

## ADJUSTMENT OF EU AGRICULTURAL POLICY TO THE NEW ENVIRONMENT

*Milan Marković<sup>1</sup>*

### Summary

*The aim of this study is to examine the position of the EU in world trade in agricultural products. Emphasis is placed on identifying the influence tendencies of liberalization of international trade in agricultural products on the development and character of the reform of EU agricultural policy. The EU is the world's largest exporter and importer of agricultural products, and thus represents the most important actor in the global agricultural market. Due to the adjustment to the conditions of the world market, the EU seeks to increase the budget for rural development and the funds independent of production volume in the total budget structure, while the goal of improving the competitiveness of European agriculture will be a top priority.*

**Key words:** EU, "new environment", agriculture, common agricultural policy.

**JEL:** F13, F15, F55, Q17.

### Introduction

The agricultural policy of the EU includes numerous instruments and measures to encourage the development of the agricultural sector of European members. The objectives of this policy are: improving domestic agricultural production, protection from foreign competition, improving the living standards of farmers, equitable rural and economic development of countries, as well as the stabilization of the market. Measures of foreign agricultural trade policy must be compatible with the functioning of the domestic market, as well as with the requirements of the World Trade Organization (hereinafter WTO). WTO is the main institution that regulates the flow of international trade, especially agricultural trade system which is complex and still evolving (Francois et al., 2005).

The mechanism of protection of EU's agriculture constitutes a major obstacle in facilitating and improving foreign trade with other countries (integrations). The

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common agricultural policy (hereinafter CAP) of the EU means a system of agricultural protection, which is made up of a combination of mechanisms: defensive protectionism, which refers to the protection of domestic agricultural production and farmers' income, and attacking protectionism, which is done to encourage and provide exports support. In this way, the EU provides an increase in food production and meets the requirements in terms of constant availability of agri-food products.

### **Methodology and data sources**

The aim of modern agricultural policy of the EU is adapting to new conditions. The EU has long been shifted from pricing policy to direct payments, which less influence on the modern trends of international trade. This paper examines the modifications of the agricultural policy in order that farmers produce freely, based on market principles and in accordance with market demands.

First, we will display characteristics of international trade in agricultural products and emphasize the importance of the EU from the perspective of world exports and imports based on data from the official publication of the European Commission (Overview of CAP Reform 2014-2020 - Agricultural Policy Perspectives Brief, Agricultural trade in 2013: EU gains in commodity exports, EU28 agricultural trade with: extra - EU28 and Member States Factsheets – Statistics of the EUROSTAT). The EU and the United States (USA) are by far the most important actors in this field. You will then see the main import and export destination i.e. major trading partners of this economic integration. Also, you can see the structure of trade in agricultural products the EU with other countries in various areas, in accordance with the methodology of EUROSTAT.

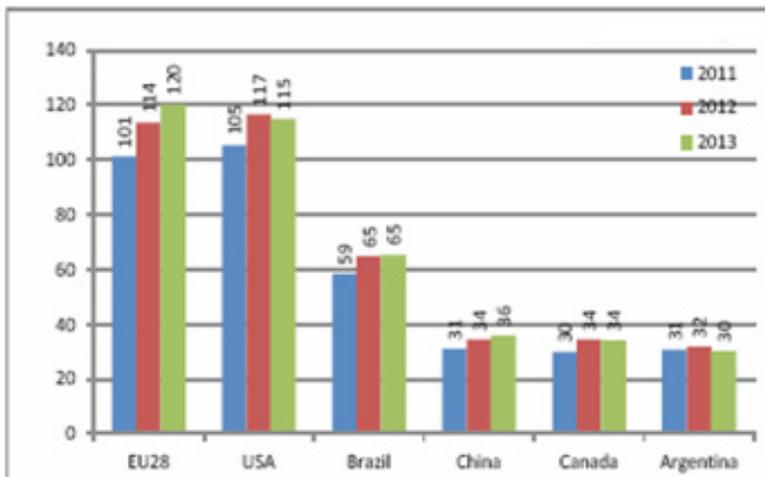
Development of the agricultural policy will be described since the beginning of European integration to the latest reforms include reduction of direct payments and price support in favor of the funds are opting for rural development. Researching period covers the entire period and the quantitative data relating to the period after 2003 or 2010, depending on the goal of analyses and data availability.

