The EU agricultural policy and developing countries: lessons from the past and future directions. *

Vanessa Constant LaForce
Dundee Business School, University of Abertay Dundee, Scotland, United Kingdom.
Email: v.constantlaforce@abertay.ac.uk

Abstract

There are inherent tensions and contradictions between the highly protectionist approach of the EU's Common Agricultural Policy (CAP) and the EU's stated intention behind its relationship with developing countries (DCs). This has been exacerbated since the coming into force of the World Trade Organisation (WTO) Agreement on Agriculture, in 1994, by which the EU is bound. This conflict has been at the forefront of the debate since the establishment of the CAP in the 1960s focusing on increasing domestic agricultural production, through direct support to farmers, and through intervention. Since 1994, the EU's CAP has had to be restructured to meet WTO legal requirements on domestic support measures. Domestic subsidies still form a large part of the post 2003 mid-term review approach to agriculture that is still creating distortions in world trade agricultural commodity markets. This affects in particular DCs' market access to the EU for agricultural food products. The CAP "Health Check" agreed in 2008, aimed at simplifying and modernising the CAP, provides for further market orientation improvements. This paper analyses, from a legal perspective, the extent to which the current market support instruments and direct aid system under both of the CAP's pillars, alter trade distortions in agricultural commodities. The analysis will demonstrate the consequences for DCs' access to the EU market.

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I- Introduction

The Common Agricultural Policy (CAP)[1] is the most important policy of the European Union (EU) in terms of budgetary expenditure. It represents around 42.5% of the EU annual budget.[2] Since the establishment of the CAP in the early 1960s, EU governments have always sought to protect their agricultural markets, mainly through intervention prices and direct support to farmers, protecting them from competing directly with farmers of other countries. This was in line with the objective of the CAP to increase productivity by providing subsidies and systems guaranteeing high prices to farmers. Since then, the EU has been classified as one of the top "users" of domestic farm support policies[3] which are a "source of market and trade distortions."[4] This was affecting in particular the DCs' market access to the EU for agricultural products.

The mechanisms of domestic support, market prices and farmers' incomes, are falling under the so-called "first pillar" of the CAP, which is funded by the European Agricultural Guarantee Fund (EAGF). They have helped change the EU trade profile "from a net importer of agricultural produce into a major net exporter."[5] It is clear that this practice is in contradiction with the EU's stated intention in its relationship with developing countries (DCs).[6] Since the accession of the EU to the WTO in 1994, the operation of the EU's CAP has had to be further restructured to meet WTO legal requirements on domestic support measures. The "*Mac Sharry*" reforms, made in 1992, reduced the market support prices and created instead a system of direct payments. Further reforms in 2000 led to the allowance of direct payments to farmers in order to compensate them for the losses of income arising from new price support cuts. As a result of these reforms, the CAP has also been redesigned into a two pillar

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[1] The CAP is regulated by Articles 38 to 44 (ex Articles 32 to 38) of the Treaty on the Functioning of the European Union (TFEU). OJ C 83 of 30.3.2010

[2] European Commission, "The European Union budget at a glance", Luxembourg, June 2010

[3] Stout, J., Leetmaa, S. and Normile, M. A., "Evaluating EU Agricultural Policy Reform Using the EU WTO Model", Economic Research Service, USDA: Washington, DC, 2002. p.1

[4] Young, E., et al., "Domestic Support and the WTO: Comparison of Support Among OECD Countries", Economic Research Service, USDA: Washington, DC, 2002. p.1

[5] This includes cereals, sugar, dairy products and beef. See Roberts, I. and Gunning-Trant, C., "The European Union's Common Agricultural Policy, a stocktake of reforms", ABARE research report 07.13, Australia, 2007. p. 1

[6] Pursuant to Article 3 TEU post-Lisbon, the EU must, as part of its external relations, contribute to "free and fair trade" and the "eradication of poverty." OJ C 83 of 30.3.2010

structure in order to contribute to a "new European Regional Policy."[7] Payments made towards agriculture under the first pillar of the CAP were decreased and transferred to the rural development policy pillar. This "second pillar" of the CAP is funded by the European Agricultural Fund for Rural Development (EAFRD).[8]

However, the most radical reforms in the EU agricultural area, took place in 2003 during the Mid-Term Review of the CAP. The so-called "*Fischler*" reforms implemented the decoupled Single Payment Scheme or Single Farm Payment, which is an income support for farmers replacing the previous compensation payments.[9] Farmers now receive the same payment of aid, but which is now independent from the type and volume of the production. The EU is still guaranteeing these payments for its farmers as they are considered to be less distorting than market price support. They are no longer linked to production and are classified within the WTO "green box" of measures, as having "no, or at most minimal, trade-distorting effects or effects on production."[10]

However, coupled domestic subsidies still formed a large part of the post 2003 mid-term review approach to agriculture. The EU "green box" did not contain all direct payments because EU Member States (MS) could decide to retain a degree of coupling in a number of sectors.[11] Some supports were not fully decoupled and MS could continue to make direct payments linked to production. It was thus believed that the above changes did not really reduce market distortions as only minor changes had been introduced.[12] Consequently, the export of agricultural food products to the EU was still posing problems for DCs. In 2007, the European Commission has thus proposed to review the implementation of the 2003 reforms. The CAP "Health

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[7] O'Neill, M., "The winds of change blow again: the World Trade Organization's impact on the European Community's Common Agricultural Policy", *Liverpool L. R.*, vol. 24 (3), 2002, pp. 181-208, p. 186

[8] The two pillars of the CAP are governed by one regulation: Council Regulation (EC) 1290/2005 of 21 June 2005 on the financing of the common agricultural policy OJ L 209/1, 11.08.2005.

