven to be efficient in terms of support to producers and price stability, at least for now. However, the ban has lead to a reallocation of agricultural products into the internal market and abroad, which has turned out to be one of the main factors of the farming sector crisis characterized by market imbalances and low prices.

b) Market Support

Since summer 2015, the dairy, pig meat and other sectors have suffered difficulties mainly due to excess supply worldwide and the Russian ban.

Dairy sector

In the dairy sector, one of the key issues has been the lifting of milk quotas. After more than 30 years, milk quotas were abolished in 2015. They were established in 1984 when the European Union (European Economic Community back then) faced a huge overproduction of milk which led to what at the time was known as "milk lakes and butter mountains". The EU created the quota system in order to control the production and bring stability to the markets. If producers exceeded the quota they had to pay a levy. In 2009, the CAP reform, known as Health Check, laid down the end of these quotas with the objective of turning the milk sector more market oriented and to meet the increasing world demand for milk.

In order to help the smooth transition to a new situation, a "soft landing" with an increase of 1% in quotas during 5 years was foreseen. The EC also created the Milk Market Observatory, where farmers can follow the evolution of the dairy market and adapt their investments and production. The end of the quotas was made effective in April 2015 but, it has come together with one of the most severe crisis ever in the sector. With the new system without quotas, which is more market based, farmers have to cope with the market trends in order to adjust their production and have to face the volatility of prices for the first time. For instance, prices were high in 2013-2014, which boosted production, but dramatically dropped in 2015 due to the Russian ban, an excess of supply and the decrease of world demand. Moreover, the removal of ceilings has boosted milk production which has contributed to an excess of dairy products supply in the EU and in the world.

Figure 2: EU raw milk prices development (2001-2016)

Source: Milk Market Observatory
In order to help the farmers’ cash-flow difficulties, and stabilize both markets and the supply chain, the EU adopted in 2015 a 500€ million aid package which includes 420€ million for temporary exceptional aid to farmers in the livestock sector, private storage aid for cheese, improved private storage aid scheme for skimmed milk powder, increased rate of advances of the CAP direct payments, certain rural development measures, increase in EU funding for promotion under the 2016 Annual Work Programme, and humanitarian assistance. These measures were reinforced in 2016 by new measures, which included, amongst others, the application of a voluntary supply management, a temporary increase of state aid, an increase of intervention ceilings for SMP and butter, a strengthening of producers in the supply chain, the participation of the European Investment Bank (EIB) to ease new financial instruments and the increase of promotion in third countries. As a follow-up, the dairy sector development will stay under close scrutiny and more structural measures are underway, such as: improving farmer’s position in the food chain and a proactive export policy.

**Pig meat sector**

Regarding the pig meat sector, the crisis it is facing is mainly due to two factors which are linked: excess of supply and the sanitary ban from Russia following an outbreak of African Swine Fever (ASF) in Lithuania, Poland, Estonia and Latvia in 2014. This sanitary ban is different from the embargo as the second does not include edible offal nor bacon from pig meat. However, the sanitary ban prevent products from the entire EU being commercialized in Russia.

**Figure 3: Main importers of pig products 2016 (excluding live animals)**

![Figure 3: Main importers of pig products 2016 (excluding live animals)](chart)

Source: DG Agriculture and Rural Development

The result, as for dairy products, is that pig meat products that were once destined for Russia now have to be absorbed by the internal market and abroad. The outcome has been a reduction of prices due to oversupply, causing a price crisis in the sector. The EU launched a case against the Russian ban in the World Trade Organization (WTO) claiming that the sanitary ban is disproportionate, discriminatory and not based on scientific evidence. A ruling from the WTO is expected in 2016.
In the meantime, the EU has to face the crisis in the sector. Apart from sanitary and control measures, the EU has set up a series of actions in order to support the pig meat sector, such as aid for private storage and the creation of a Meat Market Observatory.

Sugar sector

Since 1968 the EU sugar policy uses a quota system. This policy concerns three main areas: quota management, a reference price and a minimum guaranteed price to growers, and trade measures. In 2006, the WTO questioned this system and the EU decided upon the removal of quotas, first foreseen for 2015 and finally postponed until October 2017.

The EU is the world’s biggest producer of beet sugar (around 50% of the total world's production, which is made of 20% beet sugar and 80% cane sugar) and the principal importer of raw cane sugar for refining. Sugar quotas account for 13.5 million tonnes divided between 19 Member States. From 2017, the sugar sector will have to operate on its own and its production will be marked by market conditions. The economical effect of this decision is expected to bring the EU sugar sector to be more globally competitive.

