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# **A POLICY FOR AGRICULTURE**

ENDING STATE INTERFERENCE

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## SUMMARY

- Current agricultural policy is highly wasteful. The system produces high prices in the shops, costs a lot, fails farmers, is vastly bureaucratic and causes disputes with major trading partners.
- The measures in place bear scarcely any relation to the principles which ought to apply to agriculture and, broadly, do apply to the rest of the economy. The market is distorted, where it should be free. Public expenditure on agricultural subsidies is high, where it should be close to non-existent. Prices are kept unnecessarily high by Government intervention. Despite this, farm incomes are at their lowest level for over 60 years.
- The Government's Policy Commission on Farming and Food, asked to report by 31 December 2001, is unlikely to recommend the radical reforms that are needed.
- Despite the problems facing farmers today, there is room for optimism in the medium term.
- Agricultural policy is set by the EU. The following factors suggest that radical reform – or even the dismantling – of the Common Agricultural Policy (CAP) will eventually happen:
  - the liberalising agenda of the World Trade Organisation (WTO), reaffirmed at the Doha Ministerial Conference;
  - the cost of the CAP and the effect on this of the forthcoming accession to the EU of the Central European and Eastern Countries;
  - the readiness of some current member states such as Denmark and Sweden, and perhaps Germany, to consider agricultural reform.

- The following principles should inform agricultural policy:
  - economic efficiency;
  - the operation of free markets, in particular the elimination of all subsidies (which distort the operation of the free market);
  - support for the WTO in the forthcoming round of trade talks;
  - continuing, limited support for programmes designed to protect the environment.
- Agricultural policy should not be concerned with:
  - establishing an appropriate level of farm incomes. That is best decided by the free operation of the market;
  - creating a policy on the size of farms. There is no economic or social merit in protecting unviable farms. Again, the market, not the state, should be allowed to decide which types of farms are viable;
  - alleviating social problems in the countryside. Governments should address such problems in whatever way they wish through non-agricultural programmes;
  - developing “consumer-friendly” policies. The consumer’s long-term interests are best served by the free operation of the market.
- Reform within the EU (which sets all agricultural and most food policies) is not impossible. The above principles can be implemented in the medium term if the UK ensures that the WTO is supported; if the costs of the CAP are attacked; and if agriculture is treated in the same way as any other industry.
- Only then will consumer prices fall; public expenditure on agriculture decrease; and eventually farm incomes rise.

## CHAPTER ONE

### INTRODUCTION

Agricultural policy is a matter of suspicion in the UK. It is associated with butter mountains and wine lakes, BSE and foot-and-mouth disease. It is known that the European Union (EU) is particularly active in the area, which is not a recommendation to some. It is claimed that the policy is responsible for the closure of small slaughterhouses, for the death of the corner shop, for allowing our health to be put at risk by pesticide residues and in other ways. From a different direction, it is claimed that “intensive farming” has caused the environment to be degraded.

*Almost every aspect of agricultural policy seems to be imbued with an Alice in Wonderland quality.*

Even those who seek to look behind the headlines find real oddities. Prices in the shops are high by world standards. Some farmers are paid for not growing crops. Subsidies are widespread, and the rules governing them Byzantine. Rows over agricultural policy with the United States seem endemic, the consequences affecting industries which have nothing to do with agriculture. Almost every feature of policy seems to be imbued with an Alice in Wonderland quality.

To say that the public is disenchanted with agricultural policy probably understates the position.

This paper focuses on agricultural policy, that is government policy towards the production of and trade in agricultural commodities such as wheat, milk and beef and first stage processed products such as butter. It therefore covers some of the same ground as the Policy Commission on Farming and Food set up earlier in

the year by the Government under Sir Donald Curry as one of the responses to the Foot and Mouth outbreak. The Commission is due to report to the Prime Minister and the Secretary of State for the Department for Environment, Food and Rural Affairs (DEFRA) by 31 December 2001. Its remit is challenging:

To advise the Government on how we can create a sustainable, competitive and diverse farming and food sector which contributes to a thriving and sustainable rural economy, advances environmental, economic, health and animal welfare goals, and is consistent with the Government's aims for Common Agricultural Policy (CAP) reform, enlargement of the EU and increased trade liberalisation.

This remit is daunting and will be difficult to fulfil in the time allowed for the task. Many of the specific goals could be considered to be incompatible. And its members,<sup>1</sup> while all individually knowledgeable and distinguished, represent a wide and perhaps irreconcilable variety of interests and opinions. The Commission seems most likely to produce a bland report that conceals the structural problems innate in its remit behind a call for further "consultation and review". At worst, it will recommend more of the interventionist policies that have caused the problems facing agriculture in the UK today.

*The Commission seems likely to produce a bland report... At worst, it will recommend more of the interventionist policies that have caused the problems facing agriculture in the UK today.*

In contrast, this paper sets out:

- an assessment of the present position;
- a specification of the principles with which any agricultural policy ought to conform; and examination of some other potential principles which it would not be appropriate to adopt;
- an analysis of the constraints which must be noted;
- suggestions for future policy, taking account of the above three points.

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<sup>1</sup> The members of the Commission are: Sir Donald Curry CBE (farmer and former Chairman of the Meat and Livestock Commission); Helen Browning OBE (former Chair, Soil Association); Sir Peter Davis (Group Chief Executive, Sainsbury's plc); Iain Ferguson (Senior Vice-President, Unilever plc); Deirdre Hutton CBE (Chair, National Consumers' Council); DeAnne Julius (former member of the Bank of England's Monetary Policy Committee); Fiona Reynolds CBE (Director-General, National Trust); Mark Tinsley (farmer); David Varney (Chairman, BT Wireless); Graham Wynne (Chief Executive, Royal Society for the Protection of Birds).



## CHAPTER TWO

# THE PRESENT POSITION

It may be helpful to start with the least contentious facts for 2000.