[9] Council Regulation (EC) No 1782/2003 of 29 September 2003 establishing common rules for direct support schemes under the common agricultural policy and establishing certain support schemes for farmers and amending Regulations (EEC) No 2019/93, (EC) No 1452/2001, (EC) No 1453/2001, (EC) No 1454/2001, (EC) No 1868/94, (EC) No 1251/1999, (EC) No 1254/1999. OJ L 270, 21.10.2003

[10] Annexe 2 of the WTO Agreement on Agriculture.

[11] Regulation (EC) No 2237/2003 laying down detailed rules for the application of certain support schemes provided for in Title IV of Council Regulation (EC) No 1782/2003. OJ l 339, 24.12.2003.

[12] Rude, J., "Production Effects of the European Union's Single Farm Payment", *Canadian Journal of Agricultural Economics*, 2008, vol. 56 (4), pp. 457-471, p. 458

Check" was agreed in November 2008. It aimed at simplifying and modernising the CAP and provided for further market orientation improvements. EU spending on agricultural support measures has been fixed until 2013. The CAP is thus due to be reformed again soon. The Commission published in 2010 its proposals with regard to a further simple framework for the CAP after 2013.[13] The legislative proposals will be published in mid-2011.

Against this background, this paper proposes to examine from a legal perspective, the extent to which the current market support instruments and direct aid system under both of the CAP's pillars alter trade distortions in agricultural commodities. There is a need for a timely examination of this area, given the context of the current Doha Development Round trade negotiations pursued under the Doha Development Agenda.[14] The negotiations which started under Article 20 of the WTO Uruguay Round Agreement on Agriculture have still not been concluded. The negotiations are due to be completed by 2012. The analysis will highlight the consequences for DCs' access to the EU market.

II- <u>From the 'MacSharry' to the 'Fischler' Reforms</u>

The CAP has undergone three main reforms since 1992. The 1992 MacSharry reforms were the first major reforms to the CAP under which farm support was transferred from the product to the producer. Support prices, as the then main instrument of the CAP, were substantially reduced for crop and livestock production in order to make agricultural products "more competitive both within the community and on world markets."[15] Intervention prices were reduced in cereal by 29%, and by 15% over three years, in the beef sector.[16] In compensation for these prices cuts, farmers received direct income payments. The reform of the CAP in 1992 was considered at that time

[13] European Commission, "The CAP towards 2020: Meeting the food, natural resources and territorial challenges of the future", Brussels, 18.11.2010, COM(2010) 672 final.
[14] WTO, "Ministerial Declaration adopted on 14 November 2001", Doha, 09-14 November 2001, WT/MIN(01)/DEC/1, 20 November 2001
[15] Baltas, N. C., "The restructured CAP and the periphery of the EU", *Food Policy*, vol. 22(4), 1997, pp.329-343, p.333
[16] O'Neill, M., "The winds of change blow again: the World Trade Organization's impact on the European Community's Common Agricultural Policy", *Liverpool L. R.*, vol. 24 (3), 2002, pp. 181-208, p. 191

as being “the most significant development in the field of agriculture,”[17] mainly because of the changes that appeared in relation to farm financial support.

The above reforms were strengthened by the 1999 reforms, which were made pursuant to the Agenda 2000 programme, with additional price support cuts and an increase of direct payments to farmers affected by the cuts. The reforms also implemented the idea of a ‘second’ CAP pillar, introducing a new policy for rural development, which changed the scope of the CAP. Under this pillar, agricultural production was to receive less support in order to promote the “European Farm Model.”[18] Despite this, it was argued that because of the “very limited additional funds” made available under the second pillar, any actual changes to the new design of the CAP were only “modest.”[19]

The CAP reforms by the then European Community (EC) came under severe pressure during the 2003 WTO agricultural negotiations in Cancún, Mexico. DCs were pushing for further adjustments on top of those made under Agenda 2000. Brazil, commenting on the trade barriers to agricultural goods, declared that they “harm DCs by denying them market opportunities” and that domestic and export subsidies in developed countries also depress “prices and incomes throughout the world, cut into the export earnings of competitive exporters and increase food insecurity in developing countries.”[20] The Dominican Republic also argued that its own agricultural export earnings had declined significantly since 1997, affecting the Dominican economy, mainly because of “the falling international prices in the main export items, due to subsidies and distortions.”[21] DCs, were therefore calling for the

[17] Snyder, F., “Agriculture, environment and fisheries”, *I.C.L.Q.* vol. 42 (3), 1993, pp.720-724, p. 720
[18] This refers to the ‘multifunctionality’ of agriculture. See for instance O’Neill, M., “Agriculture, the EC and the WTO: a legal critical analysis of the concepts of sustainability and multifunctionality”, *Env. L. rev.*, vol. 4 (3), pp. 144-155.
[19] Daugbjerg, C. and Swinbank, A., “The politics of CAP reform: Trade Negotiations, Institutional settings and Blame Avoidance”, *JCMS*, 2007, vol 45 (1), pp. 1-22, p. 8
[20] WTO, *Brazil, Statement by H.E Mr Celso Amorim, Minister of External Relations,* Ministerial Conference, fifth session, Cancún, 10-14 September 2003 WT/MIN(03)/ST/28, 11 September 2003. para 10.
[21] WTO, *Dominican Republic, Statement by H.E Mr Orlando Jorge Mera, Minister for Telecommunications,* Ministerial Conference, fifth session, Cancún, 10-14 September 2003 WT/MIN(03)/ST/55, 11 September 2003, para 5.