### **Characteristics of contemporary world trade in agricultural products**

Trade in agricultural products is an important part of world trade. This trade is of special importance for developing countries, because they collect significant funds necessary for its industrialization and economic growth and development (Marković, Veselinović, 2015). Also, in these countries, agricultural products realize the highest share in total exports. Exports of these products tend to compensate for balance of payments deficit, which is caused by the increased imports of industrial and other products. On the other hand, some developed countries (primarily the EU) seek to delay the implementation of measures relating to the liberalization of international trade (McCalla, 2003). Along with that, there is pressure from the USA and other developed countries in order to promote the free movement of food in the world market. They want it to be no problem to sell these products to the European market.

In international trade, there is a specific relationship between developed and developing countries. Unlike developing countries that export mainly primary, cheap agricultural products, developed countries, because of the far greater development of the food industry, have benefits from this situation. In fact, they sold abroad more expensive agri-food products and products with higher level of processing thus attaining a significant benefit on the balance of payments. This leads to overflow accumulation in developed countries and improving their position in the international division of labor. In the structure of trade largest share exercise crops, livestock for slaughter and meat and meat products. This leads to a permanent increase in the participation of developed countries in world exports of agricultural products. The most important EU partners are the USA, Russian Federation and Switzerland, which in total exports of participating with 30%, while from the point of importation into the EU the most important partners are Brazil, Argentina and the USA, which have participation of 26% (Puškarić, Kuzman, 2014). The largest exporters of agricultural products in the world are the EU, the USA, Brazil, China and Canada (*Chart 1*). These results were achieved, among other things, thanks to measures of agricultural policy, primarily instruments of agriculture (tariffs, premiums, levies, permits, prohibitions, price policy, and credit policy).

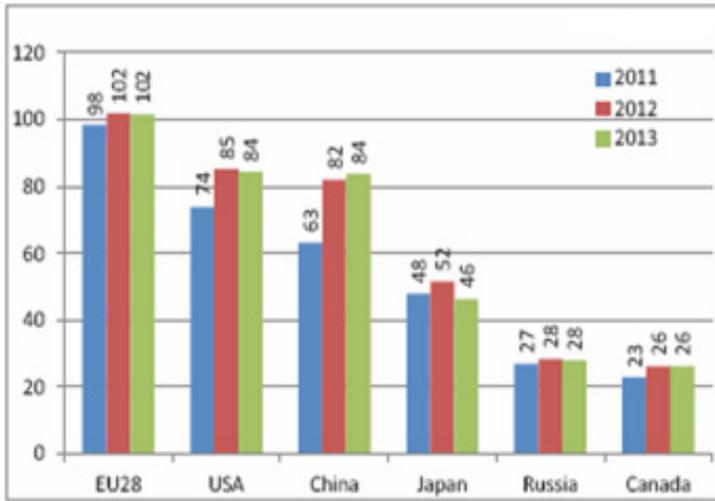
**Chart 1** - Top 6 world agricultural exporters (€ billion)



Source: European Commission, 2014.