TABLE ONE: BASIC DATA, 2000 (EXCEPT WHERE STATED)

Area of UK agricultural land (thousand hectares)	18,306
(% of total UK land area)	74.7%
Workforce in agriculture (thousands)	533
(% total employment)	2.1%
Total Income from Farming, 2000 (£ millions)	£1,882
(compared to 1995 Total Income from Farming, (£ millions)	£6,070
Average size of farm (hectares, 1997)	69
(compared to EU average size of farm, 1997)	18
Total value of agricultural production	£15,324
Gross value added (£ millions)	£6,646
(% total Gross Value Added)	0.8%
% share of agriculture in UK GDP (1999)	0.9%
(compared to share of agriculture in EU GDP, 1999)	1.8%
Cost of direct agricultural support in the UK* (£ millions)	£3,182
Value of exports of food, feed and drink (£ millions)	£8,720
Value of imports of food, feed and drink (£ millions)	£17,004

\* paid from both EU and UK funds.

Sources: *Agriculture in the United Kingdom 2000*, ONS, 2001; *Agriculture in the European Union - Statistical and economic information*, EUROSTAT, 2000.

There is one further set of figures which is vital for understanding the true state of affairs but which needs some introduction. Government support for agriculture takes two principal forms. One occurs via the direct payment of cash normally to farmers. The other is brought about by measures which keep prices higher than they would be otherwise. It is easily seen that enabling producers to sell their output at prices above those that would otherwise prevail has an effect, so far as farmers are concerned, similar to paying a cash subsidy. However the effects on taxpayers and consumers are quite different. Subsidies in the form of cash subventions have to be paid for by taxpayers. Support provided via high prices does not necessarily involve any public expenditure at all. The cost is borne by consumers rather than taxpayers. The important point is that indirect price support distorts the efficient allocation of resources every bit as much as direct support. From an economist's perspective it is, therefore, just as undesirable.

*Indirect price support distorts the efficient allocation of resources just as much as direct support. Both are undesirable.*

To compare the degree of agricultural support in different countries therefore requires a measure which takes account of both types, direct and indirect. Methods of doing so were developed in the 1980s and 1990s. These allow all support to be included within a single figure, the Producer Support Estimate (PSE).<sup>2</sup> The figure quoted below, the percentage PSE, is the PSE expressed as a percentage of gross farm receipts: the higher the figure, the greater the level of support.

TABLE TWO: PRODUCER SUPPORT ESTIMATES (1999)

Country	% PSE
Australia	6
US	24
EU	49
Japan	65

Source: *Agricultural Policies in OECD Countries: Monitoring and Evaluation*, OECD, 2000.

The PSE figures show that EU agriculture is heavily supported. It is also helpful to have a measurement of the cost of this support to the national economy. The most recent authoritative estimates were published by an independent Ministry of Agriculture Advisory Group in 1999.<sup>3</sup> It estimated that

<sup>2</sup> Producer Support Estimate is defined as an indicator of the annual monetary value of gross transfers from consumers and taxpayers to support agricultural producers, measured at the farm gate level, arising from policy measures that support agriculture, regardless of their nature, objectives or impacts on farm production or income.

<sup>3</sup> *Europe's Agriculture: the case for change*, MAFF, 1999.

the direct resource cost in the UK in 1996 amounted to about 0.5% of UK GDP (or about £5 billion), and that if indirect costs were included the figure would be considerably higher.<sup>4</sup> In addition, because UK agriculture is small relative to the size of the economy, the UK bears some of the cost of supporting the CAP in other member states. This effect is significantly reduced by the UK budget rebate. The cost is about £600 million a year, after taking account of the rebate.<sup>5</sup>

The figures quoted above suggest:

- that a relatively small proportion of the UK population makes its living from agriculture;
- that agriculture covers most of the country, which is one reason for its importance for the environment;
- that UK farms are large by European standards;
- that agriculture makes only a small contribution to GDP (and the percentage has been declining for many decades);
- that whether it is measured in terms of money or misallocated resources, the cost of subsidising agriculture represents a substantial proportion of the value of its gross output of £15.3 billion. No other industry is supported to the same extent;
- that the EU subsidises agriculture to a greater extent than most other OECD countries;
- that the CAP represents a significant burden on the UK economy;
- and that trade represents a significant proportion of output.

All agricultural and most food policies are set at the level of the EU – agriculture and food are “occupied fields”. EU agricultural policies apply in (virtually) identical ways in all member states, hence the term “common” agricultural policy or CAP. This means that within EU member states there is very little scope for independent national action on agricultural matters. Any national measures that are adopted are subject to EU law and control by the European institutions, in particular the Commission and, ultimately, the Court of Justice.

The precise details of the policy are complex and vary by commodity. However, traditionally for most commodities the EU has opted for support via high prices, placing the main burden of support on consumers. The situation was changed somewhat by the two waves of CAP reform in the 1990s.

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<sup>4</sup> The direct resource costs approximate the extent to which producer gains from the policy are smaller than the combined losses to consumers and taxpayers. The difference between the two is a measure of the inefficiency of the policy. Taking account of indirect effects also involves estimating for the fact that real costs throughout the economy are higher than they would be otherwise.

<sup>5</sup> *Europe's Agriculture: the case for change*, MAFF, 1999.

In these reforms, support prices (broadly the prices defended by the system) were lowered while, to secure agreement, farmers were compensated by receiving new, direct payments from EU funds. It is possible to show that (in most cases) the gains to consumers were greater than the cost to taxpayers, hence the word “reform” can be used. Nevertheless it should be noted that these CAP “reforms” resulted in the money cost of the CAP increasing significantly.

Some find the concept of a CAP reform which increases public expenditure odd. This group sometimes includes the Treasury, especially when they are concerned with total public expenditure; at other times it accepts the (logical if unusual) idea that such a reform can have merit when consumer gains outweigh the increased public expenditure. If this condition is met, the PSE will, for example, decrease, which should be the accepted definition of successful reform.

The last two reforms have adopted this pattern of reducing prices and increasing direct payments. There is, therefore, an expectation that further reforms will initially follow this path.

