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Policy Reform without Administrative Reform: The Case of the Common Agricultural Policy of the EC

Colin Brown

Department of Agriculture, The University of Queensland

In euphoric manner late last year, trade ministers across the globe trumpeted a long awaited Multilateral agreement on agricultural trade and policy reform. In many ways, however, the agreement was merely ratification or affirmation of unilateral reform already in progress. In general, agricultural policy reforms across many developed countries represented a move away from relatively blunt support instruments such as price support towards more targeted forms of support. The move reflected not only the inefficiencies and ineffectiveness of price based support in maintaining agricultural incomes (Brown, 1990), but also some of the emerging megatrends in agriculture (Warley, 1990).

Recent changes in the type of support have typically been associated with much greater administration and control. Much of the extra administration and control may be associated with the more sophisticated policy targets. Although keen to implement the new policy measures, decision makers have found it more difficult cast aside of much of the now largely redundant administration and control associated with the old policy measures. Yet there are sizeable, often overlooked, gains to be made here as well. To illustrate these issues, examination is made of the May 1992 and subsequent reforms to the cereal support regime of the Common Agricultural Policy (CAP) of the then European Community (EC) and now European Union (EU).

Reform of CAP cereal support regime[1]

Of all the problems confronting EC agricultural decision makers at the start of the 1990s, the cereal support regime of the CAP stood out. Efforts at supply and budget control through enhanced production thresholds and co-responsibility levies along with voluntary, poorly conceived early retirement and land set-aside schemes had singularly failed. The use of feed cereals as an intermediate input, especially on-farm or on neighbouring farms, entailed that many of the supply control measures possible for other commodities were not appropriate

[1]Full details of the cereal reforms are set out in Council regulation (EEC) No. 1765/92 while an outline and discussion of them appears in various sources such as Manegold (1993). Apart from the reforms to the cereal support regime, similar changes occurred to the regimes for other arable crops. Protein crops operated on the same principle receiving area payments based on cereal yields with payments 65 ECU/tonne higher. Area payments were initially trialled with oilseeds (Official Journal L356, 24/12/91) with the payments representing the difference between the current EC price and the world market price. The temporary system for oilseeds were incorporated into the common system for arable crops in the 1992 reforms. For ruminant livestock there was an extension of the move towards headage payments and away from price support.

for cereals. Furthermore, because of the livestock-cereal feed interactions, high cereal prices resulted in many of the distortions in the CAP. Transatlantic agricultural subsidy wars typically waged over cereals and the closely related oilseed market. The CAP, and its political and administrative masters, faced a barrage of pressures such as those outlined in Sturgess (1991).

To their credit, EC decision makers sought to attack the problem at its root, namely the high level of cereal price support. Brown (1990) clearly showed just how blunt price support through the CAP was in achieving various EC objectives along with the inequity and ineffectiveness of that support. In a quite remarkable feat of statesmanship, the EC Commission finally coaxed "recalcitrant" agricultural ministers of the member countries to accept a fundamental shift away from price support.

The essence of the cereal reforms was a reduction (35%) in support price levels to be compensated for by direct area payments (Figure 1). The area payments were limited to the average of areas cultivated in 1989, 1990 and 1991 and to a fixed yield representing an average of the three middle yields over the 5 year harvest period, 1986 to 1990. For farms with potential for more than 92 tonnes of program crops, then a percentage, initially 15% on a rotational basis, of their crop base area had to be set-aside. Selected non-program crops could be grown on the set-aside area and, at least in the initial 1992 reforms, set-aside areas were to receive compensation at the level of the direct area payments. Set-aside land originally was to be rotated to prevent setting aside of marginal land. The final proposal, however, allowed for non-rotational set-aside at a higher percentage.