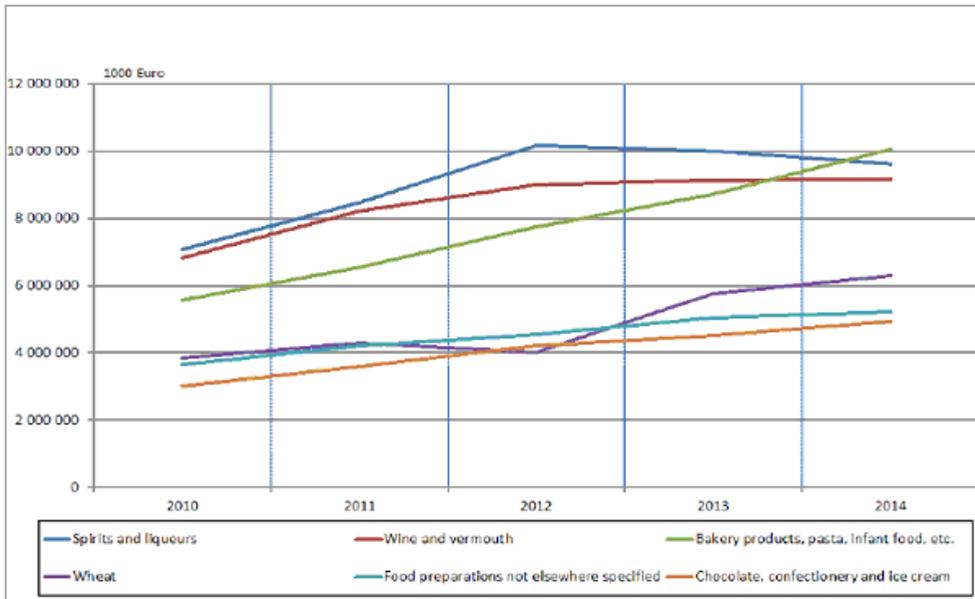
Besides the EU, countries with the largest imports are the USA, China, Japan, Russia and Canada (*Chart 2*). It is obvious that these developed countries significantly present both in imports and in exports of agricultural products. As the main reason may be the high income of the population in these countries. In fact, these countries want to provide a wide range of products to meet the discerning requirements of its customers. A secondary reason for the import of products is to prevent an increase in domestic prices due to excessive demand for these products. The main export products (average from 2010 to 2014) of the EU are shown in *Chart 3*, while the main import products for the same period are shown in *Chart 4*.

**Chart 2 - Top 6 world agricultural importers (€ billion)**

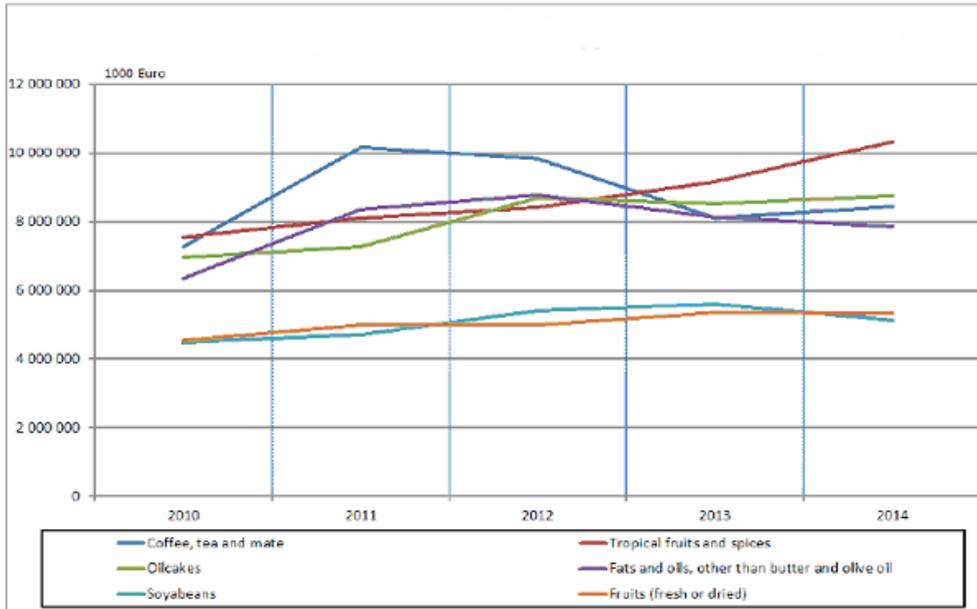


Source: European Commission, 2014.

**Chart 3 - EU28 trade with extra EU28 2010-14 - Top 6 exported products: ranked by average 2010-2014**



Source: European Commission, 2015.

**Chart 4** - EU28 trade with extra EU28 2010-2014 - Top 6 imported products ranked by average 2010-2014

Source: European Commission, 2015.