## **AGRICULTURAL SUPPORT: A BRIEF ANALYSIS**

Despite these reforms over the last decade, prices in the EU are still generally higher than those on the world market, and for some commodities much higher. They are kept high by three important components of the EU system:

### **1. Import charges**

These used to vary according to world prices but, following the last World Trade Organisation (WTO) round, are now fixed in terms of euros and are slowly diminishing. However they are generally high compared to those for industrial products and in some cases effectively exclude imports.

### **2. Export refunds**

Given that many EU prices are well above world levels, exports of some products would not, other things being equal, take place. However, several member states are traditionally large exporters of agricultural products. This is explained by export refunds. Originally they were set, notionally at any rate, at a level equal to the difference between EU prices and world prices. Refunds are unpopular with other agricultural exporting countries which have attacked them in the WTO and its predecessors. EU refunds are now subject to a number of WTO rules and constraints which set various limits on them and on the tonnage on which they can be paid. Nevertheless refunds remain significant. In the UK they cost the EU budget nearly £200 million in 2000 and for the EU as a whole the figure was £3.5 billion.<sup>6</sup> They are certain to be a target in the next trade round.

It will be appreciated that refunds help to keep prices high by reducing the level of supply to the EU market. They are thus at the same time a mechanism for raising prices and a response to high prices.

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<sup>6</sup> European Commission, *30th financial report on the Agricultural Guidance and Guarantee Fund for the 2000 financial year*, 2001.

### **3. Intervention**

Some commodities can at times of low prices be sold to the public authorities at predetermined prices, and stored for future use. Again this keeps up prices by reducing supply on the EU market at least in the short run.

Other important elements of the CAP include:

### **4. Headage and area payments**

Livestock producers are entitled to a range of payments per head and arable producers to payments on area sown to many of the main crops. These payments come within the category of direct subsidies. Some of these payments are of long standing while others were put in place as a result of the 1990s CAP reforms mentioned above.

### **5. Bureaucracy**

To ensure accuracy and fairness and to protect public funds, the running of the system described above necessitates a highly complex set of rules and a substantial bureaucracy. Thus area payments are only paid to an arable producer if he or she claims by the required date in respect of eligible land (the definition of “eligible” is itself a matter of some complexity) planted with the crop; and if he or she also specifies precise measurements of each field (including giving details of each and every bare patch, hedge of more than a certain width etc). Areas sown for which subsidies are claimed generate an obligation to “set aside” – that is leave fallow – a specified proportion of the acreage sown. Penalties for errors made in submitting such claims, accidental as well as deliberate, are severe, commonly running to many thousands of pounds. Experience shows that such penalties greatly exceed any that would be imposed by a UK court.

Similar complexity attends livestock production. Production of milk, cattle and sheep rearing are subject to quotas. Complex rules govern quota transfers. Producing without quota is heavily penalised. Managing their quota holding so that quotas and production are in line is an important task for many farmers. Mistakes can easily prove more expensive than bad farming practices. In the UK there is a well-developed service industry specialising in the transfer of quotas both by sale and by leasing. Similarly there are professional advisers who will (for a fee) help in completing the arable area claims described above.

### **6. Environmental and Rural Development measures**

These differ in kind from the measures mentioned above. They are, ostensibly at least, not designed to support agriculture but are intended either to protect the environment or to invigorate the economy in rural areas. Unlike measures of agricultural support, they do not in general attract 100% EU funding but a lower figure, typically 50%; the remainder has to be found by national governments. Though there is an obligation on member states to adopt such measures there is national discretion in deciding the detail. These environmental and developmental measures can be viewed either as a recognition that this is the direction in which policy needs to evolve in response to EU-wide public criticism of the CAP (not to mention international criticism) or, more cynically, as a more acceptable way of subsidising agriculture. Both assessments probably have some truth in them.

In 2000 the total cost of all UK agri-environmental schemes was under £200 million compared to total direct expenditure on agricultural support of £3,182 million. Though expenditure on agri-environmental schemes is set to rise it will only represent a small proportion of agricultural support for many years. In the UK at present the four most important environmental schemes are:

- **Environmentally Sensitive Areas (ESAs)** are areas of the countryside where there are special, attractive features which have often been created by agricultural practices and are sustained by them. They cover some 10% of the land area of the UK. Examples are the Lake District, the Norfolk Broads and Exmoor. Payments are made to farmers provided they adopt farming practices which will sustain the key features of the area in question.
- **Countryside Stewardship** provides grants for specific and detailed environmental improvements at the farm level. A typical grant might provide part of the cost of planting or renovating a hedge and maintaining it over a defined period or for constructing and maintaining a “beetle bank”. Often a farmer will enter into a series of detailed commitments covering many features on his farm.

*Is it not odd to subsidise someone to convert to a system from which they expect to secure a market premium?*

- **The Organic Conversion Scheme** provides a farmer with aid during the conversion period required to qualify for organic status. Yields will normally decline during the conversion period, while the premium for organic produce cannot be obtained. On one view it is odd to subsidise someone to convert to a system from which they expect to secure a market premium. However, there is surprisingly little criticism of the scheme. Indeed such criticism as there is argues in favour of more generous payments. Aid is for conversion only; it ceases to be paid when the farmer has qualified for organic status, though there is pressure to extend the scheme to a general subsidy for organic production.
- **The Woodland Schemes** provide grants for planting trees on agricultural land. The rates are such that 90% of planting in England is of deciduous species.

It would be reasonable to add one other measure to the above list since it has already been announced that the payments on **hill cattle and sheep** will be changed so as to transform the scheme from a production into an environmental one (by basing payments on area rather than number of animals). In 2000 the hills scheme cost £150 million. Including it among the agri-environmental measures described above would bring the total annual cost of such schemes to £350 million.

