Péter Halmai

Common agricultural policy, common budget?

The Common Agricultural Policy (CAP) has proved to be the most expensive policy of the European Union so far. Its necessity was first recorded as early as in 1955 at the Messina Conference. It was clear that the common market meant the common market of agricultural produces, too. The common agricultural market required a common agricultural policy, especially a policy for the common agricultural market: different national policies for the agricultural market could have resulted in a distorted common market.

The contradictions and costs of the established system, especially the common financing thereof have long been roundly criticised. We are going to overview the common financing of the CAP in an unusual way and highlight possible alternatives, too.

ORIGINAL CAP MODEL

The basic rules for the CAP were integrated in the Treaty of Rome in 1957. The central pillar of the system is the common market organisation, which is responsible for the regulation of certain agricultural produces (or groups of produces).

The objectives of the common market organisations are the following:

◗ Single market as far as the trade between the member states is concerned; i.e. free movement of goods and uniform regulation of the conditions of competition (especially institutional prices).

◗ Preferential treatment within the EU aims at the protection of the European producers against cheap agricultural import – until 1995 primarily by levies on the price difference of similar products.

◗ Based on financial solidarity the costs of the common market organisations (intervention in the agricultural markets) are covered through a common financial fund.

It means that the most important feature of the original CAP model was the common financing. Its source is the European Agricultural Guidance and Guarantee Fund (EAGGF).

The EAGGF is split into two sections:

- Guarantee Section, which was originally the instrument of the market and price support and
- Guidance Section, which finances the policy reforming the structure of the agriculture.

The biggest portion of the EU budget (more than 50 per cent) has until recently been allocated to EAGGF. (For the expenditure of the EAGGF, *see Table 1.*)

The expenditure of the Guarantee Section is more or less equal to the export subsidies and

Table 1

EXPENDITURE OF EAGGF

	Total EU budgetary expenditure	EMOGA Guarantee Section expenditure		EMOGA Guidance Section expenditure	
	million ecu/ million euró	total	percentage of the EU budget	Total	percentage of the EU budget
1989	40 918	25 873	63.2	1 352	3.3
1990	44 378	26 454	59.6	1 847	4.2
1991	53 823	31 784	59.1	2 128	4.0
1992	58 857	31 950	54.3	2 939	5.0
1993	65 269	34 748	53.2	3 386	5.2
1994	59 909	32 970	55.0	3 335	5.6
1995	65 498	34 503	52.7	3 609	5.5
1996	80 457	39 108	48.6	3 935	4.9
1997	80 880	41 423	50.0	4 240	5.2
1998	79 245	38 748	49.7	4 367	5.4
1999	79 249	39 541	49.9	5 580	7.0
2000	77 879	40 467	52.0	1 387	1.8
2001	101 051	42 083	41.6	3 509	3.5
2002	95 656	43 214	45.2	2 970	3.1
2003	96 962	44 379	45.7	3 112	3.2
2004	99 724	43 579	43.7	3 660	3.6

Forrás: EU Commission. Directorate-General for Agriculture

intervention expenditure. Since the reform in 1992 the biggest expenditure item of the Guarantee Section has been the direct subsidies provided to farmers.

The Guidance Section facilitates the achievement of the Common Agricultural Policy's goals. Its expenditure has served the implementation of the following objectives:

- improvement of production conditions,
- improvement of the structure of agriculture and the quality of produces,
- improvement of sales conditions and the market sales organisation of agricultural produces.

In the first twelve years the Community budgetary expenditure was financed by direct contributions of the member states. However, from 1970 this was to be covered entirely through Community income. The "own sources" of the Community, i.e. amounts automatically received by the common budget:

❶ Community customs duties;

❷ agricultural duties (and agricultural customs duties replacing them in 1995) and sugar levies;

❸ a pre-defined percentage of the value-added tax base (Gross Domestic Product, GDP);

❹ in 1988 the Delors 1 Package introduced a fourth resource, which is the GNP of the member states, and later a variable balancing source calculated based on the GNI. At the same time the maximum rate of the total own sources was determined compared to the GNI (1.27 per cent until the end of 2006).

Although the budget of the European Union has 'own sources', there are no Community taxes (determined and collected by the EU). The budget is actually an expenditure plan, which may be executed up to the amounts made available regardless whether additional expenditure is necessary or not.

Until the end of the 1970s incomes generated in the framework of the CAP were covered by 20–25 per cent of the EAGGF expenditure. Due to the increase in expenditure and decrease in income this rate fell below 3 per cent by the mid 1990s.

The Common Agricultural policy has long been seriously debated. Such criticism was first formed in the 1970s, and from the beginning of the 1980s (when the open crisis of the CAP began) criticism became fiercer.

The criticism of the original CAP model is summarised as follows.