### EU in the negotiations on world trade liberalization

The process of international trade liberalization has progressed slowly because of the high level of protection in the field of agriculture. Talks have intensified with the establishment of the WTO, i.e. in the negotiations which are currently referring to this area of economy. The EU has done some concessions in terms of elimination of non-tariff barriers on some products and, in turn, lowering tariff rates (Božić et al., 2011). The intention was to significantly reduce tariffs. These requirements are primarily initiated by the USA, and other countries that are major importers of food.

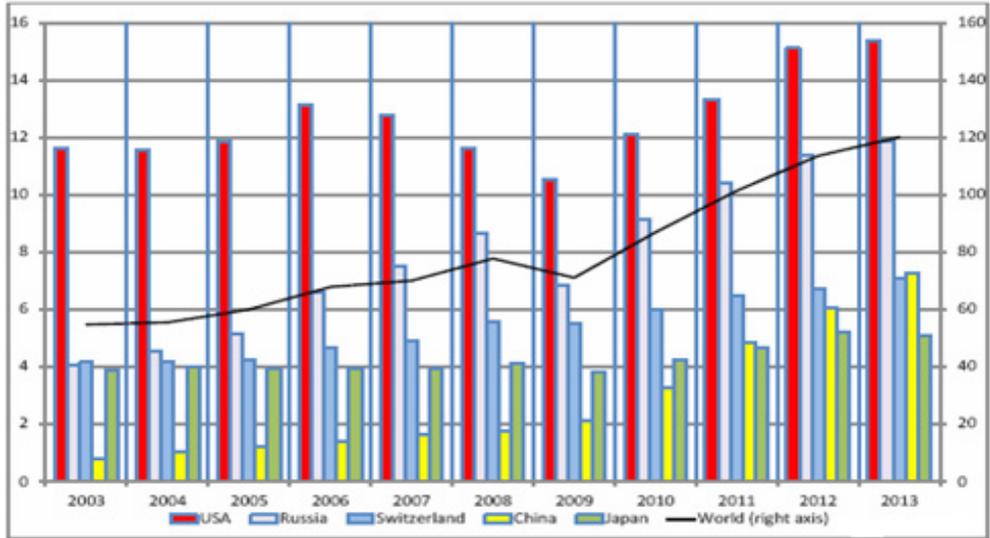
Defining rules for the liberalization of world markets for agricultural products was a significant result of the „Agreement on Agriculture“. Each member country of the WTO negotiation process has created its own list of products as part of tariff concessions. The aim was to convert non-tariff barriers in the customs, in order to increase transparency and reduce discrimination. The main goal was to reduce non-tariff barriers to imports of agricultural products, as well as tariffs (Nasser de Carvalho, 2014). For model reduction is chosen linear model which included the same percentage reduction in height independently of the initial rate. Swiss formula, which implied higher rates of tariff reductions for products with higher tariffs, was rejected despite the efforts of some countries for its introduction (USA). The plan also envisaged the application of tariff quotas, which include the determination of the volume of imports of certain products within which will apply lower tariff rates. In the case of importing larger

quantities of agricultural products defined scope, customs rate increased. Under the „Agreement on Agriculture“ could be established quotas to ensure imports retained at the level of the base period of 1986 to 1988, and relating to the highly protect agricultural products in the base period. In addition to these, could apply the quotas of minimum approach, providing an opening markets to additional imports of at least 3% of the volume of consumption in the same base period of each product group (while in the period of implementation of additional imports must be increased to 5%) (Božić et al., 2011). The contract involves the special safeguard clause, which allows it to occasionally apply additional tariffs if import volumes growing rapidly, compared to the average for the previous three years and if import prices fall by more than 10% below a certain threshold level of prices. This clause is defined under EU pressure, because it is obviously reluctant watched the tendency of liberalization of trade in agricultural products.

At the WTO Ministerial Conference in Doha (Qatar) in 2001 began a new round of negotiations on the liberalization of world trade in agricultural products. This round of talks has continued implementation of the agreement established under the Uruguay Round. The effects of the „Agreement on Agriculture“ were modest. They marked only a partial liberalization of world trade in agri-food products. During the implementation of the agreement there has been some small progress because the tariff and non-tariff barriers gradually decreased, and over a longer period of time. It can be concluded that the protectionist measures still present in spite of the enormous efforts for their reduction. This did not suit the developing countries are still faced with the impossibility of free trade of their agricultural products in foreign markets. Production subsidies in the developed countries were almost not reduced. That is why developing countries are allowed to reduce production support for a longer period in which to implement all the results of the previous agreement in the WTO. However, harmonization flowed very slowly, and the proposals were not found adequate reception in some countries in the negotiation process.