It is necessary to mention briefly, if only because politicians tend to make much of it, one other feature, namely the **Rural Development Regulation**. Member

states are given considerable discretion in the way they apply it though they do not have the option of not applying it. The agri-environmental schemes described above are included within its aegis as are a number of other schemes ancillary to farming such as aid for “outgoers” (farmers leaving the industry), aid to young farmers, investment aids and so on. Some of these other schemes are applied in parts of the UK. To the extent that they are applied they clearly provide additional support for agriculture and distort the allocation of resources. However, in the UK the sums are small apart from the agri-environmental schemes already covered.

## CHAPTER THREE

### PRINCIPLES

The following principles are proposed. Obviously they are likely to have to be compromised for one reason or another in devising practical policies. However, clarity of objective is essential in order to establish priorities. As will be seen, some principles are closely related to constraints.

#### ECONOMIC EFFICIENCY

The human desire for standards of living to be increased as rapidly as possible is virtually universal. It can only be satisfied if all industries (and services) continually increase efficiency. Agriculture should be expected to contribute to this process. Claims that it is in some way a special case should be treated with scepticism.

*It is often implied that efficiency ought not to be a major consideration in determining agricultural policy.*

This might at first sight appear uncontentious. However, it is often implied that efficiency ought not to be a major consideration in determining agricultural policy. Also many innovations have throughout history attracted criticism. The English land enclosures of the seventeenth and eighteenth centuries are one example. This involved fencing off land which, so it was claimed, acted to the disadvantage of the rural poor who had previously often made use of the land in question. Whether these claims were justified is still argued today. What is clear is that enclosures allowed major gains in productivity to be achieved.



The present issue of similar controversy involves genetically-modified (GM) food. This probably offers the prospect of large increases in efficiency and, in the longer run environmental benefits as well. However, it is the target of a vociferous counter-campaign. This takes various forms, often expressed in terms of concerns over food safety and environmental grounds. Yet much opposition really seems to be based on philosophical or religious, rather than scientific, grounds. (To be fair, some well-known opponents of genetically modified foods openly admit that their opposition is one of principle). The grounds of opposition are important as concerns based on practical issues can, at least theoretically, be removed or confirmed as new information comes to light. Philosophical objections are in a different category. They cannot be answered by the findings of research.

Policy on GM foods is currently in some disarray. However, GM technology already makes major contributions to medicine, for example in the production of new drugs. It seems most unlikely it can be excluded from agriculture in the long term, not least since some countries are already making extensive use of it. In the short term, the main need is to ensure that genuine concerns are answered if necessary by new research while at the same time not giving way to the wrecking tactics of some of the technique's opponents. Ultimately, of course, any foods containing GM products will have to prove themselves in the market place.

## **MARKETS**

The action of freely-operating markets is preferable to government intervention or regulation. Markets allocate resources in accordance with human wishes more efficiently than planners ever do.

*The objective should be the marked reduction, if not the complete elimination, of all public expenditure on agricultural support.*

Thus prices should be allowed to find their own level according to supply and demand with minimal distortions brought about by government policy. To the extent that such a principle is followed, both the money cost and the resource cost of the CAP would diminish. It would also be possible to dismantle the bureaucracy which administers the present system. These would be major gains.

## **PUBLIC EXPENDITURE**

Public expenditure is only justified for defined benefits which cannot or will not be provided by the market. Close scrutiny is required of any proposed public expenditure if the benefits it is designed to provide can be, but are in fact not, provided by the market. In such cases, it may be that a proposal is merely an attempt to force the general public to subsidise the preferences of a minority.

The traditional justifications for agricultural support, such as security of the food supply, are no longer valid. In the long term, the objective should be a marked reduction, if not the complete elimination, of all public expenditure on agricultural support.<sup>7</sup>

## **SUPPORT FOR THE WTO**

Prosperity in individual countries depends in large part on an expanding and vibrant world economy. Achieving this requires the expansion of international trade. This in turn relies on countries and firms having confidence in the conditions which are applied by importing countries. Hence the need for countries to enter into commitments about the treatment of imports in terms of the charges and other rules applied. The WTO is the international body which registers and administers these commitments. It is thus a central plank in world prosperity.

The WTO is sometimes portrayed as a cause of world poverty. Nothing could be further from the truth.<sup>8</sup> Prosperity requires that the WTO be supported.

*“We commit ourselves to comprehensive negotiations aimed at reductions of, with a view to phasing out, all forms of export subsidies and substantial reductions in trade-distorting domestic support” – WTO Ministerial Declaration on Agriculture, 14 November 2001.*

In particular, the next world trade round needs to be supported. The fourth WTO Ministerial Conference held in Doha, Qatar in November 2001 succeeded in putting agricultural reform firmly on the agenda. The WTO Ministerial Declaration of 14 November 2001 announced.

We recall the long-term objective... to establish a fair and market-oriented trading system through a programme of fundamental reform encompassing strengthened rules and specific commitments on support and protection in order to correct and prevent restrictions and distortions in world agricultural markets... Building on the work carried out to date and without prejudging the outcome of the negotiations we commit ourselves to comprehensive negotiations aimed at:

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<sup>7</sup> Genuine agri-environmental schemes ought not to be considered as “support”.

<sup>8</sup> Robert Stern of the University of Michigan estimates that cutting barriers to trade in agriculture, manufacturing and services would boost the world economy by \$613 billion p.a. See the speech “The WTO – challenges ahead” given by Mike Moore, Director General of the WTO, to the German Council on Foreign Relations, Berlin, 23 April 2001.

- substantial improvements in market access;
- reductions of, with a view to phasing out, all forms of export subsidies;
- and substantial reductions in trade-distorting domestic support.

These goals are ambitious. But the outcome of the last round gives room for guarded optimism. Significant progress was made then on agriculture for the first time (previous trade rounds had mainly been concerned with industrial tariffs). Agreement was reached over the following issues:

- that an absolute limit should be placed on overall agricultural support in money terms for each WTO member with no allowance made for inflation;
- that reductions be made in some types of agricultural support (such as export refunds and import charges); and
- that agriculture should be covered by a mechanism for resolving disputes.