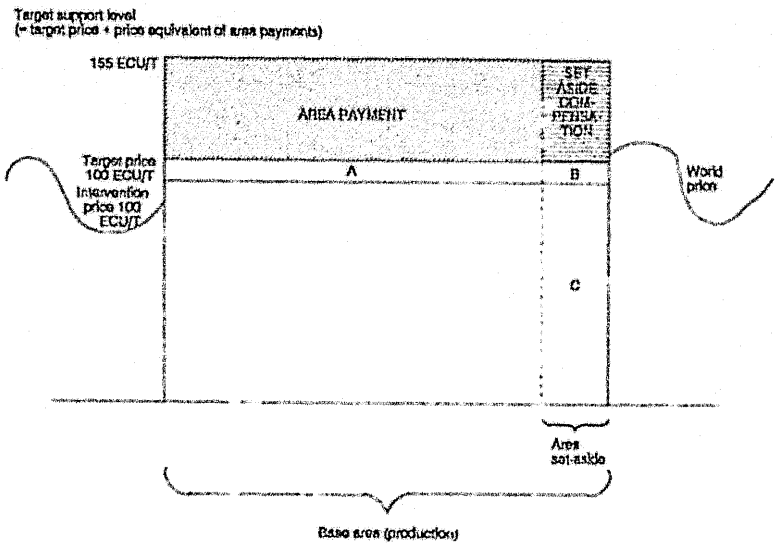

Figure 1 CAP Cereal Support Regime Following 1992 Reforms

Source: Brown (1993)

Extra administration associated with the new support regime

Getting prices right and removing some of the distortions associated with high price support was not achieved without some trade-offs. Decision makers incurred a political cost in that the true costs of support shifted from the more obscure consumer opportunity costs to the more readily observable taxpayer payments. More importantly, the switch to area payments for cereals was accompanied by substantive extra administration and control. Farms had to be registered to receive area payments, with each producer submitting annual applications outlining areas to be sown and areas to be set-aside. Set-aside land must be fallowed for a minimum of 7 months (15 December to 15 August) while conditions apply regarding the minimum size and shape of land set-aside.

Control measures for area based payments in the EU are problematic. Although technically possible, extensive control measures such as satellite imagery and aerial photography face considerable practical problems in the EU (Platou, 1992). In essence, aerial photography, as used in US control schemes for their cereal support, can be severely affected by the overcast weather likely to occur at least in some parts of the EU during the control periods. Satellite imagery is restricted by the satellite paths in the perious when the fields are to be monitored. The small and often highly fragmented nature of EU farms heightens these problems. Consequently, most control schemes to date have relied on intensive, on-the ground, inspection. Large databases have been developed to facilitate the control system and effect the schemes. Apart from adding an extra administrative tier, set-aside arrangements have more fundamental effects on the control procedure as they almost inevitably require full field control to prevent abuse as location also has to be reconciled rather than just production.

The intensive control measures needed involve substantial costs. Thompson (cited in Anon, 1992) suggested a control cost of around 2 billion ECU based on US experience of a cost of control of around $US 1000 per farm. Various reasons, however, make Thompson's estimates a lower bound and suggest substantially higher administrative and control costs in the EU. These include the long history of deficiency payments and set-asides in the US, its more advanced and well developed administrative channels, and its more homogeneous agriculture.

One of the key aspects about the cereal reforms was that the new support instruments (area payments, set-aside) were an adjunct and not a replacement for the existing instruments (price support). That is, the reforms involved a change in the level of price support and not the removal of the price support itself. This is a key point with respect to the costs of administration as an extensive infrastructure maintains the wedge between internal EU prices and world market prices. Export restitutions could, in principal, support the higher internal prices. However, a multitude of institutional prices are employed. To prevent disruption of CAP support regimes by external imports various threshold prices and variable import levies have been implemented. Intervention buying and associated prices were introduced to set a floor under market prices. However, depending on particular policy parameters including the level of stocks, both the intervention price and the export restitution have guided internal EU prices at different times and in different markets. Indeed,

intervention buying has increasingly been used as a market management tool rather than a safety-net mechanism. Consequently, both the intervention prices and the prices implied by the export restitutions are collectively referred to here as support prices. The reliance on a range of administrative measures partly is historical and partly reflects the heterogeneity of EU agriculture. In this paper, it is suggested that the evolution of a range of instruments is also partly the result of interplay between EU decision making and administrative control.

Although intervention buying and export restitution are conceptually simple, practical implementation in the EU is demanding. Ongoing, detailed management of these schemes is required given the dynamics of EU and world agricultural markets. Product differentiation that characterises agricultural markets complicates support regimes. Special problems arise for the EU in that while management parameters are set at the supranational Commission level, most of the actual administration or control occurs at the national, member country, level. The agrimonetary arrangements further add to the administration.