- The system based on artificially high institutional prices distorted the price mechanisms, and resulted in an artificial growth in production regardless the actual market demand and a continuously increasing structural surplus.
- The channelling of the surplus heavily burdened the common budget; in certain years (for example in the 70s) the CAP expenditure exceeded 80 per cent of the common budget and at the same time such amounts were spent nearly fully on market support, and no sources could be allocated for restructuring.
- There was a significant distortion in the system of allocations: firstly the high agricultural prices resulted in high food prices, which burdened especially those with lower incomes, secondly, the system based on high prices allocated the most of the subsidies to the most productive market players, while producers in need operating in marginal areas received hardly any support.
- The system intensified production, increased the use of chemicals and the concentration of livestock, which resulted in increasing levels of environmental pressure.
- The increasing protectionism of the CAP lead to international conflicts in trade policy and after nearly thirty years the EC had to conduct agricultural trade negotiations in the course of the GATT Uruguay Round.

The adjustments made in the 1980s could not possibly solve the problems of the original model. The increasing internal pressure (coming from the common budget) and the external pressure (exerted by the major players of global commerce) necessitated a fundamental change of the system.

A CHANGING COMMON AGRICULTURAL POLICY

From the early 1990s significant changes have been taking place in the Common Agricultural Policy (CAP). In 1992 a comprehensive reform of the CAP began and in 2000 the second phase of the reform was launched in the framework of the Agenda 2000. In 2003 the third and most recent phase was introduced. A central element of the reform is the decoupling of subsidies from production and sales.[1]

From our point of view the following of the changing priorities are to be highlighted.

- Instead of support that distorts the market (export, intervention subsidies etc.) direct aid provided to the agricultural producers was focused on, which adds up to nearly 80 per cent of the expenditure of the Guarantee Section of the EAGGF (for the changes in the structure of the CAP subsidies, *see Figure 1)*.
- As a result of the reform competitiveness is becoming imperative for the players of the agricultural market due to the decrease in market prices and the decrease in external protection.
- In the Common Agricultural Policy the role of the agri-environment management is becoming more important. The agri-environment management programmes are extended on the one hand, and more stringent agri-environment protection conditions are set for the provision of direct payment on the other hand (the latter is the so-called cross compliance).
- Rural development, the second pillar of the Common Agricultural Policy is becoming more significant.
- The reform phase approved in 2003 (to be implemented in 2005–2007 in the EU15) is a

great step towards the deepening of the reform and the decoupling of direct payment from the actual production.

Since the conditions existing at the establishment of the Common Agricultural Policy have fundamentally changed, reform is inevitable. However, the European agricultural is permanently characterised by multi-functionality. In Europe the role of agriculture is different from that of the overseas industrial countries. In the heavily populated European countries agriculture is responsible not only for production, but also for "the management of the landscape". Maintenance of the cultural landscape, production of environmental resources, contribution to the maintenance of rural communities and the preservation of rural values are major tasks for the agriculture.

In the course of the reform process the requirement of sustainability emerged: the renewing Common Agricultural Policy should be sustainable not only in an agriculture, but in a social sense, too.

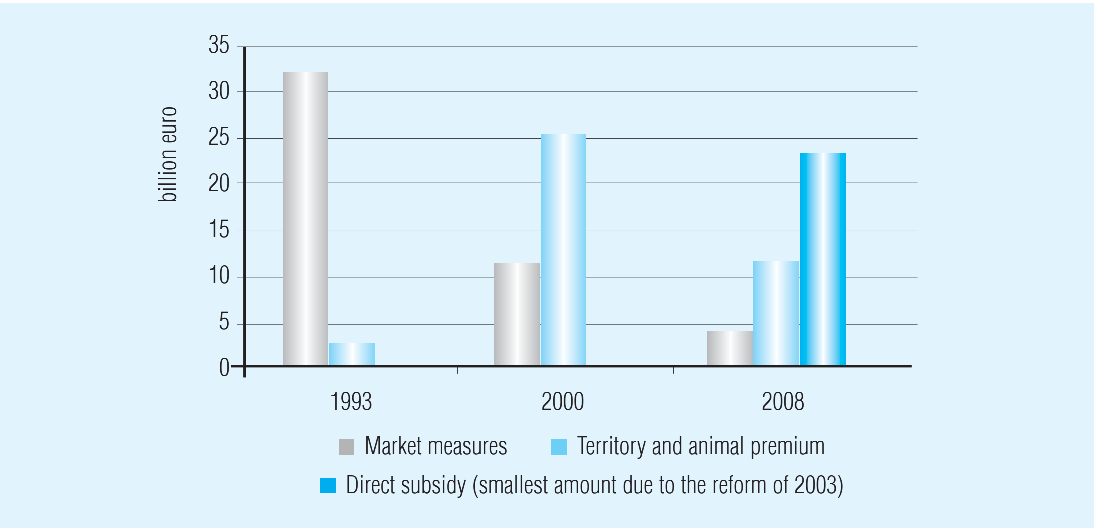
In this transformation rural development plays an important role. In the European Union rural development is an integrated part of the agricultural policy and from 2000 it forms the 'second pillar'. At the same time it goes beyond agriculture. The Salzburg Conference of October 2003 and then the strategy paper of 2005 set three priorities for rural development:

- establishment of a competitive agricultural system, which requires the transformation of the structure of the agriculture (in the EU15 and especially in the new member states);
- protection of the rural environment, with special emphasis on land management, which is to be carried out by the agriculture sector (including forestry and aquaculture);
- enhancement of the economic and social viability of rural communities, which, inter alia, requires the diversification of economic activities and the support of local initiatives.