The last point is important. It means that some methods of hidden support for agriculture are no longer possible. For example, some countries often used to restrict imports very quickly if there were an outbreak of animal or plant disease in a supplying country. Whether these measures were justified was a matter of opinion. Often such restrictions were not lifted as quickly as the supplying country thought reasonable. Sometimes the import restriction assumed a permanent status where the threat was said (by the importer) to be permanent.

Historically there was no way of settling whether such restrictions were reasonable. As a result of the last trade round, however, this is no longer the case. The system now is that a WTO member (let us call it A) which considers that its interests have been disadvantaged contrary to the rules by the actions of another member (B) has the right to demand that the matter be referred to an independent panel whose findings have real weight. If the panel find against the rules in question, B is not obliged to change them, though it is hoped that they will do so. If B refuses, however, A is entitled to penalise B, for example by increasing import charges on B's exports to A. The size of these punitive measures can also likewise be referred to an independent panel. This system has been proved to work. As a result of successive cases brought by the US, the EU has been forced to amend its banana regime.

As a result of this development, countries are for the first time under real pressure to ensure their policies can be objectively justified to a neutral audience. In the longer run this should result in more transparent policies.

## THE ENVIRONMENT

Much of our rural environment is valued by the public. Evidence from academic studies funded and published by MAFF suggests that they want it preserved and are even (up to a point) willing to pay for it. Landscapes such as that of the Lake District have been created and are sustained by farming but, as

has been forcefully demonstrated during the recent foot and mouth outbreak, the agricultural output from the area is only a small part of its economic importance. Hence there is an economic, as well as an environmental, case for preserving rare environments.

Another aspect of the environment relates to biological diversity. Here, too, there is much public interest, though it is normally more difficult to demonstrate a public willingness to pay for it.

It is to be expected that the value the public place on the environment, especially rare environments such as the Lake District and the Norfolk Broads, will increase with growing affluence. In economists' terms they are "superior goods". It is to be expected, therefore, that should the economy continue to grow, these environments will be valued increasingly highly.

The measures needed to protect the environment go beyond agricultural policy though the latter can make a contribution to that aim. The principles suggested here are that agricultural policies should not encourage environmental degradation and should contribute to protecting the more fragile environments. Public expenditure on the environment is likely to increase over time. However, the total current expenditure on agri-environment schemes amounts to £350 million a year (including the costs of hill cattle and sheep subsidies), whereas agricultural support in the UK costs over £3 billion a year. Hence it is possible to increase support for the environment by a substantial proportion while reducing public expenditure overall.

*Support for the environment can increase substantially – while simultaneously cutting public expenditure.*

## **FARM INCOMES?**

The CAP is based on the Treaty of Rome which specifies as one of its objectives the maintenance of a "fair" standard of living for farmers. This no doubt reflected the political reality of the mid 1950s in the countries of the six founding member states. In practice, UK policy at the time was also based in part on such a consideration. It should, however be noted that inclusion of the objective in a Treaty potentially gives it a weight for the longer term: cases in the European Court could be based on a claim that policies give insufficient weight to this Treaty commitment.

The level of farm incomes has been of some public interest and comment during the last few years mainly because farm incomes are at an historically low level. The government itself acknowledges that they may be as low or lower than at the time of the agricultural depression of the 1930s, hitherto thought of as the worst experience in modern times.<sup>9</sup> There is no doubt that the industry

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<sup>9</sup> *Agriculture in the UK 2000* (ONS, 2001) states that: "Total Income from Farming is at an historically low level. It may be as low or lower than at the time of the depression in the late 1930s (exact comparison is not possible because statistics on farm incomes before 1973 are not directly compatible with the current series)."

has done very badly for a period, mainly as a result of the low level of the euro (the currency in which CAP prices are determined). This leads to calls that “something must be done”.

A theoretical case can be constructed for having a farm incomes objective as agriculture is a very highly-regulated industry. After all, it might be said that in the case of the privatised utilities, regulators are specifically appointed to ensure that firms can make reasonable (or “fair”) profits. However this analogy is not compelling. Electricity and gas producers do not, for example, produce surpluses which can be sold to the public authorities at defined prices.

Farmers have been caught by a number of major setbacks which were none of their making and as such deserve sympathy. In some cases, where their losses can be attributed directly to public policy, there may be an argument for short-term support. However, that does not justify having a general policy on farm incomes. In general, government intervention to affect profit levels is not desirable or helpful. In other sectors, competition and the market determines the level of profits. Why should farming be different?

There is no need for a farm income objective. The UK should therefore argue for the relevant article of the Treaty of Rome to be amended.

*There is no need for either a farm income policy or a farm size policy... There is no special virtue in unprofitable farms or in small farms.*

#### **FARM STRUCTURES?**

Two facts are widely understood about UK farm structure. The first is that as a result of early UK industrialisation and the absence of a tradition of dividing property equally between children (which exists in much of Continental Europe), UK farms are in general larger than Continental ones. There is some smugness about this; commentators often refer to “inefficient” Continental farms.

The second fact is that many farms are “family” farms, that is they are run by members of one family often through more than one generation. This, too, has attracted some attention recently – often when the youngest generation, finding itself under financial pressure, is unable to carry on the family tradition. Some regard this as a particularly undesirable development and sometimes it is said that policy should “support the family farm”.

However, the economic realities should be remembered. The average size of a viable farm has steadily increased for decades. It may be regrettable (and upsetting for those directly affected) that many small farms which have been viable in the past are no longer viable; others may be viable now but will not be so in the future. But it is in nobody’s long-term interests to hinder the structural adjustment necessary, any more than it would have been in the other sectors of the economy which have experienced significant restructuring.

Thus, the temptation to create a farm structure policy should be resisted. There is no special virtue in small farms. Nor is there any special virtue in large farms. Rather the market should be allowed to determine which types of farm survive.