"removal of all kinds of subsidies on agricultural products."[22] As a consequence, in 2003, another reform of the CAP, proposed by the Fischler led EC Agricultural Commission,[23] was undertaken and described as a "new step away from such trade distortion."[24] The reform pursued the objectives of the previous CAP reforms and maintained intervention prices for major commodities. Again, farmers received high direct payments as compensation resulting from these changes. However, the reform implemented a new system, the Single Payment Scheme (SPS), providing for direct decoupled payments to farmers.[25] The SPS eliminated the link between direct payments and production in what Wickman called "strategic goods."[26] These included cereal, beef, sheep, oil seed, and rice. The amount of taxpayer's money paid remained the same, but it would increasingly be directed towards the second pillar of the CAP and accordingly away from intensive agriculture.

However, in order to receive these payments, farmers must respect animal and plant health, environmental, food safety and animal welfare standards, as well as the requirement to keep all farmland in good agricultural and environmental condition.[27] This is the so-called "cross-compliance" requirement leading to reductions or withdrawal of direct support in the case of non-compliance.[28] By implementing the obligation of cross-compliance, the EU intends to move towards sustainable agriculture, although it was pointed out that this requirement was mainly "a political decision to convince the EU public that farmers are getting support for doing something in return."[29] Direct payments were also reduced by way of "modulation,"[30] or top slicing, for bigger farms in order to finance and reinforce the new rural

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[22] WTO, *Cote d'Ivoire, Statement by H.E Mr Amadou Soumahoro, Minister for Commerce,* Ministerial Conference, fifth session, Cancún, 10-14 September 2003 WT/MIN(03)/ST/124, 13 September 2003, para 9.
[23] European Commission, "Communication from the Commission to the Council and the European Parliament, Mid-Term Review of the Common Agricultural Policy"**,** Brussels, 10 July 2002, COM (2002) 394 final. The draft legislative text was published on January 2003.
[24] European Commission, "EU agriculture and the WTO: Doha Development Agenda, Cancun-September 2003", Brussels, 2003.
[25] Based on the 2000, 2001 and 2002 historical base areas. Article 38 of Regulation (EC) No 1782/2003.
[26] Wickman, K., "Whither the European Agricultural Policy? A viable reform of the CAP in the context of an enlarged EU and Doha Development Round", Stockholm: TIMBRO, 2003. p. 23
[27] Article 5 of Regulation (EC) No 1782/2003.
[28] Article 6 of Regulation (EC) No 1782/2003.
[29] Alberta Agriculture, Food, and Rural Development, "The EU CAP Reform, Context and Implications", prepared by the Policy Secretariat, 2003, p. 5
[30] Article 10 of Regulation (EC) No 1782/2003.

development policy, now in the second pillar of the CAP, with the aim of improving the environment, food safety and the rural landscape.[31]

III- The CAP and the WTO rules on agricultural subsidies

Domestic support, including both market price support and direct farm payment, is defined in the WTO Agreement on Agriculture (AoA) as support measures "expressed in monetary terms, provided for an agricultural product in favour of the producers."[32] These subsidies are important elements of agricultural protection and are thus classified into three "boxes" corresponding to their level of trade distorting. First the "amber box" containing payments directly linked to production quantities and measures to support prices. This box includes all measures distorting production and trade. Secondly, the "blue box", which according to Stevenson and Filippi is "an Amber box with conditions"[33] as it contains direct payments made under production-limiting programs with no spending limits established. Lastly the "green box" covers support measures that are, according to the AoA, deemed to be minimally market distorting.[34]

In order to comply with the WTO requirements, most EU direct payments introduced by the 1992 and 2000 reforms have been made under the "blue box." However, the shift from market price support to direct payments did not decrease the level of subsidies, which has instead increased from 30.536 million Euros in 1991 to 39.876 million Euros in 1999.[35] It is argued that this genuine shift of support to EU farmers from the most trade distorting "amber box" into the "blue box" was made in order to "avoid mandated reductions."[36] The shift of direct payments to the "blue-box" measures allowed the then EC to maintain compensatory payments as part of the

[31] Article 10 of Regulation (EC) No 1782/2003.
[32] Article 1(a) of the WTO AoA.
[33] Stevenson, C. and Filippi, I., "Distorting the truth? The economics of domestic farm subsidies", Int. T.L.R., 2004, vol.10 (3), pp. 50-58, p. 50
[34] Annexe 2 of the WTO AoA.
[35] Dillen, B. van, "Submission to the European Commission on the Mid-Term Review Agenda 2000", CIDSE, Brussels, 2002.
[36] Jean, S., Josling, T. and Laborde, D. "Implications for the European Union of the May 2008 Draft Agricultural Modalities", ICTSD, Geneva, 2008, p. 1

CAP[37] without being unfairly challenged by other members. These payments are also exempt from the imposition of countervailing duties[38] "on subsidized imports that are found to be hurting domestic producers."[39] Therefore, it can be said that the 1992 and 2000 CAP reforms did not effectively alter the trade distortions in agricultural commodities, leaving the problems encountered by DCs in accessing the EU agricultural market unresolved. The shift from one box to another, without any reduction in the level of payments, only changed the form of domestic support, making the trade distortion which was being created by domestic subsidies less apparent. This practice has been referred by Koning as a movement "from open dumping to disguise dumping"[40] under which the "[EU] continues to export large volumes below its own cost of production."[41] This support continued its shift into the "green box" during the mid-term review of the CAP in 2003.