These priorities well fit in the Lisbon process. For example, the production of biomass (a significant renewable energy source) is an important element of the land management. (The Lisbon Strategy wishes to increase the

Figure 1

CHANGES IN THE STRUCTURE OF THE CAP SUBSIDIES



contribution of renewable energy sources in the field of electricity production as well as motor fuels.)

Criticism, which is often rather abstract, is against the earlier period of the Common Agricultural Policy, therefore it does not take into account these changes. If the Common Agricultural Policy is transformed in accordance with the above, it cannot be set against the Lisbon process. (However, there is a true ground for criticism as far as the frameworks of transformation and the methods of implementation are concerned.)

With regard to the reform of the CAP the following should be highlighted.

◗ As far as decoupling is concerned, which was meant to be pivotal to the reform, progress has been limited; the most recent reform related decision – against the European Commission's more radical recommendation on total decoupling – approved only partial decoupling. (Nonetheless, even this compromised solution is a great step forward compared to the earlier situation; in addition each country may decide to introduce full decoupling.)

◗ The produce market distorting impact of the system on the way to decoupling has significantly weakened, still a great proportion of direct aid may be realised in land prices and land lease fees, i.e. it may distort input markets and the transfer rate of agricultural aid (i.e. the rate of one unit of aid received by the agricultural producer) may change.

◗ Paradoxically, the reformed system is more complex and bureaucratic than the original model. The reform of 2003 promised the simplification of the system; however, the compromised solution (a system of different national implementations including various links) disrupts the existing unity of the system, and endangers the implementation of the unity of the market principle. Furthermore, this could lead to significant redistribution; while the regulation of cross-compliance and the implementation of the rules result in even more complex conditions.

◗ The elements of quantitative regulation may still cause disorder, the compulsory set-aside is still effective and the elimination of the milk quota may be placed on the agenda only after 2013.

◗ Regardless the declarations the role of rural development is still limited.

It has to be noted that in 2004 the CAP system was expanded by ten new member states. As far as support is concerned significant disparities have evolved making the new member states handicapped: while the producers in wealthier member states receive high amount payments falling in the scope of the first pillar fully from the common budget, the poorer countries' share is much smaller. (In 2004 95 per cent of EAGGF aid was allocated to the EU15, out of which only 5 per cent was received by the EU10.)[2]

CAP AND THE COMMON BUDGET

The financing of the CAP costs is rather particular. The common budget plays a decisive role in this field:

- market support and direct payment (the first pillar of the CAP) are fully covered through the common budget in accordance with the principle of solidarity;
- rural development (second pillar) is financed in accordance with the principle of additionality; sources are covered jointly through the common and the national budgets (hereinafter the beneficiaries). (It means that most rural development projects are financed similarly to the structural policy.)[3]

In 2003 expenditure related to the agricultural policy added up to 0.55 per cent of the GDP in the EU15. Most of such expenditure (0.4 per cent of the GDP) was covered by the common budget. National agricultural support

Table 2

EXPENDITURE OF FEDERAL GOVERNMENTS BY CHIEF FUNCTION

(percentage of the total federative expenditure)

	Security	Education	Health	Social Security and welfare	Debt service	Other functions
Australia	7.0	7.6	14.8	35.5	6.1	29.0
Canada	5.6	2.3	1.4	44.6	15.1	31.0
Germany	3.9	0.5	18.9	50.0	7.1	19.5
Switzerland	4.6	2.4	19.6	49.1	3.5	20.7
USA	15.4	1.8	20.5	28.2	12.6	21.5
EU15	0.0	1.0	0.0	0.0	–	99.0

Source: El Agraa (2004)

counts for 0.15 per cent of the GDP. (Only a part of the latter serves the co-financing of the CAP rural development programmes, another part covers national, mostly rural development grants notified by the European Commission.)

National budgets do not finance expenditure falling in the scope of the first pillar. (Except for the 'top-up' (national contribution to the direct aid) temporarily financed in the new member states.) The national budgets support primarily rural development programmes up to a certain limit.

Since agricultural policy expenditure burdens mostly the common budget, the rate of agricultural expenditure is higher. This rate cannot be qualified in itself.