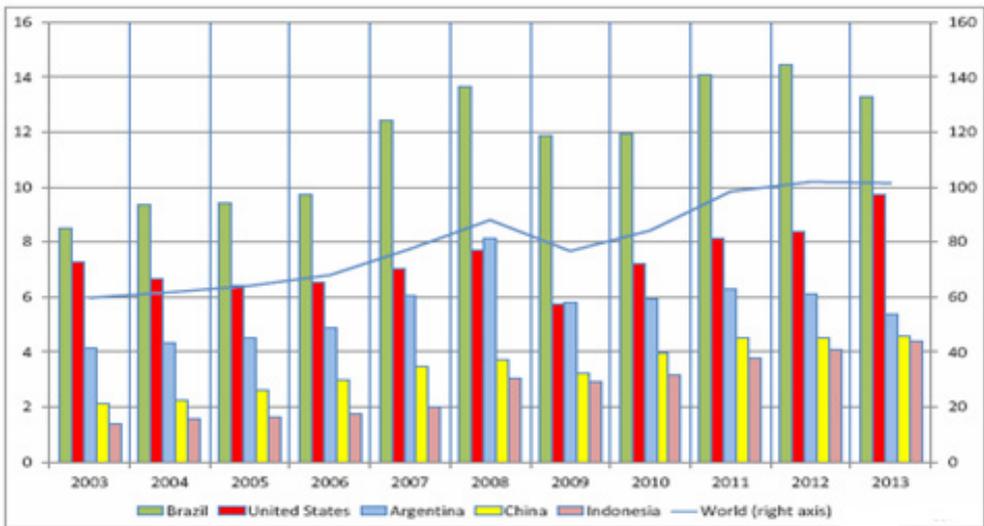
Due to a strong agricultural protectionism of the EU, the USA sought some radical reforms in the field of European agriculture. In this respect, the US advocated the reduction of tariffs on agricultural products, while the EU has sought to be a lower rate reductions and longer period of adjustment. The EU had to give in because they could follow some countermeasures which did not suit her, bearing in mind the importance of the USA from the point of import of agricultural products (*Chart 5*), and the possibility of further exports to the largest export market of the EU, and that is the USA (*Chart 6*).

**Chart 5 - EU agricultural exports by destination (€ billion)**



Source: European Commission, 2014.

**Chart 6 - EU agricultural imports by origin (€ billion)**



Source: European Commission, 2014.

**Arguments for EU agricultural policy reforms**

In the EU, roots of protectionist agricultural policy were conceived. Britain, France and Germany are the countries which have applied the state monopoly and a system of guaranteed prices. State monopoly is very important for the protection of domestic agricultural production to foreign, but also in domestic trade. The conditions of world

trade in agricultural products were worse taking into account the strengthening of the system of agricultural protectionism. Many countries faced with balance of payments deficit, particularly after World War II, have continued to establish more favorable economic relations with foreign countries. Agricultural protectionism has existed since ancient times, and “the real” is associated with the expansion of CAP European countries in sixties of the twentieth century (Marković, Marković, 2014).

Unlike defensive model of agricultural protectionism of the EU, in the USA was primarily implemented a model that favors the stimulation of exports through price policy, quantitative restrictions on imports and exports and commercial export programs. Most significant instruments of the EU trade policy are: a common external tariff, trade defense instruments (anti-dumping, anti-subsidy, regulation of trade restrictions, safeguards) and instruments for access to third country markets (Cvetanović, Jovović, 2010). Also, in the area of agriculture are also applied measures to improve the structure of placements, the combined market regulation with solid protective prices through intervention in the internal market, as well as special programs for areas with unfavorable conditions.