The SPS was designed in order to meet the WTO "green box" criteria. This box exempts from cuts or limitations, income supports that do not involve transfers from consumers and which do not have the effect of providing price support to producers.[42] Decoupled payments of the WTO "green box" are thus supposed to be, as classified by the OECD, to the "effectively fully decoupled" payments which require that "production (or trade) not differ from the level that would have occurred in the absence of that measure."[43] However, Cardwell and Rodgers argue that the fundamental "green box" requirement of "hav[ing] no, or at most minimal, trade-distorting effects or effects on production" is unclear and lacks precision as to whether it is a free-standing obligation or not.[44] This is in line with the case of *United States- Subsidies on Upland Cotton*, where Brazil claimed that the US breached the

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[37] Stevenson, C. and Filippi, I., "Distorting the truth? The economics of domestic farm subsidies", Int. T.L.R., 2004, vol.10 (3), pp. 50-58, p. 51
[38] Article 13(b) (i) of the WTO AoA.
[39] WTO website, "Subsidies and countervailing measures" [Online]
Available from: http://www.wto.org/english/tratop_e/scm_e/scm_e.htm (Accessed 18/05/2011).
[40] Konin, N., "Agriculture, development and international trade: Lessons to be learned from the Common Agricultural Policy of the European Union", Forum on Food Sovereignty, Niamey, 7-10 November, 2006, p. 9
[41] Ibid., p. 9
[42] These are the "basic criteria" established by Annex 2, paragraph 1 of the WTO AoA. These payments include for instance assistance to help farmers restructure agriculture and direct payments under environmental and regional assistance programmes.
[43] OECD, "Decoupling: a Conceptual Overview", Paris, 2001, p 7
[44] Cardwell, M. and Rodgers, C., "Reforming the WTO legal order for agricultural trade: issues for European rural policy in the Doha Round", *I.C.L.Q.*, vol. 55 (4), 2006, pp.805-838, p. 823

Subsidies and Countervailing Measures Agreement.[45] Here the ruling was that "the Panel does not decide whether the fundamental requirement in paragraph 1 of Annex 2 is a freestanding obligation or not."[46] In the view of Cardwell and Rodgers this fundamental requirement also lacks clarity as there is "no indication of the basis for quantifying the effects of support for the purposes of ascertaining whether its trade-distorting effects are more than 'minimal'."[47]

IV- <u>Issues with the 2003 CAP reforms</u>

The then EC had the ability to stay within the domestic support rules and commitments by reforming its CAP in such a way that it can meet the green box criteria.[48] However, a problem arose as the SPS did not contain all direct payments. The 2003 CAP reforms provided for a broad range of options giving the MS the possibility of deciding which subsidies to decouple or not, and when to start decoupling.[49] As a consequence, in order to avoid abandonment of production, some supports were not fully decoupled and MS could continue to make direct payments linked to production.[50]

MS could decide to retain a degree of coupling in a number of commodities sectors. 25% of direct payments for arable crops and 40% of durum wheat could stay linked to production.[51] MS could also continue to couple up to 50% of the premiums for sheep and goats.[52] In the beef sector, they could retain up to 100% of the suckler cow premium plus 40% of the slaughter premium or alternatively they could either keep up to 100% of the slaughter premium, or 75% of the special male premium.[53] Cardwell and Rodgers pointed out that this decoupling derogation had not been

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[45] WTO, *United States – Subsidies on Upland Cotton –Request for Consultations by Brazil* (WT/DS267/1), 3 October 2002.
[46] WTO Panel Report, *United States – Subsidies on Upland Cotton,* WT/DS267/R para 7.412, adopted 8 September 2004.
[47] Cardwell, M. and Rodgers, C., "Reforming the WTO legal order for agricultural trade: issues for European rural policy in the Doha Round", *I.C.L.Q.*, vol. 55 (4), 2006, pp.805-838, p. 823
[48] Brink, L., "WTO Constraints on Domestic Support in Agriculture: Past and Future", *Canadian Journal of Agricultural Economics*, vol. 57 (1), 2009, pp.1-21.
[49] Regulation (EC) No 2237/ 2003 laying down detailed rules for the application of certain support schemes provided for in Title IV of Council Regulation (EC) No 1782/2003, OJ L 339, 24.12.2003.
[50] Ibid.
[51] Article 66 of Regulation (EC) No 1782/2003.
[52] Article 67 of Regulation (EC) No 1782/2003.
[53] Article 68 of Regulation (EC) No 1782/2003 .

exercised in the same way by all MS.[54] For instance, no partial decoupling was made in England in 2005 while in Italy up to 142,491,000 Euros could be linked to arable crop production.[55]

Specific aid schemes were also granted to farmers if MS decided to implement them. These support schemes were maintained for various products and were either linked to the area under crops or to production.[56] Moreover, with the option to delay implementation granted under Article 71 of Regulation (EC) No 1782/2003, it was pointed out that MS had the possibility to retain "substantial coupled support for up to two years."[57] The SPS was in principle applicable as from 1 January 2005 but MS could delay implementation at either 1 January 2006 or 1 January 2007.[58] This advantage has been taken by Finland, France, Greece, the Netherlands and Spain which implemented the SFP in 2006. Malta and Slovenia chose to implement the SPS in 2007.[59]

Despite the view of the EU Commission on the 2003 CAP reforms being positive, these flexibilities offered to the MS have been strongly criticized. It was argued that the systems of support were considered as not "fully decoupled" [60] and that decoupled payments could not "guarantee that production will not occur, hence the dilution of the principle."[61] It was also believed that the 2003 CAP reforms have led to the "re-nationalization of the CAP" making the CAP a complex policy.[62] However, according to the Commissioner Fischler, these options given to the MS did not mean a step

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[54] Cardwell, M. and Rodgers, C., "Reforming the WTO legal order for agricultural trade: issues for European rural policy in the Doha Round", *I.C.L.Q.*, vol. 55 (4), 2006, pp.805-838, p. 816

[55] Annex II of Commission Regulation (EC) 118/2005 of 26 January 2005, modifying Annex VIII to Council Regulation (EC) No 1782/2003 and establishing budgetary ceilings for partial or optional implementation of the Single Payment Scheme and annual financial envelopes for Single Area Payment Scheme provided for in that Regulation, OJ L 24/15, 27.1.2005.