The common budget differs from the national budgets. Its primary function is to promote common and Community policies, activities and objectives, i.e. it is not a miniature of the national budgets for its structure is different. If you compare the expenditure of certain federal states to that of the EU, the difference in the structure of the expenditure is obvious. *(See Table 2)* 99 per cent of the EU common budget expenditure serves different expenditure functions compared to the federal states. The supranational system of agricultural policy in the EU so far has generated a high rate of agricultural expenditure (though this rate is getting lower). As a result the rate of agricultural expenditure is insignificant in the national budgets.

Table 3

GOVERNMENTAL LEVEL EXPENDITURE IN FEDERAL STATES

(as a percentage of GDP)

	GOVERNMENTAL LEVEL			
	Federal	State	Local	Total
Australia	15.7	15.6	1.9	33.2
Canada	13.3	17.0	7.2	37.5
Germany	30.1	8.6	7.4	46.1
Switzerland	9.9	12.3	8.5	30.7
USA	15.9	7.0	7.2	30.1
EU15	1.1	44.7	–	45.8

Source: IMF (2001). European Commission (2000)

Table 3 demonstrates the governmental level expenditure of certain federal states in comparison with similar levels of the European Union. According to the data it is clear that the common budget totalled up to 1.1 per cent of the GDP, while this rate was 44.7 per cent for the national budgets in the EU15 in 2000. (The high rate of CAP expenditure characterises the common budget, while the national budgets, which play a decisive role in the centralisation, finance agricultural expenditure only to insignificant levels.)[4]

The social and economic role of the EU agriculture in the GDP generation and employment is well demonstrated by the rate of agricultural land and forests. This rate exceeds 80 per cent in most EU member states, i.e. most of the land is looked after by the agriculture. *(See Table 4)* In the EU such areas, including forests, are significant cultural landscape. These areas are continuously maintained through economic activity. The maintenance of this landscape, the prevention of erosion, the covering the surface with plants, the elimination of allergenic and other weeds, compliance with various environmental regulations, preservation of the cultural heritage in the rural areas are all positive externalities contributing to the deliverance of public goods.

Thus agriculture provides extra services to the society in addition to the production of produces. Therefore the European agricultural model is typically characterised by multifunctionality.[5]

The fundamental question is firstly how to promote the deliverance of public goods, and secondly to what level financing can be justified.

Table 4

RATE OF AGRICULTURAL TERRITORY AND FORESTS IN THE EU AND IN THE INDIVIDUAL MEMBER STATES

	Agricultural territory (1)	Forest* (2)	Total (1+2)
Austria	40.1	41.6	82.5
Czech Republic	46.1	34.1	80.1
France	54.1	31.6	85.6
Greece	64.0	22.8	86.8
Poland	52.1	30.0	82.1
Hungary	61.8	19.7	81.5
Great Britain	69.9	11.6	81.5
Germany	47.7	30.2	77.9
Italy	50.1	23.3	73.4
Spain	50.0	33.3	83.3
Sweden	7.0	73.5	80.5
Slovakia	39.3	41.6	80.9
Slovenia	24.2	60.1	84.3
EU25	42.4	–	–
EU15	41.9	38.2	81.1
EU10	44.8	–	–

Source: EU Commission. Directorate-General for Agriculture

Note: * data from 2001t

The multifunctional factors result in economic policy action, if there is no private market for certain multiple welfare increasing or decreasing outputs. If there is a need for political action in such cases for the internalisation of externalities, the characteristics of the affected activity will have an impact on planning and the application of the corrective measures.

As a basic principle, agriculture should fulfil the needs of the society not only in quantity, but also as far as composition and quality are concerned. According to certain OECD countries (including the EU member states) the decrease in support linked to production and the liberalisation of the trade will decrease positive joint non-product output of the agriculture that has no market through the reduction of production. In case of the joint production of private and public goods efficiency will require that private goods are produced, used and traded governed by market mechanisms. In addition, for the production of public goods required by the society targeted and separated economic policy measures are necessary. “The eventual goal is to establish principles of good policy practice that permit the achievement of multiple food and non-food objectives in the most cost-effective manner, taking into account the direct and indirect costs of international spillover effects.” [OECD (2001) page 10]

At the same time the definition of economic costs of such agricultural externalities is rather difficult. Such costs may vary depending on the different conditions. It is also difficult to calculate the value of natural goods.[6] Research on preferences related to natural goods may bring interesting results. (Through for example the examination of a hypothetical market, the intention to pay of those questioned for multifunctional services.[7])

Not much is known about the actual value and costs of such public goods. Yet we know that these are not free goods; the positive externalities generated as tied output have additional costs. (Eliminating these would result in less cost.)

According to the fiscal federalism theory [Pelkmans (2000), Baldwin-Wyplosz (2004), El Agraa (2004)] centralised (or Community level in this case) financing may be justified in case of significant, positive and negative cross-border externalities and escalating effects.

Originally the common financing of the CAP facilitated the establishment of the common agricultural market as a positive externality for the member states. At the same time the agricultural production in the EU member states has always had goals going beyond the direct production of produces. These multifunctional elements serve significant cross-border externalities. The condition of the surface has a significant impact on cleanliness of surface water, air, the catchment areas of rivers and the climate. The standard application of animal and plant health and environmental management criteria is a priority in the EU member states. It is a common goal to have the landscape in less developed countries meet the requirements of the European model. This is all considered common European public goods.