The introduction of the CAP was supposed to provide a safety net and preserve the agricultural sector from potential collapse of what they have experienced in some countries, i.e. Argentina in 1950 (Njegovan, 2006). The first attempt to formulate a common policy is the initiative came from the agriculture ministers of the Netherlands and France. France was interested in the export of almost all agricultural products, and the Netherlands for export-oriented production of fruit and vegetables. Rising costs of subsidies and threatening competition from overseas countries has led to negative implications for agricultural activity of certain European countries. The basic principle of agricultural policy was the creation of a single agricultural market within which there is free circulation of agricultural products. The basic aim was to establish a common policy in order to prevent unfair competition from abroad and enable a unique approach to the market by third countries. At that time, progress has been made in the production and mutual cooperation as Western European countries, to the formation of the European Economic Community, applied individual models of agricultural policy. Through specialization in production and the creation of a common market of agricultural and food products in EU, the objectives of agricultural policy of all the associated countries were achieved.

The main reasons for the occurrence of CAP are:

- Balance of payments impact (by reducing imports and increasing exports which can result in positive effects on the balance of payments),
- Stabilizing effect (reflected in the provision of reasonable income for producers and balancing supply and demand of agricultural products in the market),
- The effect of self-sufficiency (the goal is to reduce dependence on imported food products bearing in mind that one of the basic functions of agriculture ensuring food security, as well as the constant availability of food).

By creating a common policy in the field of agriculture, it is established a customs union of the original six countries. It was defined by the Treaty of Rome, which presupposes the elimination of all duties and quantitative restrictions between member states and the introduction of a common customs tariff to third countries. It is built concept of common prices, the competitive rules and standards harmonization. The mechanism of protection of domestic agricultural production was based on the protection of European market from excessive imports. It should be said that the agricultural protectionism of the EU was much stronger and in relation to the closure of other countries such as the USA, which more attention directed towards encouraging exports.

All the reform of EU agricultural policy had (among other things) target a gradual reduction of high protective measures (Huan-Niemi et al., 2009). The need to reform the CAP is followed as a result of pressure from inside (due to demonstrable weaknesses in previous policy) and external pressure, i.e. approaching common solutions in the context of the WTO (Marković et al., 2012). The objectives of the reform of the CAP in 1992, as part of a new strategy of agricultural policy, were: the achievement of greater competitiveness of domestic agricultural production in the world market, preventing unnecessary accumulation of agricultural products through the matching of supply and demand, the use of the agricultural budget to finance individuals so that provide long-term binding of farmers living in rural parts of the EU and improving the social and age structure of the population in the country (Marković, Marković, 2014). The plan was to decrease the intervention price and compensations for the abandonment of production and the establishment of agricultural environmental movement. The task was to eliminate the aforementioned disproportions, not just because of “internal” reasons, but also due to the start of the Uruguay Round negotiations in the context of creating a market-oriented system of agricultural trade (Marković, Marković, 2014). It was anticipated reduction of subsidies for the production, domestic support and export subsidies. The costs of export support were decreased and those funds directed towards fostering rural development.

Reassessment reform was carried out due to the existence of many insoluble problems (“Agenda 2000”). The most important external factors that led to the implementation of this reform are: the growing demand for food in the world due to the drastic population growth, the Doha Round negotiations in the WTO and expected accession of new member states (Janković, 2009). Among the internal factors stood out: the risk of market imbalance and destabilization of the economy, the Amsterdam Treaty, which obliges EU member states to respect the various regulations and environmental legislation, as well as respecting the interests of consumers. “Agenda 2000” has led to a further reduction of prices (grain 15%, beef 20%), which offset the increase in direct payments and the establishment of the second pillar of the common policy (rural development) (Marković, 2009). This reform also includes the mechanisms of common market regulating. Primarily refers to the market policy and price policy. The common market of certain agricultural products is governed by regulations in order to establish a stable market. These regulations included a very heterogeneous measures and mechanisms.

Support the production of milk and sugar was based on the import protection, with oilseeds defensive protectionism is almost non-existent, in the production of grapes was applied import protection and direct payments, etc.