[56] These included for instance, quality premium for durum wheat, protein crop premium, area aid for rice, nuts, crops, seeds, starch potatoes and dairy premiums. Articles 72 to 143 of Regulation (EC) No 1782/2003.

[57] Cardwell, M. and Rodgers, C., "Reforming the WTO legal order for agricultural trade: issues for European rural policy in the Doha Round", *I.C.L.Q.*, vol. 55 (4), 2006, pp.805-838, p 815

[58] Article 71(1) of Regulation (EC) No 1782/2003.

[59] European Commission, "Overview of the implementation of direct payments under the CAP in Member States", 2010.

[60] Roberts, I. and Gunning-Trant, C., "The European Union's Common Agricultural Policy, a stocktake of reforms", ABARE research report 07.13, Australia, 2007. p 25

[61] Alberta Agriculture, Food, and Rural Development, "The EU CAP Reform, Context and Implications", prepared by the Policy Secretariat, 2003, p 2

[62] Ibid., p 5

towards the renationalisation of the CAP, but "serve[d] to introduce some flexibility where this is warranted and [did] not distort competition."[63] He believed that, the CAP has largely moved away from the trade distorting support system and was a more "trade-friendly policy, particularly as regards its effects on developing countries."[64] The SPS remained nevertheless, not being fully decoupled and still enabled EU farmers to "compete unfairly with DCs."[65] Against this background, the so-called "CAP Health Check", proposed by the Commission in 2007, with the aim of assessing the implementation of the 2003 reforms and simplifying the CAP, was adopted.

V- <u>The CAP 'Health Check'</u>

The Health Check did not imply a fundamental reform of the CAP, but provided instead for "the possibility of further adjustments in line with market and other developments."[66] The "Health Check" aimed to pursue three objectives: to simplify the SPS and make it more effective and efficient, to modernize agricultural market support instruments tools in order to improve market orientation and lastly, to respond to new challenges of fighting climate change, the protection of biodiversity, water management and bio-energy.[67]

1) <u>Direct payments</u>

While the CAP Health Check cuts further the link between direct payments and production, it still allows MS to exclude certain payments from the SPS scheme. Pursuant to Article 63 of Regulation (EC) 73/2009, all coupled support schemes referred to in Annex XI had to be transferred into the SPS from 2010.[68] Full

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63 Fischler, F., "CAP reform", Brussels, 9 July 2003, SPEECH03/356.
64 Fischler, F., "The New, reformed agricultural policy", Final press conference after the decision at the Council on agriculture, Luxembourg, 26 June 2003, SPEECH/03/326.
65 Bureau, J. C. and Matthews, A., "EU Agricultural Policy: What Developing Countries Need to Know", IIIS Discussion Paper No.91, 2005.
66 European Commission, "Communication from the Commission to the Council and the European Parliament, "preparing for the "Health Check" of the CAP reform", Brussels, 20 November 2007, COM (2007) 722 final.
67 Ibid.
68 Council Regulation (EC) No 73/2009 of 19 January 2009 establishing common rules for direct support schemes for farmers under the common agricultural policy and establishing certain support

decoupling of schemes was, for example, made for arable crops, olive groves and hops. However, seeds, beef and veal payments, except the suckler cow premium, are to be decoupled from 2012 at the latest in order to "adjust to the new support arrangements."[69] MS can still maintain the link between subsidies to the level of production for the suckler cow, goatmeat and sheepmeat sectors.[70] Such a possibility was considered "necessary" in order to support economies in regions which do not offer economic diversification.[71] In addition to this, MS can also decide to partially couple the fruit and vegetable payments until 2012, within the limits provided by Article 54 of the regulation.[72]

2) <u>The funding of special measures</u>

Under the 2003 CAP reforms, MS had the possibility to retain up to 10 per cent of national ceilings per sector in order to support farming systems with environmental benefits or improving the quality and marketing of agricultural products in that sector.[73] While MS already spend a large amount of money on direct farm payments,[74] this possibility is maintained by the CAP Health Check in order to fund the targeted issues of Article 68 of Regulation (EC) 73/2009.[75] MS can for instance grant support, which can be coupled to production, to the dairy, beef and veal, sheep meat and goat meat, and rice sectors, in order to help farmers in disadvantaged regions or in environmentally sensitive areas.[76] In such a case, MS are only authorised to use 3.5 per cent of their national ceilings.[77] Despite these restrictive spending limits, these measures can still allow for the reintroduction of coupled support, especially in the dairy sector, which has been completely decoupled since 2007. There is no doubt that the current Article 68 pursues legitimate objectives within the first

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schemes for farmers, amending Regulations (EC) No 1290/2005, (EC) No 247/2006, (EC) No 378/2007 and repealing Regulation (EC) No 1782/2003. OJ L 30/1.
[69] Preamble 33 of Regulation (EC) No 73/2009.
[70] Article 51(1) and 111 of Regulation (EC) No 73/2009.
[71] Preamble 34 of Regulation (EC) No 73/2009.
[72] Article 51 (1) of Regulation (EC) No 73/2009.
[73] Article 69 of Regulation (EC) No 1782/2003. This system has been used in several sectors by Finland, Greece, Italy, Portugal, Spain, Slovenia, Sweden, and the United Kingdom.
[74] The EAGF has been allocated EUR 313 050 million under the 2007-2013 financial framework. See European Commission, "Investing in our future: the European's Financial Framework 2007-2013", Luxembourg, June 2010.
[75] Article 69 (1) of Regulation (EC) No 73/2009.
[76] Article 68 (1)(b) of Regulation (EC) No 73/2009.
[77] Article 69(4) Council Regulation (EC) No 73/2009.

pillar of the CAP. However affording such flexibility to MS, in order to address these issues, could also potentially lead to support that could be used in a trade distorting way.