In addition to promote this, rural development may open up significant modernisation and restructuring opportunities. At the same time through common financing the effects distorting the internal market and the competition due to the different national support systems may be eliminated.

However, it should be highlighted that the actual amounts of the CAP support was not determined based on a thorough assessment of these function. (The difficulty of the evaluation of agricultural externalities has been noted already.) In the EU the amount of agricultural support is usually based on past amounts, on the old and outmoded 'original model' already discussed. Therefore it is necessary to debate the actual amounts.

COMMON BUDGET UNDER DEBATE

The common budget has been debated for various reasons. The EU member states' problems to adapt to globalisation and the unfavourable trends in their competitiveness would all require a decrease in the redistribution of the budget. (A much higher rate of centralisation compared to the competitors is indicated by the data in *Table 3.*) Note that the high rate of centralisation is not the outcome of the common budget amounting to 1.1 per cent of the GDP.

The mid-term financial plan for the period of 2007–2013 was fiercely debated by the member states.

- While the Delors 1 and 2 packages in the successful period of the integration significantly expanded the sources of the common budget, and further expansion seemed viable, the six biggest net contributors insist on significantly decreasing the rate of the contribution to the common budget.
- The maintenance of the acquis communitaire, including CAP, still requires substantial amounts.
- The beneficiaries of the compromises built in the system (for example the British refund) have been sticking to their position; most of the member states have been focusing on the improvement of their net position rather than the common policies serving the common objectives.
- With the expansion towards the East the demand for cohesion funds suddenly increased; after the temporary measures set in the Agenda 2000, significant and growing sources had to be allocated for such objectives for 2007–2013.
- The Lisbon process and the support of the increase in competitiveness through the budget are inevitable, and as far as the structural actions are concerned together with the cohesion the Lisbon Strategy should be considered and financed.

In their mid-term financial plan the Commission wished to fulfil these demands together. The draft presented on 10 February 2004 had a significantly different structure compared to the former documents:

- In the framework of the sustainable growth (the new 1st chapter) expenditure was appropriated to enhance growth and competitiveness (for goals such as R+D, education, vocational training, support of the internal market and the related policies, employment etc.) and promote economic and social cohesion.
- The 2nd chapter focuses on sustainable management by natural resources and the preservation of natural resources (Common Agricultural Policy, Common Fisheries Policy and environment), i.e. CAP is no longer assigned a separate chapter in the budget, and in line with the reform the future role of this common policy is indicated by this class of expenditure.
- Financing the expansion of the EU to the East, the acquis communitaire achieved so far and the Lisbon process require substantial amounts; however, taking into account the problems noted the European Commission set the expenditure level somewhat lower compared to the average of the last seven years, equalling 1.14 per cent of the GNI and the upper limit for the owns sources was set lower than earlier: this rate is 1.24 per cent of the GNI.
- The rate of certain budgetary items would have changed in accordance with the changing political priorities: The highest growth rate would have been realised in category 1a separated for the improvement of competitiveness. (This amount was to be tripled from 8.8 billion euro in 2006 to 25.8 billion euro for 2013 and so their rate compared to the total expenditure would have increased from 7.3 per cent of the commitments to 16.3 per cent by the end of the period in question.) In 2007 due to the expansion the cohesion expenditure significantly

increases in one step to remain on that level. As far as expenditure related to the preservation of natural resources is concerned the Brussels summit of 2002 froze the expenditure of the first pillar of the CAP (the maximum amount of the market support and direct aid), while the rate of rural development expenditure was meant to be increased. By 2013 the rate of expenditure related to the preservation of natural resources would have decreased from 46.4 per cent to 36.5 per cent.

The Commission's draft of February 2004 evoked fierce debate. The major net contributors were ready to approve only an expenditure item equivalent of 1 per cent of the GDP. However, the Commission emphasised that the 1 per cent level of expenditure is not sufficient for the sustenance of the acquis communitaire and the political priorities for the forthcoming years (such as the Lisbon process and the Eastern expansion).

The Common Agricultural policy is a main target of sharp debate. The upper limit for the expenditure was set in the first pillar (market and direct aid) for approximately the level of the earlier period. Taking into account the newest phase in the reform announced in 2003 as well as the demand to expand to the East, this appropriation – even without a further decrease – would be too tight for the Common Agricultural Policy[8]. Due to the 'budgetary discipline' mechanism built in the most recent reform phase a significant degression is anticipated in the support field.

However, paradoxically the victim of a possible cut down in the budgetary appropriation could have been the rural development. Owing to the October 2002 decision of the Brussels summit the decrease in the expenditure would have affected the expenditure of the second pillar, i.e. rural development.