This principle implies that the UK should continue to argue in Brussels against proposals to discriminate against large farms. Such discrimination would hinder desirable structural developments. Unfortunately the European Commission is prone to putting forward such proposals, partly out of a sentimental regard for the position of small farmers, and partly as a result of the political pressure exercised by small farmers in some EU countries.

### **SOCIAL FACTORS?**

A common view in the EU has been to regard the CAP as in part a social policy. This is understandable given that farmers with little land are among the poorest citizens in some southern member states.

Nevertheless this approach should be avoided. An agricultural policy should deal with agriculture. If there are social problems in rural areas which a government wishes to address, they should be met by developments in social or transport or housing policy or whatever, depending on the precise social problem identified. It should not be within the remit of agricultural policy to implement social programmes.

*It should not be within the remit of agricultural policy to implement social programmes.*

This distinction between different policies needs to be firmly maintained. Even in the UK there are those who speak of changes to the CAP in the context of the needs of rural areas. This is suspiciously close to setting agricultural policy on the basis of the income needs of individuals.

### **CONSUMER INTERESTS?**

Consumer interests are served not by governmental intervention, but by a policy which puts the emphasis on market signals, engages wholeheartedly in WTO negotiations, views sceptically proposals for public expenditure and price support and has regard for the environment. Such policies will allow consumers to express their preferences in the market place. They will therefore benefit far more than they would from any special "consumer" policies. Hence the latter are not required.

## CHAPTER FOUR

# CONSTRAINTS

### THE EU

The 1957 Treaty of Rome contains specific articles on agriculture. In the subsequent 45 years, the CAP has been constructed on the legal basis of these articles. It (the CAP) is composed mainly of EU regulations which are directly applicable in all member states and bestow legal rights on individuals. In most member states, the CAP is regarded with fondness and even sentimentality as the first “common” policy.

*Any significant changes to UK agricultural policy will involve negotiating changes to the CAP... But it should not be assumed that nothing can be done.*

Prescriptions for agricultural policy reform can lack credibility because they do not deal convincingly with the EU factor. The UK would not be able to opt out of the CAP while retaining EU membership. To do so would have enormous implications. How, for example, could the European Commission act for the EU in world trade discussions if one member state operated a different policy from the others? In reality the only way the CAP could be made not to apply in the UK would be for the UK to leave the EU. That course is not advocated by any major party and is not considered further here.

Any significant changes to UK agricultural policy will, therefore, involve negotiating changes to the CAP. That places distinct limits on what can be achieved, particularly in the short run. On the other hand, it should not be assumed that this means that nothing can be done. Considerable modifications have been made to the CAP over the last decade some of which would have looked unlikely from the perspective of, say, 20 years ago. In part this reflects outside pressure, especially in the WTO. Also, agricultural reform has found progressively more support in the Council of Ministers over the years, though it is still a minority taste.

There is therefore no alternative to trying to negotiate in Brussels. This may be frustrating as the UK is in a reforming minority in the EU. However, long-term forces appear to be operating in the market-friendly direction advocated here. That is also accepted, albeit reluctantly, by most other member states. As Franz Fischler, the EU Commissioner for agriculture, rural development and fisheries, stated in a recent article in the *Financial Times*:<sup>10</sup>

The European Union wants to see a broad-based trade liberalisation round at Doha. We are willing to open up our agricultural markets further, dismantle import tariffs, reduce the trade-distorting elements of our agricultural subsidies and give special treatment to developing countries.

In short, our World Trade Organisation negotiating position demonstrates that we intend to continue to put our own house in order and make concessions to push forward with liberalisation in agricultural trade.

In the past 10 years the EU has carried out two comprehensive agricultural reforms. This time, the EU will not be negotiating with its back to the wall, as it did during the Uruguay Round. Our farmers, as the world's second largest exporters of farm produce, want more liberalised markets for their products.

As Fischler is well aware, this is more liberal than the average view among the member states. But it is realistic.

It is sometimes said that enlargement to the East will also make it easier to negotiate CAP reform. There is something in this. However, while it is true that existing member states will be concerned that applying the existing CAP in the Eastern countries would cost very large sums – many billions of pounds – it is naïve to think that member states will therefore immediately conclude that subsidies must be reduced. Initially, they are more likely to argue for long transition periods before the acceding countries can benefit from the full CAP. In the longer run, however, the potential extra cost will make reform more likely.

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<sup>10</sup> “Farming fairly in Europe”, *Financial Times*, 2 November 2001.



## THE WTO

As already noted, agricultural policies are now subject to WTO rules including the dispute settlement rules. This was a significant development and one of great importance to the main agricultural exporters, notably the US. The US, and other exporters, have ensured that the next trade round will include a substantial agricultural component.

However much they might complain about specific issues, all countries have a major stake in the effective operation of at least some parts of the world trading system – whether their interest lies in industrial products, services, intellectual property or agriculture or, like most large developed countries, in all of them. The outcome of the WTO Doha Conference suggests that further commitments on agriculture are more or less accepted as being inevitable.

*In the medium term, the pressure from the WTO to reduce levels of public support will be irresistible.*

This means that the next round will contain something on agriculture. Given the complexity and difficulty in putting together a wide-ranging package of the kind required, it may take some time. However, in the medium term, the pressure in the WTO to reduce levels of agricultural support will be irresistible.

There is, however, a further dimension to WTO discussions which is not immediately obvious and which could temporarily slow down reform. Advances in the WTO will be made in packages covering several areas so that all countries gain something from the overall outcome. This is in line with the way negotiations are conducted in many international forums – the EU's Council of Ministers would be a good example.

However, this method of proceeding can encourage countries to retain illiberal policies and only give them up in exchange for gains elsewhere. If countries know that everyone will be required to make concessions, there is something to be said for retaining extreme policies just so they can be given up. Otherwise they may be obliged to give up something else which would be even more difficult for them.

This is very much the case within the CAP. Most experts think that export refunds will not be sustainable for very much longer. There is simply too much hostility to them from other countries. However, the EU negotiators will try at the least to “sell” them for real advantages (which may well be outside the agricultural sector).