The last major and radical reform was made in 2003 (Fischler reform). The main elements of the CAP reform were:

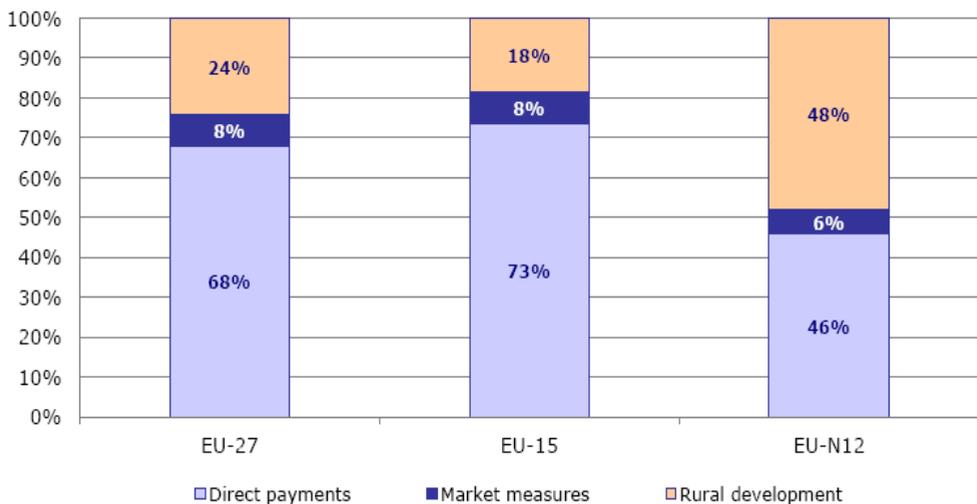
1. The introduction of the single payment scheme independent of production volume. This direct payment replaces former numerous types of direct payments. The aim was to strengthen the position of the EU in negotiations within the WTO and commitment to farmers to produce according to market demands. This would provide to farmers in the EU increased competitiveness and stability of income. It was expected to promote sustainable agriculture taking into account both economic and environmental criteria.
2. Limited retaining elements of production-related payments. It was necessary to prevent the abandonment of certain production that can lead to disturbances in the market of agricultural products. In particular, this applies to cattle and sheep production, which is linked to the hilly and mountainous areas and the need for their maintenance.
3. “Cross-compliance requirements.” This mechanism is the obligation of the manufacturer to meet certain conditions if they want to get support through direct payments. This mechanism was related primarily to preserve the health of humans, plants and animals. According to the classification of agricultural support measures WTO, such payments fall under the so-called green package, or green box, which means that they do not cause distortion in the relations between the EU and its trading partners (Jevdović, 2013). Swinbank and Tranter (2005) point out that payments made under the green box are not subject to reduction in the negotiations because it does not directly affect or have a very little impact on agricultural production.
4. The introduction of modulation. Modulation is to achieve a better balance between the first and second pillars. Modulation provided the funds for rural development.
5. The mechanism of financial discipline. In order to prevent excessive spending, it is introduced strict financial control and the obligation to respect the limits of the budget.

The European Council in 1997 adopted a document “Partnership approach” which defines a unique strategy of approach and the measures that candidate countries are required to meet to join the EU. Most of the new member states opted to support the market and the prices (high tariffs) as the leading instrument of foreign trade protection. It is defined by a transition period to the country gradually adapted to CAP. The net providers of funds in a common budget (Germany, Britain, Sweden, the Netherlands and Austria) were against support through direct payments. But a common policy had to take account of farmers from new member states in order to maintain production potential. In order to use these funds it is necessary to fulfill certain conditions regarding the modernization of its agricultural sector.