In the first half of 2005 the Luxembourg Presidency of the EU tried to have the mid-term budgetary appropriation approved. The final proposal of the Presidency was presented before the summit on 16–17 June 2005, in

Table 5

DRAFT MID-TERM FINANCIAL APPROPRIATION
(billion euro)

Budgetary appropriation	2006	2007	2008	2009	2010	2011	2012	2013
1. Sustainable growth (Structural and Cohesion Funds)								
out of which	47.6	59.7	62.8	65.8	68.2	70.7	73.3	76.8
Improving competitiveness	8.8	12.1	14.4	16.7	19.0	21.3	23.5	25.8
Gap-bridging cohesion	38.8	47.6	48.4	49.1	49.3	49.4	50.2	51.0
2. Preservation and management of natural resources	56.0	57.2	57.9	58.1	58.0	57.9	57.8	57.8
out of which								
Common Agricultural Policy	54.3	55.3	55.9	56.1	55.9	55.7	55.9	55.5
out of which								
Market and direct aid	43.7	43.5	43.7	43.4	43.0	42.7	42.5	42.3
Rural development	10.5	11.8	12.2	12.7	12.8	13.0	13.1	13.2
3–5. Other issues	17.1	16.7	18.1	19.2	20.5	21.7	22.8	23.9
Total commitments. appropriation	120.7	133.6	138.7	143.1	146.7	150.2	154.3	158.5
Payment appropriations as a percentage of GNI	1.09	1.15	1.23	1.12	1.08	1.11	1.14	1.15

Note: Draft for 2004 by the European Commision
Source: European Commission

which the commitment appropriations were to be 0.16 per cent of the GNI and the payment appropriations 1 per cent. This was a significant step back compared to the Commission's proposal; competitiveness (1a) and rural development (2b) related expenditure would have decreased.

For the primarily British opposition even this compromised proposal was refused.

The proposal of the British Presidency for the common budget was even tighter. At the Brussels summit in December 2005 a compromised solution between the Luxembourg and the British proposals was reached. (The figures in the Commission's proposal and the Luxembourg and the British proposals and the decision of the Brussels summit are shown in *Table 5*.) All debates focused primarily on the amount of the common budget. Its structure reflect the Commission's proposal. In fact the structure reflects rather the rates to be achieved through the compulsory decrease: compared to the Commission's original proposal there is a substantial reduction in the sources for competitiveness, rural development and external action. Furthermore, cohesion expenditure is substantially curtailed, too. At the same time the European Council invited the European Commission to review the revenues and expenditure in the budget in the report to be published in 2008 or 2009, which may be considered in the next financial perspective.[9]

FOUND MONEY?

The budget related disputes chiefly focused on the Common Agricultural Policy. One might ask whether this substantial amount in the common budget is 'found money'?

The British opinion can hardly be considered consequent: on the one hand in October 2002 Great Britain voted for the decision of the Brussels summit, including the upper limit for the agricultural expenditure in 2007–2013, and on the other hand – in line with the above – in June 2003 they approved the new reform phase of the CAP for the period of 2007–2013. However in spring, 2005 the British refund became a target of debates, through which the United Kingdom is refunded approximately 66 per cent of their total negative net balance.[10]

As a matter of fact Great Britain followed a 'hidden agenda'. In the beginning of June *Margaret Beckett*, Foreign Secretary, preparing for the British Presidency stated the relevant committee of the European Parliament that the major task was to implement the 2003 CAP reform. However, on 15–16 June the British Prime Minister announced that the envisaged decrease in the British refund was acceptable only through a further reform of the CAP, which he did not detail, and a drastic reduction in the CAP expenditure. In the summer of 2005 there was no government paper, which offered alternatives for the decision on the reform of June 2003. At the summit of 2005 the general British criticism on the CAP ignored the CAP reform and was relevant to the agricultural policy of the 1980s.[11]

Nonetheless the possibility of the 'found money' piqued interest throughout the Union. However, one may question whether such criticism was well-grounded and inquire about the intents.[12]

According to the documents reviewed the cancellation of financing the Common Agricultural Policy through the common budget or a radical reduction:

- aims at improving the position of the net contributors rather than a parallel increase in the cohesion expenditure as many would expect in Hungary;
- the thought of decreasing the cohesion expenditure and the common budget arises [for example, *R. Baldwin* says that he common budget could be reduced to 80 per cent of the earlier amounts, Baldwin (2005)];

- agricultural expenditure would decrease (or disappear) only in the common budget to be re-nationalised, i.e. the wealthier nations are ready to spend on their own agricultural producers, and when political solidarity is dismissed the poorer countries have to face new challenges.

At the same time the reasons, the multifunctional nature of the European agriculture and its role in preserving the natural resources, which serve as a basis for the Common Agricultural Policy, are still existing. (And these are fundamental for the national agricultural policies, too.) The production of such public goods require budgetary support – either from the common or the national budgets. No 'free lunch' is possible.