3) The second pillar: Rural Development

The EU rural development policy for 2007 to 2013 has been divided into three objectives areas under Article 4 of Regulation (EC) No 1698/2005.[78] Rural development measures implemented by the MS in order to achieve these objectives are grouped into four thematic 'axes'.[79] In order to ensure a balance between the objectives pursued, axes 1 and 3 must receive at least 10% of the EAFRD total contribution. Axis 2 has to be allocated a minimum of 25% of the budget and axis 4, a minimum of 5%.[80]

In order to assist tackling the new challenges posed, such as climate change and water management, the Commission is of the view that rural development and cross-compliance measures are the way forward.[81] With this in mind, the CAP Health Check reinforced spending under the second pillar of the CAP. Under the 2003 CAP reforms, the modulation for MS started in 2005 with a rate of 3% and increasing to 4% and to 5% from 2007 onwards until 2012.[82] Following the CAP Health Check, the rate of compulsory modulation is to be increased by 10 percent in 2012 and applied to direct payments exceeding 5000 Euros per year.[83] Higher farm payments, above 300 000 Euros, are to be reduced further by an additional 4 percent of the basic modulation.[84] This modulation will create extra revenue for supporting rural

[78] Improving the competitiveness of agriculture and forestry; improving the environment and the countryside; improving the quality of life in rural areas and encouraging diversification of economic activity. Council Regulation (EC) No 1698/2005 of 20 September 2005 on support for rural development by the European Agricultural Fund for Rural Development (EAFRD), as last amended by Regulation (EC) No 473/2009, OJ L 277, 21.10.2005
[79] Axis 1: improving the competitiveness of the agricultural and forestry sector; Axis 2: on improving the environment and the countryside; Axis 3: on the quality of life in rural areas and diversification of the rural economy; and Axis 4, on Leader. See Title IV of Council Regulation (EC) No 1698/2005.
[80] Article 17 (1) and (2) of Regulation (EC) No 1698/2005.
[81] European Commission, "Communication from the Commission to the European Parliament and the Council, preparing for the "Health Check" of the CAP reform", Brussels, 20 November 2007, COM (2007) 722 final.
[82] Article 10 of Regulation (EC) No 1782/2003.
[83] Article 7 (1) of Regulation (EC) No 73/2009. The modulation for the 2011 year was set at 9 percent.
[84] Article 7(2) of Regulation (EC) No 73/2009.

development programmes, under the CAP Pillar II.[85] However, it is to be noted that MS are also guaranteed to receive back, up to 80% of the unspent rural development money.[86] As MS can decide how to use the rural development money it was argued that this possibility could also lead to the re-nationalisation of the CAP.[87] This issue could be further complicated with the CAP being now a shared competence rather than an exclusive competence policy area following the entry in force of the Lisbon Treaty.[88]

4) Intervention measures

In order to simplify the CAP and to increase EU competiveness on the world market, the previous 21 Common Market Organisations (CMOs)[89] have been collapsed into one single CMO which entered into force on July 1, 2008.[90] The CMOs have been important instruments of the CAP. They have governed production and trade of agricultural products and set the conditions for exports and imports with DCs.[91] They were intended to "stabilise the market, increase agricultural productivity and guarantee a stable income for farmers." [92] Most importantly they aimed to reach the then three interlinked basic principles of the CAP. These were the "common prices, common financing and the Community preference" principles[93] which according to the Commission "have become the golden rule of the CAP."[94] According to the Commission, the then EC was safeguarding its 10 million farmers, which were also

[85] Article 9(1) of Regulation (EC) No 73/2009. Under the 2007-2013 financial framework, the rural development policy has been allocated EUR 96 519 million, after transfer from the EAGF. See European Commission, "Investing in our future: the European's Financial Framework 2007-2013", Luxembourg, June 2010.
[86] Article 9(2) of Regulation (EC) No 73/2009.
[87] Alberta Agriculture, Food, and Rural Development, "The EU CAP Reform, Context and Implications", prepared by the Policy Secretariat, 2003, p. 5
[88] Article 4(2) TFEU, OJ C 83 of 30.3.2010.
[89] The CMOs covered about 90 percent of the agricultural production in Europe. Each CMO was providing for a set of measures for specific commodities.
[90] Council Regulation (EC) No 1234/2007 of 22 October 2007 establishing a common organisation of agricultural markets and on specific provisions for certain agricultural products (Single CMO Regulation) as amended by Council Regulation (EC) 361/2008 of 14 April 2008, OJ L 121, 7.5.2008. The single CMO allowed the repeal of almost 78 Council acts and replaced more than 920 legal articles in the previous regulations.
[91] Delayen, C., "The Common Agricultural Policy: A Brief Introduction", Institute for Agriculture and Trade Policy, Washington, D.C., 2007, p. 3
[92] Ibid., p. 3
[93] McMahon, J., "The Common Agricultural Policy: From Quantity to Quality", *N.I.L.Q.*, vol. 53(1), 2002, pp. 9-27, p. 14
[94] Hill, B. E., *The common agricultural policy: past, present and future*. London: Methuen, 1984, p. 91

amongst the most productive in the world, by upholding these basic principles.[95] The then "Community preference" principle provided by the original Article 44(2) EC Treaty implied that EC agricultural products should be favoured over foreign imports.[96] In order to support this system, import duties or levies were imposed on imported goods and making them more expensive. The marketing of Community products was thus facilitated. Another tool used to protect the internal market was the payments of subsidies to exporters. This system was encouraging the export of agricultural products and depressed world market prices. This inevitably restricted EC market access for third countries' products.