To sustain high levels of price support within the CAP, various supply and budget management measures were introduced especially during the 1980s to limit production receiving support and thereby the costs of that support. Included among these were quotas, production thresholds and co-responsibility levies all of which involved their own substantive administrative structure. Despite the trend away from product market support and a move towards input control, there is little evidence of a removal of this extra administrative apparatus.

Substantial direct costs are incurred in setting the various institutional prices and in managing and controlling the support regimes; costs shared by the EU, national administrations, producers and traders. When combined with substantial additional administration associated with the new support regimes, a veritable army of lawyers and other officials are needed to effect the schemes and substantial transaction costs are incurred. Determining the magnitude of these costs is extremely difficult, however, as many different agencies administer the schemes or conduct the control, while the activities of the officers involved are not solely confined to EU matters. Anecdotal evidence, nonetheless, suggests that substantial resources are involved. Haure (1993), claiming to cite an internal Ministerial paper, stated that the number of officials involved in administering agricultural support in Denmark was roughly equivalent to the number of full time farms (around 30000). Although unsubstantiated, the report reflected widespread concerns both within the farm community and the rest of society over the growth in administration associated with agricultural support. In the Danish Ministry of Agriculture, administration of various agricultural policies, especially the CAP, has increased the proportion of staff involved in control to 43% (Landbrugsministeriet, 1992). The latest CAP reforms will increase markedly both the absolute number and share of officials involved in administration and control.

Avoiding the need to administer export restitution, intervention buying and related measures frees up substantial resources for national administrations and involves considerable cost savings. Although some of the costs such as salaries are simply transfer payments, administering unnecessary CAP regulations is hardly an efficient or productive use of these often highly skilled resources. The CAP reforms risk tying up a large

proportion of the activities of agricultural ministries in the various member states. Tying-up of resources is not limited to the official sector. In Denmark, for instance, much of the time of agricultural consultants attached to the farm unions has been devoted to assisting farmers complete forms associated with the new support measures. Although less tangible, the indirect cost of the diversion of consultants' time away from technical advice to completing regulatory forms may be substantial in the longer term.

Although the direct costs of administering CAP support regimes are substantive if not directly observable, no less significant are the indirect costs of such schemes. Indirect costs arise through difficulties in program management such as over-generous refunds. For instance, difficulties in day-to-day management entail that export restitution in excess of that needed to effect the transaction are often granted. Complex regimes combined with substantial transfers are also conducive to system abuse. Such abuse may involve outright fraud but it may also be legal misuse of loosely defined regulations or be the result of imperfect information given the complex rules. Combating the abuse requires a large control system and legal infrastructure to support the control. Various Court of Auditor's reports also allude to the substantial indirect costs. The Court of Auditor's report on export subsidies in 1990 (Official EC Journal No. C133; 1991), in particular, reports a plethora of system abuses, over-generous refunds, a physical control rate well below the legislated 5% level, and lax audit and follow-up procedures.

Abuse of support regimes, therefore, was a well established and widely known part of the pre-1992 CAP. However, elements of the new support regimes such as headage and area payments are particularly susceptible to abuse. Headage payments for livestock have foreshadowed some of the difficulties in implementing such schemes on an EU-wide basis and the potential control problems (see Official EU Journal C330; 1992) as have the earlier set-aside schemes and area payments for oilseeds. In an effort to fend off an escalation of fraudulent misuse of the support regimes, an integrated agricultural control system (IACS) was established (Council Regulation (EEC) No. 3887/92). The system which involved the establishment of large computerised databases draws on information from on-site and remote sensing sources. Severe penalties are proposed for observed irregularities (Manegold, 1993). Despite the more sophisticated, more co-ordinated and tougher approach to combat fraudulent practices, it is far from clear that the system can cope with the new support regimes.

New pressures on the CAP

Fundamental changes implied in the 1992 reforms did relieve some of the pressures raised by Sturgess (1991), Brown (1990) and others, especially the various commodity market distortions related to high price support. At the same time, however, it introduced a range of new pressures on the CAP which, unless addressed, are likely to make the new support regimes unsustainable.