However, from the point of view of economics the level of the CAP support is not appropriately justified for the above mentioned reasons, therefore it should be debated. A deeper examination and economic assessment of the externalities produced by agriculture are the prerequisites of the establishment of a future (either EU or nationally financed) support system and the acceptance thereof by the tax-payers.

POSSIBLE OPTIONS WITHIN THE CAP

Taking all these factors into account the CAP related options closely linked to the future functions of the common budget and a possible changing structure thereof may be reviewed.

❶ According to the first version the CAP will survive. However, around in 2008 a fundamental assessment of and a significant correction to the reform is possible (in the framework of the scheduled mid-term review or the review defined in the mid-term financial plan.[13]

❷ Theoretically the CAP could be completely refused or renationalised when the common policy is replaced by national competences and national financing. In such case the agricultural expenditure of the common budget would diminish to increase the burden on the national budgets. In addition the wealthier countries may provide more generous support to their producers. Stopping the common financing would have an anti-cohesion effect: the rural disparities between countries and regions could greatly increase.

❸ Total liberalisation is possible in theory, when the common policy stops to function, the same would happen to the national policies, too. The implementation of this version would have drastic consequences in regions, where agriculture is less competitive. Most of the cultural landscape would lose its maintainers.

The agricultural policy of the past cannot be continued. It should be noted, however, that the agricultural policy is not a representative of the past. As a maintainer of the European landscape it produces public goods and through further reform it can produce even more. Consequent reform could facilitate a sustainable Common Agricultural Policy, which serves environmental values and competitiveness. At the same time the complete refusal and the renationalisation of the Policy are viable options, too. Nevertheless, the deepening of the European integration is possible through the preservation of the acquis communitaire and the reform process promoting sustainability.

It is also necessary that the common budget should operate as an instrument of the effective implementation of the common policies and objectives. If the member states focus narrowmindedly only on improving their net budgetary position, the common policies would become of secondary importance and the process of the European integration would come to a halt after decades of development or stagnate at the present level.

Notes

[1] This reform process has been analysed by the author in a number of his works. For example: Halmai et al (2002), Halmai (2004) etc.

[2] The new member states supplement the dominantly direct aid among the CAP support facilities from their own national budgets otherwise financed through the common budget in case of the EU15 after 1992. Therefore the rate of the national support is paradoxically higher in case of the poorer new member states compared the wealthier original members. However, according to the Treaty of Accession the rate of financing through the common budget increases from year to year. After 2009 the additional national support of the new member states will gradually decrease and finally stop in 2013. Eventually it has to be noted that the data for the year of 2004 in itself is not sufficient to judge the allocation among the new member states.

[3] The situation is somewhat more complex. Nowadays aid is supplied for rural development programmes from the Guidance Section of the EAGGF (see the Agricultural and Rural Development Operational Programme, ARDOP in Hungary) and the Guarantee Section of the EAGGF (see the National Rural Development Plan, NRDP in Hungary) according to different rules. From 2007 rural development projects will be financed through the European Agricultural Fund for Rural Development (EAFRD), an organisation evolving from the EAGGF, while direct and market aid will be provided by the European Agricultural Guarantee Fund (EAGF).

[4] It is often noted that "too much" is spent on the Common Agricultural Policy from the common budget. In 2003 the CAP expenditure from the common budget was 0.4 per cent of the GDP in the EU15. One may ask the question: what level of agricultural expenditure would not be considered 'too much'? Perhaps 0.2 or 0.3 per cent of the GDP? There is no answer. According to this logic 0 per cent support paid from the common budget would be ideal.

[5] According to Perry et al. the 'natural' biodiversity in Europe is a result of centuries of farming activities, which created and formed the rural areas and the landscape. Additional positive effects of the agriculture include among others the promotion of recreation, the maintenance of catchment areas, protection against storms, flood prevention by the maintenance of the vegetation cover, reducing the carbon-dioxide content of the air with plants and soil etc. (Perry et al. p. 26). Among the positive social externalities, in addition to the otherwise decreasing number of agricultural workplaces, the OECD highlighted the contribution to the local economies and the maintenance of rural communities. OECD (1997)

[6] According to certain authors the present economic calculations significantly underestimate the present and future value of the natural capital. See e.g. Costanza et al. (1997), Daily (1997)

[7] According to the empirical research carried out in 2002 by the Finnish authors, Hanley et al. (1998), Finnish citizens would pay an average of 94 euro per year for multifunctional agricultural services. As it was revealed by the research the citizens intended to pay 189–377 million euro annually, which the authors deem significant compared to the annual agricultural support. Yrjölä–Kola (2004)

[8] It should be emphasised that the other most questioned item of the common budget was the cohesion expenditure.

[9] It is expected that this review may fundamentally affect the common financing of the CAP.