In order to further modernise the market support instruments under the CAP Health Check, the European Commission proposed important changes to the remaining price support measures in the arable, livestock and dairy sectors.[97] The last elements of the supply control mechanisms have been either reduced or removed to allow farmers to "respond to market signals" by producing what the market wants.[98] Public intervention for pig meat has been abolished.[99] Intervention purchases for common wheat, beef, butter and skimmed milk powder have been maintained, but have to be made by way of a tender procedure.[100] For instance, intervention for common wheat will take place at the price of 101.31/tonne up to 3 million tonnes and beyond that, intervention will be done by way of tender.[101] Intervention levels for these products have also been limited. They have, for instance, been set at a zero level for durum wheat because the market prices were significantly above the intervention price.[102] Public intervention in agriculture can significantly influence price formation and it was seen in the past as an important instrument of the CAP. Today its role has changed. It only provides a "safety net," which should only be used in cases of "market disruptions and facilitating farmers' response to market conditions."[103]

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[95] Commission of the European Communities, *Our farming future*, Luxembourg: Office for Official Publications of the European Communities, 1993.
[96] Bureau, J. C. and Matthews, A., "EU Agricultural Policy: What Developing Countries Need to Know", IIIS Discussion Paper No.91, 2005, p.7
[97] European Commission, "Health Check" of the Common Agricultural Policy, Commission proposals, Brussels, 20 May 2008, COM (2008) 306 Final.
[98] Ibid., p 8
[99] Preamble 6 of Regulation (EC) No 72/2009.
[100] Article 4 of Regulation (EC) No 72/2009.
[101] Article 4 of Regulation (EC) No 72/2009.
[102] Preamble 3 and Article 4 of Regulation (EC) No 72/2009.
[103] Preamble 3 of Regulation (EC) No 72/2009.

Earlier land set-aside obligations are now considered to be obsolete, and are therefore removed from the CAP framework.[104] Countries have the possibility to use cross-compliance as a compensation of the environmental effects of ending the set-aside regime. Given that set-aside is deemed to have "reduced the average use of fertilisers and pesticides and thus total emissions from EU agriculture,"[105] it is argued that the abolition of set-aside will threaten biodiversity.[106]

VI- <u>The CAP framework after 2013</u>

More improvements within the CAP framework are expected after 2013. A public debate on the future of the CAP was opened between April and June 2010 in order to inform the future preparatory framework for CAP reforms. The debate was focused on four key questions: why do we need a European common agricultural policy? What do citizens expect from agriculture? Why reform the CAP? What tools do we need for the CAP of tomorrow?[107] As a result of the debate contributions, the Commission published in November 2010 its first proposals on the orientation of the "CAP towards 2020."[108] In its Communication, the Commission stressed the importance of agriculture to the European economy and to society in general. Agriculture is thus tasked with ensuring food supply, contributing to rural economy with the creation of local employment and providing for environmental benefits.[109]

The Commission has proposed that the three objectives for the future CAP would be, a viable food production (objective 1), a sustainable management of natural resources and climate action (objective 2) and a balanced territorial development (objective 3). Given this, the Commission does not intend to change the current two complementary pillar structure of the CAP. In its view, public support paid directly to all farmers must be maintained in order to help achieving these objectives. It proposes instead, "a

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[104] Farmers were obliged under Article 107 of Regulation (EC) No 1782/2003 to set-aside 10 percent of their land each year.
[105] Bureau, J.C., et al., "Reflection on the possibilities for the future development of the CAP", Brussels, European Parliament, 2007, p.31
[106] Ibid.
[107] See European Commission, "The Common Agricultural Policy after 2013 public debate- summary report", p. 3 available at: http://ec.europa.eu/agriculture/cap-post-2013/debate/index_en.htm
[108] European Commission, "The CAP towards 2020: Meeting the food, natural resources and territorial challenges of the future", Brussels, 18.11.2010, COM(2010) 672 final.
[109] Ibid., p. 4

greener and more equitably distributed first pillar" and a second pillar that contributes to the competitiveness and innovation of agriculture, the environment and climate change.[110] These changes should therefore lead to a "more sustainable, smarter and more inclusive growth for rural Europe."[111]

In order to fulfil the proposed objectives of the future CAP, the Commission considers three potential options for the future framework of the CAP. The first option is to prioritise the first pillar of the CAP. Adjustments and improvements would be made, for instance, with regard to direct payments in order to provide a more equitable distribution between MS. The second option seeks to establish a more sustainable agricultural policy. It would thus be reformed in order to address the previously referred objectives of the CAP. According to the Commission, this option would mean "greater spending efficiency" and will therefore lead to a more comprehensive CAP framework. More targeted measures would have to be implemented to achieve this aim. The last option proposes to particularly focus on the second pillar of the CAP. Support given under the first pillar, under this option, would be gradually reduced in order to reinforce the environmental and climate change objectives addressed by the rural development policy pillar. This should encourage the development of rural development programmes which are working towards the implementation of such objectives.