A key remaining pressure is the level of administration and control associated with the reformed CAP. The substantial extra administration undoubtedly places further strains on the CAP. At an institutional level, tensions are heightened between the Court of Auditors and the Commission, between the Commission and

national administrations, between the various national administrations (northern versus southern member countries with their different control measures and compliance) and between farmers and the various administrators. All such tensions heighten potential abuse and limit effectiveness of the measures. Hence, while the costs of the administrative measures are diffuse and partially obscure, the absolute magnitude of the resources involved means that pressure will arise for a rationalisation of the administrative burden over time. This was clearly evident in the 1993 Farm Council meetings when various member countries sought changes to the new support regime on administrative grounds, namely to have support schemes that were administratively feasible.

Although administration costs and problems, especially fraud, have always been an issue they have now been elevated to even more prominence. The debate over administration was brought to the notice of the general public by a broad spectrum of the media and certainly a broader group than for most CAP issues. For instance, the article by Haure (1993) was published in one of the major Danish daily newspapers. It sparked ongoing debate in the print, radio and TV media over a series of weeks.

Another related though different pressure is that the incidence of the administration burden has changed or at least been extended. Whereas previously the administrative burden of price support measures fell on national and EC administrations and on traders, the area payment and set-aside arrangements have brought CAP administration inside the farm gate. Many farmers were confused as to their administrative responsibilities under the new arrangements in the first year of its operation and risked exclusion from the area payments. Although these problems may be one-off, the reforms involve an ongoing, substantial effort by farmers and their advisers to administrative matters.

One of the most contentious parts of the 1992 reforms for farmers were the arrangements and requirements for the setting aside of land. Setting aside of land added to the administrative burden on farmers as indicated in the previous section. Farmers main concerns, however, centred on the effects of the set-aside arrangements on their farm management. That is, uncertainty about immediate or future set-aside requirements hampers farmers from making better input allocation and investment decisions and prevents them from responding efficiently to changing market conditions. The set-aside provisions created various technical and management problems associated with leaving land set-aside such as weed management on the areas set-aside, and they created harmonisation problems with other EC and national legislation such as that related to manure production and land availability and usage.

Furthermore, the heterogeneity of EU agriculture entails particular difficulties with the set-aside arrangements as well as the other administrative and control measures. Common rules imposed on heterogeneous agricultural resources and structures inevitably result in inequities. For instance, the set-aside provisions exert markedly differing imparts across individual farms. Attempting to make these schemes more equitable, such as basing area payments and set-aside requirements on individual land quality, poses seemingly intractable administrative and control problems. The insidious, albeit unintended, heterogeneous impacts of the regulations impose a policy cost that must be borne when implementing the administrative measures. In

the evolving policy environment, EU decision makers are having to trade off greater targeting with administrative tractability.

Problems associated with the set-aside arrangements were clearly apparent shortly after their implementation and in the 1993 Farm Council meetings. Allowance or provision was made for the setting aside of land on a permanent basis albeit at a higher rate. Once again, despite the greatly divergent land quality and farm structures, administrative feasibility meant that uniform EC-wide set-aside rates were implemented implying different impacts on individual farms.[2] The Commission, on prompting from the Council, established various committees and engaged in various studies to examine the impact and implementation of the set-aside arrangements. For EU decision makers, the dilemma is that adjustments to the arrangements to limit resource inefficiency, program inequity or environmental scheme compatibility all increase the "slippage" element of the set-aside arrangements and their ability to lower EU cereal production. The further, almost inevitable, adjustments to the arrangements are likely to result in a notional set-aside rate which is too high to sustain.

Although CAP reforms arose to address various internal problems, they were also indirectly linked to bilateral and multilateral trade developments especially the desire by EC decision makers to avoid ongoing and damaging agricultural trade disputes with the US. Much of the debate in the EC in the first half of 1993 on agricultural matters was concerned with whether the 1992 CAP reforms were compatible with the so-called Blair House Accord on agricultural policy reform agreed to in principle by the EC and US in November 1992. While choices of base years and especially the exemption of area and headage payments from an aggregate measure of support meant that the 1992 reforms were compatible with the Blair House Accord in many areas, there were some notable areas in which it was not. These included minimum access arrangements for some commodities (eggs, skim milk) and the volume of subsidised exports. The latter was of particular concern as a rise in EC exports in the early 1990s meant that an unmodified Blair House Accord would have meant reductions in actual exports of around 40% for wheat, meat product and cheese exports. Furthermore, in the first year alone meat exports would have had to be cut by one quarter and wheat and cheese exports by around one fifth (Landbrugsraadet, 1992). This explains the very real concerns of the French over and above any general obstinance in concluding a trade deal as well as the changes to the Blair House Accord in the final GATT agreement.