Milk production after the reforms are characterized by asymmetric reduction of price, until the quota regime maintained (applied) by 2015. In the sector of grain, intervention

prices, as a mechanism for regulating the market stability, there is a further, but it is reduced monthly payments for storage of those farmers who produce wheat. Reform of the sugar sector has been initiated, inter alia, by the fact that the EU has a very complicated system of production quotas that motivated manufacturers to produce over quota, which required the overproduction of which is spilling over into the global market, and due to the significant export subsidies (1.5 up to 2 billion euros annually). An important package of measures came into force in 2006, containing: Reform of the Common Market Organizations of sugar in order to encourage competitiveness and market orientation in the sector; restructuring of the sugar industry, encouraging uncompetitive sugar producers to leave the production; providing direct income support to producers of sugar beet. The essence of the reforms was a reduction in the guaranteed minimum sugar price, the establishment of the reduced quotas by countries or regions and penalties for exceeding production. It was introduced as a discouraging treatment of certain arable land in order to gradually decreasing considerable level of land and natural environment degradation. In the following period, CAP and measures of agricultural protectionism will continue to lose its exclusive i.e. narrow agricultural character. The share of the agricultural budget in total EU budget will continue to decrease; due to adjustment to the conditions of the world market will tend to continuously improve the competitiveness of European agriculture. That means increasing food supply, environmental protection and increased protection from bad weather conditions (Witzke, Noleppa, 2010). *Chart 7* shows the distribution of expenditures for financing of agriculture (average for the period from 2008 to 2013) for the following categories: direct payments, market intervention and rural development.

**Chart 7** - Distribution of CAP expenditure (2008-2013)



Source: European Commission, 2015a.

Much more attention will be devoted to the environment and natural resources. The new policy for the period after 2013 will have the following priorities: viable food  
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production, limiting measures of agricultural protectionism (to discourage imports, export promotion and support to individual farmers), organic farming, the use of clean or “green” technologies, and greater support to farmers in rural areas and solving of their social problems (European Commission, 2013). All this is in line with the objectives of the new strategy in the EU, such as the strategy “Europe 2020”. So shall be the shift towards the fulfillment of a number of different social and environmental objectives through mechanisms that are significantly separated from production (Cvijanović et al., 2011). Projections suggest that the largest decrease suffer export subsidies, inventory management activities and mechanisms of state intervention.

### Conclusion

Agricultural policy of the EU has succeeded in meeting its objectives, to provide quality and safe food at reasonable prices and to transform itself from a net importer to a net exporter of agricultural products. Also, it is established acceptable mechanisms of transport in the markets of the most developed European countries. The foreign trade policy of the EU has been the initial driver of its economic prosperity. Practice shows that due to the tendency of liberalization of world trade and the process of globalization of the world economy, protectionist measures slowly lose their importance. Today at the forefront are some other objectives, which are mainly related to sustainable development of agricultural production.

EU agricultural policy has undergone a series of modifications. The reforms were caused by both internal problems and pressure from individual countries for restricting free trade in connection with the importation into the EU market. External pressures are coming from the USA, Britain, and were implemented by the WTO bearing in mind the negotiations on the liberalization of international trade in agri-food products. Negotiations were initiated primarily by the USA that required a significant reduction in the level of protectionist measures, while the EU was not ready to commit significant concessions. Despite opposition from some European countries, EU agricultural policy has had to adapt to the new environment. The EU has had to gradually reduce their protectionist measures in the field of agriculture in the negotiations on the world trade liberalization. The manufacturers now produce in accordance with the needs and demands of the market, unlike the earlier policy of subsidies for certain production.

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## PRILAGOĐAVANJE AGRARNE POLITIKE EVROPSKE UNIJE NOVOM OKRUŽENJU

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### Rezime

*Cilj ovog istraživanja jeste da se sagleda pozicija EU u svetskoj trgovini poljoprivrednim proizvodima. Naglasak se stavlja na sagledavanje uticaja tendencije liberalizacije međunarodne razmene poljoprivrednih proizvoda na razvoj i karakter reformi agrarne politike EU. EU jeste najveći svetski izvoznik i uvoznik poljoprivrednih proizvoda, pa tako predstavlja najznačajniji akter globalnog agrarnog tržišta. Zbog prilagođavanja uslovima svetskog tržišta, EU nastoji da poveća budžet za ruralni razvoj i sredstva nezavisna od obima proizvodnje, u strukturi ukupnog budžeta, dok će cilj unapređenja konkurentnosti evropske poljoprivrede biti na vrhu prioriteta.*

**Ključne reči:** EU, „novo okruženje“, poljoprivreda, zajednička agrarna politika.

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