Figure 4: Price development of the white sugar within the EU

Source: DG Agriculture and Rural Development

World sugar prices have recorded a downward trend in the last four years, with a sharp decline in the first half of 2015. This is mainly due to: ample supplies in major sugar producing countries, including Brazil, the world’s largest producer and exporter, and falling crude oil prices that have reduced the volume of sugar crops being converted into ethanol. According to the medium term review from the EC (2015) sugar beet and white sugar production are expected to increase slightly after quota expiry due to consistently high yield increases, low transportation costs and the reduced costs of longer production and processing campaigns.
In summary on market situation, the EU is providing the farming sector with a temporary and a long term assistance. Apart from these measures targeted at specific sectors, the 2013 CAP reform has introduced a reserve for crises of €2.8 billion (€400 million per year), outside the multiannual financial framework (MFF). This reserve could be used by the Commission as market support measures in response to market disruption related to animal diseases and/or loss of consumer confidence due to animal or plant health issues (Olper, A. and Pacca, L., 2015). These aids will help to address short-term problems, but if the market difficulties persist then longer term measures will be needed. This reserve would be used as a last resort measure.

c) Simplification of the CAP

Although the last reform of the CAP was agreed in 2013 and came into force in 2014, the EC, the European Parliament (EP) and the Council have been discussing about its simplification. This exercise is focused on assessing where the greatest reduction in the administrative burden can be achieved, preserving the current policy framework and ensuring the sound financial management of the CAP. Simplifying the CAP is essential to making EU agricultural economy more competitive, preserving and creating jobs and contributing to a sound development of our rural areas.

These efforts to simplify CAP are not new. Many previous efforts have been made to simplify the CAP, yet the consensus seems to be that the policy has become even more complicated over time (Matthews, 2015). For years, different measures have been taken in order to achieve this objective. For instance, in 2007, a single Common Market Organization (CMO) replaced the previously existing 21 CMOs; in 2009, the CAP reform known as "Health Check", further decoupled and abolished several schemes. For imports, license requirements were reduced from 500 to 65 and for exports, only 43 license requirements remain; specific marketing standards for 26 types of fruit and vegetables were repealed, meaning operators no longer face compliance costs, national authorities no longer need to carry out controls; farmers are no longer required to keep land at their disposal for 10 months to receive direct payments, thus gaining greater flexibility in their farm management and in responding to market developments.


d) Greening of the CAP

Climate change along with green growth/greening has become a key element for preserving the CAP (Erjavec, K. and Erjavec, E., 2015). The greening concept has been introduced with the 2013 reform and it makes the direct payments system more environment-friendly. The introduction of a ‘green’ component in the direct payments represents the first explicit attempt to link part of them to the remuneration of public goods and services produced by the farm, a goal advocated by many in the debate preceding the start of the reform process (Ania, G. and Pupo, M. R., 2015).

The Single Payment Scheme has been replaced by the Basic Payment Scheme (BPS). Eligibility for this BPS is a precondition for farmers to receive other direct payments such as the Green Direct Payment. In order to benefit from the BPS, farmers must have holdings that are at least 0.3 hectare and used for agriculture activity, and must also meet cross-compliance standards: environment, food safety and animal health and welfare laws.

Green direct payments account for 30% of EU countries’ direct payment budgets. In order to have access to these payments, farmers should implement a series of measures in their farms, namely diversifying crops, maintaining permanent grassland, dedicating 5% of arable land to...
'ecologically beneficial elements' ('ecological focus areas'). CAP has thus shifted from market support to promoting sustainable development (Dragoi, A. Balgar, C., 2015).

**Figure 5: CAP budgetary allocations (1990-2020)**

Under the current CAP, farmers receiving payments help conserve the environment and contribute to addressing greenhouse emissions by making soil and ecosystems more resilient, growing a greater variety of crops, conserving soil carbon, grassland habitats associated with permanent grassland, protecting water and habitats, and establishing ecological focus areas.

Currently, the EC is carrying out a public consultation on the greening measures introduced in the last 2013 Reform. At the time of the reform, it was agreed that the Commission should review the rules about the Ecological Focus Area after the first year of application looking in particular at the administrative burden, simplification potential, level playing field and aspects of production potential. The consultation is open until March 2016. Results should help to assess the effectiveness of these measures.