## THE ENVIRONMENT

Measures which would harm the environment – or that can plausibly be claimed to do so – will not command public support. In other words the attitude of the public in this area is itself a constraint.

The impact of agriculture on the environment can be divided into two:

- the concern about areas of special interest e.g. the Lake District;
- more general concerns about the rural environment, notably as regards appearance and biodiversity.

As for the special areas, the existing ESA scheme has much public support. The pressure is likely to be to retain and expand this scheme or something similar to it. With increasing affluence, such areas are likely to be valued by the public more and more highly, and this should not present undue difficulties.

While the Countryside Stewardship Scheme has much support, other more general schemes that are sometimes put forward are more problematic, not least because some pressure groups are prone to make exaggerated claims about the adverse environmental effects of agriculture. Those concerned sometimes seem oblivious to the fact that many of the features they wish to protect – hedgerows, stone walls and so on – are themselves the products of agricultural practices. Indeed the landscape most of us wish to protect was in effect made by agriculture. They also are vulnerable to accusations of inconsistency: for example, some are opposed to the use of pesticides pointing to the harm that they can do, but make no allowance for the improved controls put in place over the last decade nor for the benefits they also confer. If pesticides were banned world-wide, hundreds of millions would probably starve because of the reduction in plant yields.

The matter is not simple; clearly agricultural practices can and on occasion do cause environmental damage. If so, proportionate measures, including regulation, need to be adopted to deal with the matter. But it is important that unreasonable and disproportionate restrictions are not be placed on agriculture because the downside risks of some superficially appealing proposal were not properly assessed.

*Successive UK governments have been advocating reductions in EU support prices. While politicians understandably do not emphasise the point, this would inevitably lead to a sharp drop in farm incomes in the short term.*

## **POLITICAL LIMITS TO THE SPEED OF CHANGE**

How fast can agricultural policy be reformed?

Immediate reform might be difficult, not least because of the need to negotiate changes in Brussels. But there is evidence suggesting that this might be the case independently of EU considerations.

Successive UK governments have been advocating large reductions in EU support prices for very many years. That is the policy of the present

Government recently confirmed by Margaret Beckett MP, DEFRA Secretary of State in a recent speech:<sup>11</sup>

The UK Government wants to see the end of market distorting subsidies. These have broken the link between the farmer and his customer. Only when farmers are in direct contact with their customers can messages from the market on issues like food quality be translated into production. That is better for consumers and better for farmers.

Though politicians understandably do not emphasise the point, this policy would lead to a sharp drop in farm incomes, at least in the short run. However, to their credit, this has not deterred Ministers from pushing this line in Brussels.

In the last few years, UK farm incomes have fallen. While this has happened largely because of the rise in the value of the pound against the euro, its impact in the UK is identical to the Government's policy of attempting to reduce support prices in Brussels.

Inevitably this reduction in farm incomes has produced political pressure from those affected. The Government's response to this pressure has been to agree a series of support packages, eight since Labour came to power.<sup>12</sup> Most of these packages have been described as a "one-off". Though BSE and foot and mouth disease have no doubt been factors in the decisions to make these payments, notably in changing public sympathies, most of them have been justified by reference to a rural crisis, which appears to be another name for low farm incomes. But as low farm incomes would be an inevitable result of the policies the Government advocates in Brussels, at least in the short run, the Government's claims to support farmers seem, at best, incoherent.

This surely illustrates the difficulty in changing policies suddenly, at least in the UK. The sudden appreciation of sterling in the late 1990s has had many of the same effects on UK farmers as the measures for which the UK has been pressing, though without the desired CAP reform. The main difficulty, however, is that it has produced change very quickly, too quickly for those affected to respond.

If this analysis is correct, then it may not be a wholly bad thing that reforms to the CAP take some time to negotiate. That should not, however, be used as an excuse for procrastination.

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<sup>11</sup> "Whither Agriculture", Speech to CEA Conference, Margaret Beckett, Belfast, 26 September 2001.

<sup>12</sup> Author's estimate.

## CHAPTER FIVE

### **SUGGESTIONS FOR POLICY NOW**

Current agricultural policy is wasteful. The measures in place bear scarcely any relation to the principles which apply to the rest of the economy. The market is distorted, when it should be free. The resource costs of the system are high when they should be negligible. Consumer prices are high where they should be low. And farmers are suffering. The system produces high prices, costs a lot, is vastly bureaucratic and causes disputes with major trading partners.

It is tempting to conclude that a revolution is required. Should the existing system be swept away as happened in New Zealand where most agricultural subsidies were abolished in the mid 1980s? Should we leave the CAP?

*The UK's membership of the EU is inhibiting. But reform is not impossible.*

Extreme remedies would only be possible if the UK renounces its membership of the EU. The CAP, reviled as it is in the UK, is fondly regarded by a substantial proportion of the political class in the EU. Furthermore, its rules are legally enforceable in the courts and cannot be blithely disregarded. Nor is it at all realistic to think that some special arrangement distancing the UK from EU policies on agriculture could be developed. Thus the pace of change is limited by what can be negotiated in the EU.

This is inhibiting, but not beyond hope. For there are also forces operating in the direction of reform, including:

- the pressure for reform exerted by the WTO;
- the cost of the CAP including the extra costs in prospect following enlargement;
- the diminishing size of the EU's agricultural population which reduces its political influence;
- the agreement of some members with the need to move to a more market-based system.

However as next year's mid-term review of Agenda 2000 approaches, an increasing number of farm ministers, including those from Sweden, Denmark and perhaps Germany, seem to be moving in favour of CAP reform. On specific issues, alliances can be formed with other member states.

These voices, which will reinforce the pressures from the WTO, cannot be brushed aside. Reform within the EU is therefore not impossible. In the short term, however, it may well be necessary to accept that further CAP reform will involve extra public expenditure, although only if this were offset by a larger reduction in the resource costs of the system.