[10] As a result of the refund in the early 2000s the net position of Great Britain was far more favourable than that of the other major contributors. During the reform of the CAP the position of the British producers relatively improved while the refund system remained intact. This burden in borne by the new member states, too. (According to the European Commission in 2004 Hungary was allocated 268.8 million euro from the EU agricultural and structural operations expenditure. At the same time the amount contributed by Hungary was 537.1 million euro, out of which 49.4 million euro was required for financing the British adjustment.) European Commission (2005)

[11] The document containing the comprehensive CAP criticism (A Vision for the Common Agricultural Policy) was completed only in December 2005. See DEFRA (2005). According to the document the goal is the following: "by the second half of the next decade EU agriculture is treated no differently from other sectors of the economy … production-linked support and the Single Farm Payment had effectively disappeared… enabling a very significant reduction in the CAP budget." Defra (2005) 15–16. pp.) This document simply ignores the issue of multifunctionality.

[12] Taking into account the traditional British scepticism towards the integration, it can be doubted

that Great Britain would be capable of promoting a budget serving 'multiple Europes' and at the same time a stronger position of the new member states.

[13] In the long run a drastic cutback on the first pillar expenditure together with partial renationalisation, i.e. the partial renationalisation of the agricultural expenditure may be expected.

Literature

BAIMBRIDGE, M. – WHYMAN, PH. (ed) (2004): Fiscal Federalism and European Economic Integration, *Routledge*

BALDWIN, R. – WYPLOSZ, C. (2004): The Economics of European Integration, *McGraw Hill Education*

BALDWIN, R. (2005): The Real Budget Battle, Une crise peut en cacher une autre, *In: CEPS Policy Brief No. 75/June (http://shop.ceps.be/BookDetail.php?item_id=1237)*

COSTANZA, R. – D'ARGE, R. – GROOT, R. – DE FARBER, S. – CRASSO, M. – HANNON, B. – LIMBURG, K. – NAEEM, S. – O'NEIL, R.V. – PARUELO, J. – RASKIN, R.G. – SUTTON, P. – BELT, M. – VAN DEN (1997): The value of the world's ecosystem services and natural capital, *Nature, p 387*

DAILY, G. (ed) (1997): Nature's Services: Societal Dependence on Natural Ecosystems, *Washington D.C.*

European Commission: Directorate-General for Agriculture – Agricultural Statistics, *http://ec.europa.eu/agriculture/agrista/index_en.htm*

European Commission: Financial Programming and Budget *http://ec.europa.eu/budget/faq/faq_report_budg_impl_en.htm#faq9*

European Commission (2005): Allocation of 2004 EU Expenditure by Member States

EL-AGRAA, A. M. (2004): The European Union, Economics and Policies, (seventh edition) *FT Prentice Hall*

HALMAI, P. (2002): Az Európai Unió agrárrendszere, *(*The Agricultural System of the European Union), *Mezőgazdasági Kiadó*

HALMAI, P. (2004): A reform ökonómiája (The Economics of the Reform), *KJK-KERSZÖV Jogi és Üzleti Kiadó Kft., Budapest*

HANLEY, N. – WHITBY, M. – SIMPSON, I. (1999a): Assessing the success of agri-environmental policy in the UK, *Land Use Policy, p 16*

International Monetary Fund (IMF) (2001): Government Financial Statistics Yearbook, 2001

Island Press DEFRA (2005): A Vision for the Common Agricultural Policy, *(http://www.defra.gov.uk/farm/capreform/pdf/vision-for-cap.pdf)*

IVÁN, G. (2006): Az Európai Unió pénzügyi keretterve 2007–2013-ra – az infúzió bekötve (The European Union's Financial Perspective for the Period 2007–2013 – Infusion Received), *Közgazdasági Szemle, LIII., May, pp. 428–4511*

KENGYEL, Á. (2005): Az Európai Unió 2007–2013 közötti költségvetése és Magyarország érdekei (The Budget of the European Union for the Period 2007–2013 and Hungary's Interests, *Külgazdaság, XLIX., pp. 11–12, 4–36*

OECD (1997): Helsinki Seminar on Environmental Benefits from Agriculture, *OECD/DG(97)110 Paris, OECD)*

OECD (2001): Multifunctionality: Towards an Analytical Framework *(http://www.oecd.org/dataoecd/ 43/31/1894469.pdf) p 10*

PALÁNKAI, T. (2004): Az Európai Integráció Gazdaságtana (Economics of the European Integration), *Aula Kiadó*

PELKMANS, J. (2001): European Integration, Methods and Economic Analysis, (second edition) *FT Prentice Hall*

PERRY, J. – BRETT, C. – GEE, D. – HINE, R. – MASON, CH. – MORISON, J. – RAYMENT, M. – VAN DER BIJL, G. – DOBBS, T. (2001): Policy Challenges and Priorities for Internalizing the Externalities of Modern Agriculture, *Journal of Environmental Planning and Mangement, 44(2)*

YRJÖLÄ, T. – JOLA, J. (2004): Preferences of Consumers in Terms of Multifunctional Agriculture, *University of Helsinki (manuscript)*