3 International challenges ahead

Apart from the internal challenges depicted above, the EU has to deal with different international issues. As an open economy, the EU has different agreements, commitments, treaties, etc., signed with different countries and organizations.

a) Free Trade Agreements

Among the different free trade agreements (FTA) under negotiation two are very sensitive: TTIP and Mercosur. These two agreements are, in terms of size and impact for agriculture, a major challenge for the EU farm sector.
**TTIP**

The Transatlantic Trade and Investment Partnership (TTIP), is a free trade agreement between the United States (US) and the European Union. Its objective is to create the largest free trade area of the world and to boost jobs and growth in both regions.

This FTA has gained some popularity during the last years and has polarized the public opinion between those who support it and those who oppose it. In terms of agriculture, its impact could be enormous in different sectors such as beef, dairy products, geographical indicators (GIs), public procurement and others.

**Figure 6: EU-US agricultural trade (2014, mio Euro)**

![EU-US agricultural trade chart](chart.png)

Source: DG Agriculture and Rural Development

The EC has put the protection of the EU standards, such as the sanitary and phytosanitary (PSP) ones, high on the negotiation priorities. Fabri, E. (2015) states that tariff reduction is not the main topic on the table because tariffs between the EU and the US are already very low. The crucial point in negotiation are the Technical Barriers to Trade (TBT) and SPS measures. The TBT are established by the countries outlining the technical parameters that products should have. When requirements are different between two countries it could be considered as a barrier because one product has to be checked in both countries. SPS measures promote safety and animal and plant health. In this case the problem is that the EU has a different approach than that of the US. The EU follows the precautionary principle whilst in the case of the US, they rely on 'scientific evidences'.

In case an agreement is finally achieved, the overall ambition of the TTIP is to bring employment, growth and new market opportunities.
b) Mercosur

Other crucial FTA, that the EU is negotiating, is the one with Mercosur. Mercosur comprises Argentina, Brazil, Paraguay, Uruguay and Venezuela and its purpose is to promote free trade and the fluid movement of goods, people, and currency among its members. According to the EC the objective of this agreement is to negotiate a comprehensive trade agreement, covering not only trade in industrial and agricultural goods but also services and establishment and government procurement, and the improvement of rules inter alia on government procurement, intellectual property, customs and trade facilitation, technical barriers to trade.

However, there are several concerns about the impact of this agreement on the agriculture sector. Mercosur is composed of major players in agricultural production. Mercosur’s biggest exports to the EU are made of agricultural products (DG Trade website) and it is likely that this FTA would increase this number. Moreover, an impact assessment from Kirpatrick, C. and George, C. (2006) shows that Mercosur is a very competitive market in the agricultural sector. Therefore, the EU should address its defensive as well as offensive interests in this area.

c) WTO

The WTO has been the main forum for trade negotiations for last decades. Since its creation in the 90s (and before the GATT), it has welcomed the main multilateral negotiations on trade. The last round of negotiation, the Doha Development Round (DDR), which started in 2001 is the current one.

The subjects negotiated in the DDR are agriculture, non-agriculture market access (NAMA), services, trade facilitation, rules, environment, GIs, intellectual property or dispute settlement. On agriculture, negotiations are aimed more at market access, eliminating export subsidies, reducing distortion of domestic support, sorting out a range of developing country issues, and dealing with non-trade concerns such as food security and rural development. Negotiations are divided in three different pillars: trade facilitation, agriculture and development.

The DDR has suffered numerous setbacks. Disagreements on some issues between members and the single undertaking principle (nothing is agreed until everything is agreed) have hindered the negotiations. Moreover, with the limited progress in the WTO Doha Round the focus has turned to bilateral or regional trade agreements for expanding markets (Josling, T., 2015). However, during the 10th Ministerial Conference, held Nairobi in 2015, parties agreed on a global trade deal that benefits developing countries by getting rid of trade distorting export subsidies in agriculture. This agreement is likely to benefit EU producers who will see for the first time a level playing field in export competition. Although the DDR has accomplished many achievements, the difficulty to reach agreements in a multilateral system is fostering the appearance of many bilateral agreements, such as TTIP, Trans-pacific Partnership (TPP), or the Comprehensive Economic and Trade Agreement (CETA).

Agriculture will still be one of the major issues to be discussed in order to meet the Doha Development Agenda. The last Nairobi agreement shows that decisions made in this forum have an immediate and direct impact in the EU farming sector. The EU main challenge will be to combine liberalization, development and climate measures without jeopardizing the EU agriculture.
4 Policy discussions at global level: G20

The G20 is a forum which gathers the major 20 economies of the world. It was founded in 1999 with the aim of studying, reviewing, and promoting high-level discussion of policy issues pertaining to the promotion of international financial stability. Since 2009, it replaced the G8 as the main economic council of wealthy nations.