The ability of the EU to deliver the substantial reductions needed in subsidised exports or to markedly improve import access, however, depends on developments beyond immediate control of EU decision makers. Productivity rises, consumption increases and factor usage are all uncertain in the new policy environment as are world market developments. EU decision makers and market analysts simply do not know or do not have the information to tell them how EU farmers will respond to the area payments and set-aside arrangements. It

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[2] A lower rate of 18% was applied to nitrate sensitive areas with environmental controls in place or to countries which had more than 13 % of their arable areas specified to be set aside. However as the lower rate applied only to countries just having ratified the Maastricht Treaty (Denmark) or in the process of ratifying it (United Kingdom), then its basis was more political than technical or economic.

has taken almost two decades for American agricultural economists to begin to understand how US farmers respond to land set-asides. Thus, in the absence of complete knowledge about farm and EU market response, international pressure on the CAP may continue despite the recent reforms. Although the final Uruguay Round agreement may ease some of the more immediate problems in meeting the agreement, the longer term pressures remain.

Are the remaining pressures unavoidable?

No! Many of the pressures outlined in the previous section could be relieved without changing the broad thrust of the policy regime or the overall levels of support. Once again it is the price support that is at the core of the problem. Unlike the pre-1992 CAP where the problem was the high levels of price support and associated commodity market distortions, the current problems stem from the existence of the price support infrastructure alone even when levels of price support are low.

To establish that it is the price support infrastructure that is the core of the problem, consider the implications of removal of that price support. First, its removal would save on all the direct administration costs associated with the price support. Second, the sizeable indirect costs alluded to previously in terms of program management, program abuse etc. could also be avoided. Third, removal of the price support would entail no subsidised cereal exports and so avoid problems in complying with international commitments and the need to rely on unknown technical and behavioural parameters in meeting these commitments. Fourth, with no cereal price support, intensive livestock product exports (pigs, poultry) would also no longer be subsidised. As indicated in the previous section, recent bilateral and multilateral commitments would impact greatly on subsidised exports of intensive livestock products. Removing the need to artificially cut back exports would be of major benefit to some of the more efficient agricultural sectors of the EU. Fifth, by ensuring no subsidised cereal exports removes the need to have in place the contentious, inefficient and inequitable land set-asides.

Not all the remaining pressures on the CAP would be relieved by a removal of cereal price support. In particular, sectors such as beef and horticultural products would require further policy adjustments. Nevertheless, a removal of the price support could remove the key pressures related to land set-asides and the level of administration.

Critical in an analysis of any such policy move is estimation of the remaining market price support implicit in the CAP cereal regime following the 1992 reforms. Brown (1993) estimated that support prices in the CAP following full implementation of the 1992 reforms entailed, on average, negligible market price support for wheat and 4.5 ECU/tonne for coarse grain. A modest level of remaining price support is consistent with the findings of other studies such as those cited in Ando (1993). Despite the modest average levels of support, considerable variation in market price support was estimated across years, and world prices may well exceed the new support prices in particular years. This is an interesting issue as it suggests that without policy adjustments, EU producers could well be overcompensated, relative to the target support level,

by area payments in years of high world prices. A move to full area payments would avoid this potential overcompensation.

Removing the price support could be achieved in a number of ways including various inframarginal support schemes such as Producer Entitlement Guarantees (Blandford *et al.*, 1989). Examination was made of an alternative support measure which involved no price support and yet which maintained the same level of support as well as the basic thrust of the support. Essentially, the remaining price support was replaced by extending the area payments to include the remaining difference between the support price and the world price. Thus, the current fixed area payments are replaced by full area payments representing the whole of the difference between the target support level and the world price. Other conditions relating to the area payments, such as program areas and yields, remain the same under both schemes.