As a general rule, the above options would also mean further adjustments of the current CAP instruments. In particular, this implies changes with regard to direct payments and the market measures of the CAP first pillar, which have been the most criticised instruments of the CAP. The Commission proposes to redistribute, redesign and improve the objectives of current support in order to "add value and quality in spending." In this aim, it proposes that the European Parliament's suggestions could be followed. Farmers would continue to receive a basic income support through the decoupled SPS on the conditions of respecting the cross-compliance requirements. Farmers in areas with specific natural constraints would be given an additional income support in the form of an area-base payment. Voluntary coupled support, within limits, would still be maintained in order to help particular types of farming

[110] Ibid., p. 3
[111] Ibid., p. 3

which are considered crucial for the economy and society. With regard to market measures, the Commission does not propose to introduce additional public interventions. It proposes instead to extend the intervention period and to apply intervention as a safety net in case of market disturbances. It also suggests that other revisions should be made in order to "enhance efficiency and improve controls." However it does not give any details on the extent of these revisions. Finally, with regard to the rural development policy, the Commission proposes to maintain the current useful tools, such as environmental and climate change measures, but seeks to "simplify and [to cut] red tape where possible."[112]

VII- Conclusion

The entry into force of the Lisbon Treaty (LT) in 2009 has brought important changes to the CAP. The CAP is now a shared competence between the EU and the MS.[113] The LT also involves for the first time the European Parliament directly within the agricultural decision-making process *via* the ordinary legislative procedure.[114] However, surprisingly, the LT did not change the objectives of the CAP originally set out by the 1957 Treaty of Rome. These remain and are currently provided by Article 39 TFEU. Despite this, as seen earlier, the past CAP reforms have significantly changed the instruments used to achieve these objectives. The 2003 reforms have led to a clear demarcation between direct payments and production through the implementation of the SPS, which has since become the "dominant form of farm income support in the EU."[115] The CAP has also evolved into a new policy structure in order to address new challenges such as climate change and food safety and quality. In this aim, more funding from the SPS was switched to Pillar 2. The CAP has thus evolved into a more market-oriented policy, thereby giving DCs more opportunity to export their products.

Commitments made under the 2003 reforms and the EU agricultural financial perspectives were set to last until 2013. Therefore, in order to meet the Europe 2020

[112] Ibid., p. 3
[113] Articles 4 TFEU OJ C 83 of 30.3.2010.
[114] Articles 4 and 43 TFEU OJ C 83 of 30.3.2010.
[115] Swinbank, A. "Potential WTO challenges to the CAP", *Canadian Journal of Agricultural Economics*, 2008, vol. 56 (4), pp. 445-456, p. 448

vision strategy[116] and given the current Doha Round negotiations, there was a need for the EU to further simplify the CAP, while maintaining the current CAP instruments.

However, it must be noted that the future paths proposed by the Commission are articulated in very broad terms. The planned changes in the design of direct payments and market measures are unclear and seem to be merely a continuation of the previous systems. DCs had expressed their concerns in 2000 about farm subsidies classified as trade distorting, which were simply shifted to the green box. They argued that spending on the green box "masks huge supports that continue to be provided by developed countries."[117] Since the Commission does not provide any figures, it is difficult to have a clear vision on the future framework of the post-2013 CAP.

The extent to which the future CAP reforms will further alter market distortions is not very clear yet but this will be important, particularly in the context of the current Doha Development Round negotiations. These started in 2001 and have not been concluded yet. A draft text on agricultural imports was presented in 2008 as part of the "July 2008 package," in an effort to conclude the Doha Round. However, negotiations collapsed following WTO members' failure to reach a compromise. The modalities for agriculture were revised and presented in December 2008 as a draft text in order to continue future discussions.[118] The text aims to form the basis of a potential final agreement that would increase market access for agricultural products, and reduce or eliminate export subsidies and domestic support measures. The extent to which trade in agricultural products will be liberalised will thus result from the final outcomes of the negotiations which are expected by 2012. It was pointed out that in the case of a breakdown, the WTO dispute settlement system would still allow DCs to seek further access to agricultural markets.[119]

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[116] This strategy provides for three priorities: a smart, sustainable and inclusive economy growth in the EU. See Communication from the Commission, "Europe 2020: A strategy for smart, sustainable and inclusive growth", Brussels, 3.3.2010, COM(2010) 2020 final, page 6.
[117] WTO, "Agreement on Agriculture: Green Box/Annex 2 subsidies: proposal to the June 2000 special session of the committee on agriculture by Cuba, Dominican Republic, Honduras, Pakistan, Haiti, Nicaragua, Kenya, Uganda, Zimbabwe, Sri Lanka and El Salvador", G/AG/NG/W/14, 23 June 2000.
[118] WTO, "Revised draft modalities for agriculture", 6 December 2008, TN/AG/W/4/Rev.4
[119] Swinbank, A. "Potential WTO challenges to the CAP", *Canadian Journal of Agricultural Economics*, 2008, vol. 56 (4), pp. 445-456, p. 449

Given the reforms made by the CAP "Health Check" and the anticipated CAP reforms post-2013, it is unlikely that the EU could be challenged by DCs alone. However, the extent of the future CAP reforms remains uncertain. The Commission's future proposals are broad, and it is currently difficult to tell whether the post-2013 CAP will efficiently respond to the criticisms that have been raised by DCs. It is therefore crucial for the EU to be more specific with regard to domestic support in order to increase the chances of concluding Doha. We have now to wait for the Commission's legislative proposals on the post-2013 CAP which are due to be presented in mid-2011. These ought, hopefully, to assist in clarifying the future CAP reforms.

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