In terms of agriculture, the G20 Agriculture Ministers agreed at the Cannes G20 Summit in November 2011 on an "Action Plan on Food Price Volatility and Agriculture". This plan contains a broad scope of actions aimed at tackling price volatility from different angles, particularly through increasing agricultural production and productivity on a sustainable basis; enhancing market information and transparency; improving international policy coordination; better managing risks associated with excessive price volatility; and improving regulation and supervision of agricultural financial markets.

In the May 2015 G20 Agriculture Ministers meeting held in Istanbul, the Ministers agreed to set up a platform on food loss and waste, to strengthen the UN-FAO Agriculture Market Information System, and to define an Action Plan on Food Security and Sustainable Food Systems. The Action Plan identified three priority actions for the next three years: increasing responsible investment as well as incomes and quality employment in food systems, and increasing productivity sustainably to expand food supply.

The EU plays an important role in the G20. It could be an important arena where it can find allies, build commitments and put forward policies in order to improve its bargaining position in the WTO meetings.

d) Climate Change and Environment

At the Paris climate Conference of the Parties (COP21) in December 2015, 195 countries adopted the first-ever universal, legally binding global climate deal. This agreement is focused on Mitigation, Transparency and Global Stocktake, adaptation, Loss and Damage and Support. Its main objective is aimed at keeping the rise in temperature below 2°C. The agreement even establishes, for the first time, that we should be aiming for 1.5°C, to protect island states, which are the most threatened by the rise in sea levels (COP21 Website).

In terms of agriculture, the EU is aware that agriculture is one of the most susceptible sectors because of its dependence to weather. Variations in weather could severely modify the agricultural production and put at risk food sovereignty. But agriculture is both victim, executioner and saviour of climate change. It contributed about 20–25% of global emissions in 2010 (Blanco, G. R. et al, 2014) and therefore it should be also part of the solution.

The greening package included in the last 2013 CAP reform is a major breakthrough in the EU farming sector to make agriculture more sustainable and climate friendly. In terms of budget, the EU has announced that it will dedicate 20% of its 2014-2020 budget to climate-related action. Moreover, the EU is involved in many other projects such as the Global Climate alliance, whose objective is to strengthen dialogue and exchange experiences and this with developing countries most vulnerable to climate change; the Global Research Alliance on Agricultural Greenhouse Gases, which aims at finding new ways to produce food without increasing emissions; or the Climate and Clean Air Coalition, dedicated to reducing short-lived climate pollutants, such as black carbon, methane, tropospheric ozone or some hydro fluorocarbons to protect human health, agriculture and the environment.

Finally, in January 2014 the EC launched a Communication on "A policy framework for climate and energy in the period 2020 to 2030" setting the EU climate objectives for that period. The targets agreed by EU Member States for 2030 are a 40% cut in greenhouse gas emissions
compared to 1990 levels; at least a 27% share of renewable energy consumption; and at least 27% energy savings compared with the business-as-usual scenario. In line with this, the EC proposed a series of policies including a reformed EU emissions trading scheme (ETS); new indicators for the competitiveness and security of the energy system; and ideas on a new governance system based on national plans for competitive, secure, and sustainable energy.

This policy framework for 2030 also targets agriculture, especially in Land Use, Land Use Change and Forestry (LULUCF). The European Council Conclusions (European Council, 2014) on the EC initiative recommend LULUCF to be included in this strategy because of the multiple objectives of the agriculture and land use sector, with their lower mitigation potential, and the need to ensure coherence between the EU’s food security and climate change objectives.

In order to include LULUCF in the 2030 objectives, the EC is considering different alternatives, all of them with the objective of integrating LULUCF into the 2030 greenhouse gas mitigation framework, contributing to the EU’s objective of at least 40 % GHG emission reductions by 2030, supporting progress towards the multiple objectives of the agriculture and land use sector and fostering long term competitiveness, food security and sustainability. This would be one of the main challenges for the climate and farming sector.

5 Conclusions

This paper has analysed the different challenges for the EU farming sector, both at internal and international level. Agriculture is a dynamic sector and its present characteristics are unlikely to last as most of the challenges analysed here are probably going to change in the short term. However, new challenges will arise and it is paramount that the EU is ready and prepared in order to be able to face them. The five initial objectives of the CAP recorded in article 39 of the TFUE - to increase agricultural productivity by promoting technical progress and ensuring the optimum use of the factors of production, in particular labour; to ensure a fair standard of living for farmers; to stabilise markets; to ensure the availability of supplies; and to ensure reasonable prices for consumers -, are still today valid and they are worth protecting.

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