Because of the modest remaining price support, welfare effects of removing that support are relatively small for producers and consumers and involve a modest improvement in traditionally measured net social welfare. One key area of concern to EU decision makers of any proposed policy measure is changes to agricultural support expenditure. Such expenditure has always been of concern to the Commission and decision makers due to the high proportion of total expenditure devoted to agricultural support and due to the supra-national, own resource nature of the EU budget. Extending the area payments to compensate for any reduction in price support increases budget expenditures on area payments by only 5% or around 400 million ECU. Net budget effects are even lower as savings are made in cereal and livestock export restitution. The net budget effects are negligible because of the modest remaining price support and because any producer over-compensation is avoided. Although the average budget effect is neutral, payments may vary substantially from year to year. Brown (1993) estimates payment variations in the order of 6 billion ECU. Consequently, implementing full area payments requires EU budget arrangements which allow for variable payments across years.

Why retain the redundant regulation?

For the Commission, a move to full are payments would not represent a radical shift as they have previously indicated their desire to move cereal prices more in line with world prices. (The initial Commission reform proposals in 1991 called for intervention prices 10 ECU/tonne lower than those finally agreed upon.) However, while wearing much of the political cost of removing the price support, the Commission failed to capitalise on a major benefit of removing price support, namely the discarding of administrative infrastructure used to drive a wedge between internal EU and world prices. What possible reasons are there then for the Commission not seeking to capitalise on this major potential benefit of a move away from price support?

One reason would appear to be that the Commission has relied heavily on administrative measures in the past to manage agricultural markets. For instance, the Commission effectively bypassed the inaction of the EC Farm Council in reforming price policy by implementing tighter intervention measures and the like.

However, is assigning a defacto policy role to an unrepresentative and bureaucratic Commission a first best solution and is it better tackled by improving decision making institutions within the EU?

High levels of administration and complex support regimes often blur the distinction between management and policy and this has certainly been the case in the EU. Simpler regimes enable more precise limits on Commission action. Furthermore, they are of benefit to the Commission themselves in being able to operate more effectively within the parameters defined by EU decision makers.

Past administrative measures along with the new control schemes confer power not only on the Commission but also on national administrations and even some farm organisations. Weaning EU and national bureaucracies and related organisations off administrative controls may prove more difficult than weaning producers off high price support. Administrative mechanisms both in the EU and elsewhere in the past have become quickly capitalised into support regimes making their removal that much more difficult. Thus, new measures such as land set-asides may soon join the previous, supply management measures such as commodity quotas as an inseparable part of the EU agricultural support landscape.

Greater exposure to changing market conditions demands an institutional environment for producers enabling and encouraging flexibility in their production decisions to meet the changing conditions. However, at least in the case of the EU where relative producer support has fallen from the unconditional price support of the 1970s, administration and controls on production have increased. Added administration may be the result of more sophisticated policy targets. But the discussion in this paper suggests otherwise, the extra administration and control being largely unnecessary. Future analysis of agricultural policies must not only focus on levels of support but also on the efficiency of the mix of instruments used to achieve that support.

Concluding remarks

Although the case focussed on in the paper is specific to the EU, similar developments have occurred elsewhere in the world. Excess, complex administrative support schemes are not unique to the EU, and the US, for instance, has operated a labyrinth of supply management, import controls and export enhancements which, at best, have achieved only mixed outcomes in meeting their desired goals (Hillman, 1992). Various commodity market or political market failures call for intervention. Such intervention, however, needs to be conducted in the most efficient manner and in a way which allows those affected to be able to adjust to changing commodity and political market conditions. Current levels and forms of intervention in many countries seem not to meet these criteria.

There are various reasons why administrative costs may be overlooked in policy analysis, policy debate and decision making. From an economic analysis perspective, such costs are often ignored in conventional welfare analysis when considering policy alternatives. For decision makers, administrative costs are often absorbed within the overall bureaucratic infrastructure and difficult to identify at the individual policy level. Nevertheless, administration and control associated with agricultural support can involve significant real costs and tie up considerable resources and needs to be examined and considered more closely.

Global agricultural policy reform in recent times have rightly considered the "big picture" of reducing overall levels of support and in achieving more targeted support. Certainly there have been considerable bene from this course of action. But there are also large potential gains from examining nether the same policy objectives and policy thrust can be achieved more effectively.

Recent trends have been for a move away from blunt commodity market support to achieve vague agricultural fundamentalism objectives to more sophisticated policy targets to address environmental, food safety and regional concerns. Such policy changes can involve substantially greater administration and there is a real danger of too many controls and too much administration. As in other economic analysis, the benefits of greater administration must be carefully weighed against its costs.

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