The UK should seek to ensure the WTO is supported particularly in the new trade round from where the impetus for significant progress on the CAP is most likely to come. Ministers should argue their case actively without insulting policies others hold in high esteem. They should stress the resource costs of the CAP (which are well-documented by the OECD and the WTO). The long-term trends are with the liberalisers and the CAP's supporters are (gloomily) aware of the fact.

Is there really no fast track forward? The answer depends on the meaning of "fast". There is little chance of an immediate, dramatic change amounting to a discontinuity in policy. But the cumulative effect of small changes can be surprising – like that of compound interest. That, at any rate, is what is in prospect.

## **ENVIRONMENTAL POLICY**

Most agreement on the environmental aspects of agricultural policy is likely to be found in respect of the most fragile and sensitive areas, roughly those covered by ESAs now. Here the present policy needs to be sustained and, probably, developed over time. There is a wide consensus that the unique features of these areas should be preserved and that the ESA policy has been reasonably successful in achieving this. To ensure the scheme remains effective, it might be desirable eventually to make the scheme more attractive to potential participants. This would obviously have a cost though it need not be large. (Most ESAs are in areas of low agricultural productivity so the potential gain from not accepting the limitations of the ESA and acting "anti-environmentally" is small).

The ESA regime will, therefore, need to be developed over time though this is not an immediate priority.

Similarly the Countryside Stewardship scheme, which provides for environmental improvements outside the ESAs, will need to be sustained and developed over time. This, too, will have a cost. Again this need not be great and any extension of the scheme can wait until funds are available.

There is also a place on aesthetic grounds, at least in English conditions, for a limited farm woodland scheme. The Organic Conversion Scheme seems set to continue though this will need to be reconsidered if organic output reaches a level where the premium disappears. In that event the commitment of some producers to the organic system would probably come into question and a thorough reassessment of the justification for, and nature of, government support would be needed.

What cannot be recommended, at any rate for the foreseeable future, is a policy which seeks to replace agricultural policy with one that is essentially environmental. There are three principal reasons for this:

- agriculture is essentially an economic activity though one, like many others, with major environmental effects. As in other economic spheres wealth creation depends on operators having incentives continually to improve performance. In general we should interfere with economic signals as little as possible. This general statement is in no way undermined by the fact that in a few areas (ESAs) environmental issues are now considered paramount. The point can be put differently; in some ESAs, the value of the environmental effects of agricultural practices (returns from tourism) are greater than the value of the food produced. Sensible policies take account of this fact, but it remains an exception of limited agricultural importance.
- the law of diminishing returns applies to environmental matters as to all others. Value for money will be achieved best by concentrating on those areas where there is most to protect and/or gain. The best mechanisms for achieving this are the ESA and Countryside Stewardship schemes (or schemes with similar effects). Over the majority of UK farmland, even spending quite large sums would not in general achieve significant environmental gains.
- there is a danger that in viewing agriculture as primarily an environmental activity the opportunity for reform of the CAP will be lost. At present the CAP is primarily an economic policy which, as we have noted, consumes considerable resources. (The policy also has environmental provisions which are, however, of relatively recent origin and still consume well under 20% of the total expenditure). Supporters of the CAP will be only too ready to use environmental arguments to justify the *status quo*. It is obviously in the UK interest to avoid such an outcome and one means of doing so is to differentiate clearly between economic and environmental policies.

The approach advocated here is, therefore, to seek to reform the CAP in order to reduce the damage it causes. At the same time, environmental objectives for rural areas should be pursued by adopting specific environmental policies. To blend the two would be a mistake unlikely to act to the UK's advantage.

## CHAPTER SIX

### THE LONG TERM

In time, agricultural policy can be expected to move in the direction advocated by this paper. The CAP will become more economically rational and taxpayers, consumers and economically efficient farmers will benefit. With increasing affluence the environment will assume greater political importance and the resources devoted to sustaining the most fragile environments can be expected to increase gradually.

Beyond the medium-term, the future, inevitably, is murkier. The EU is likely to have a stagnant, or even declining, population which given increasing yields would suggest some land presently devoted to agriculture might not be required. On the other hand, a large proportion of the world's population lives well below Western standards but has aspirations to enjoy them. If world consumption – especially of meat – increased significantly, the output from all agricultural land might find a ready market. It is unclear which of these trends will prove stronger.

The above analysis assumes that there will be no shortage of food in the world. (Famines still occur but they are a result of governmental and organisational failure rather than a lack of available food). It is a commonplace that the economic problems of food production have for many years been problems of surplus. The historic worry of the poor even in rich countries – starvation – has effectively disappeared.

However, the human propensity to predict the future on the basis that present trends will continue is often proved to be mistaken. More specifically, discontinuities sometimes occur which radically change prospects. New diseases –

AIDS, BSE – have emerged from time to time which wreak havoc. Yet global agricultural production has continued to grow.

Matters would, however, be very different if a new disease of one of the major cereal crops (rice, wheat, maize) or, worse, all of them suddenly emerged. Then it might not be so easy to feed the world population. No doubt a scientific solution would eventually get on top of this hypothetical new pestilence. But during the time it took to find a solution, the production of food would take on a wholly unfamiliar importance. Depending on the severity of the disease hunger might become a real possibility.

New diseases are not the only threat to food supplies. A change in climate – even a temporary one – could have the same effect. Major volcanic eruptions or collisions with meteorites have occurred before with devastating effects. The chance that one will happen is very small in any given year but eventually a major setback threatening world food supplies will happen. The longer one looks ahead, the more likely it is that some such event will occur.

The precise nature of a threat of the kind described above cannot be predicted. All that can be done is to remain flexible, and to keep open the possibility of the widest possible range of responses. This requires ensuring that food production can be increased if necessary, for example by controlling development, maintaining the genetic diversity of plants and animals, and sustaining top class research.

It is salutary to remind ourselves that though we are most likely to be faced with the problems of how to manage our affairs somewhat better, one day we or our descendants may be faced with the problem of how to get enough to eat. Fortunately the possibility of the latter is small for each generation – but not zero.