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Working Paper

Political economy of the Nice treaty: Rebalancing the EU Council / The Future of European Agricultural Policies

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Deutsch-Französisches Wirtschaftspolitisches Forum

**Political Economy of the
Nice Treaty: Rebalancing
the EU Council. The Future
of European Agricultural
Policies**

Working Paper

**B 28
2001**

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Forum économique franco-allemand Deutsch-Französisches Wirtschaftspolitisches Forum

Together with other members of the European Union, France and Germany are about to embark on an unprecedented cooperative venture. To be successful, Economic and Monetary Union will require a very high degree of mutual understanding among the policymakers of the participating countries. It will also require upgrading the dialogue between those who contribute to shaping the policy debates on both sides of the Rhine.

France and Germany have a long tradition of high-level dialogue and cooperation in the framework of bilateral and European institutions. But the dialogue between their civil societies does not match this spirit of cooperation. Economists and those involved in practical economic policy making from both countries in particular rarely talk to each other to find out why they may have differing visions of the functioning of Economic and Monetary Union and of the associated challenges, and even more rarely try to narrow the divergence of their views. This lack of dialogue contributes to keeping alive entrenched prejudices on the other country's supposedly hidden policy agenda.

Yet, an Economic and Monetary Union in which policy debates with a bearing on European policy choices remain confined within national boundaries would be prone to instability, because disagreements about policies would tend to end up in disputes between countries. It is, therefore, of utmost importance to foster the emergence of a genuine *European* professional discussion on major economic policy issues.

The purpose of the *Deutsch-Französisches Wirtschaftspolitisches Forum/ Forum économique franco-allemand* is to contribute to this discussion through the organisation of a series of informal meetings between French and German economists.

The Forum assembles professional economists from academia, business and the public sector. As a non-partisan institution, the Forum brings together participants from all strands of thinking about economic policy with the aim of stimulating fruitful debate. Each meeting is devoted to one or two major policy issues: employment, exchange rate policies, the organisation of economic policy in Economic and Monetary Union, its relations with non-participating countries, and the immediate policy challenges on the eve of monetary union, to name just a few. The Forum commissions papers to provide an informed basis for the discussion, but the focus will be on debate and the exchange of views, starting with reactions from discussants whose role will be to present alternative views and to frame the key issues for the debate.

The proceedings of each meeting are published in working paper format. With the present brochure, we present papers of the discussion from the Forum's ninth meeting on June 25/26 2001 in Paris. We hope that this will be a useful input into an emerging public debate on Europe's economic policies in our two countries and beyond.

Jürgen von Hagen
Jean Pisani-

Ferry

Political Economy of the Nice Treaty: Rebalancing the EU Council¹

Frédéric Bobay²

When it was established in the 1950's, the European Community was based on a global balance of power among member States. That initial vision of the founding fathers of the European Union has been embodied in the weighted voting system of the EU Council. Since its origin, this voting system has remained largely unchanged, despite several enlargements. The scale of the member States' relative voting weights in the EU-6 of 1957 is about the same as that of the EU-15 of 2000. For several decades, voting rights of the large member States (France, Germany, Italy, and the United-Kingdom) have been 5 times higher than that of Luxembourg, the smallest member. When enlargement occurred, new member States were granted weighted votes according to their relative sizes, without any modification to the existing system or to the relative voting rights of the other members. Only once, was the initial voting system adapted because of enlargement, in 1973. However, even in that case, the same balance of power was essentially maintained. The adaptation of the voting system was nominal in nature. This nominal increase of all voting rights of member States was designed to allow better differentiation among medium-size countries (*e.g.* between Belgium and Ireland) otherwise impossible.

¹ An extended French version of this paper has been prepared for the *Revue Française d'Economie* (octobre 2001) and was presented at the 50th Congress of the Association Française de Sciences Economiques, on September 21, 2001.

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| | 1958 | 1973 | 1981 | 1986 | 1995 |
|-----------------------|-------------|-------------|--------------|--------------|--------------|
| | UE-6 | UE-9 | UE-10 | UE-12 | UE-15 |
| France | 4 | 10 | 10 | 10 | 10 |
| Germany | 4 | 10 | 10 | 10 | 10 |
| Italy | 4 | 10 | 10 | 10 | 10 |
| Belgium | 2 | 5 | 5 | 5 | 5 |
| Netherlands | 2 | 5 | 5 | 5 | 5 |
| Luxembourg | 1 | 2 | 2 | 2 | 2 |
| United-Kingdom | | 10 | 10 | 10 | 10 |
| Ireland | | 3 | 3 | 3 | 3 |
| Denmark | | 3 | 3 | 3 | 3 |
| Greece | | | 5 | 5 | 5 |
| Spain | | | | 8 | 8 |
| Portugal | | | | 5 | 5 |
| Sweden | | | | | 4 |
| Austria | | | | | 4 |
| Finland | | | | | 3 |
| Total | 17 | 58 | 63 | 76 | 87 |
| QMT | 12 | 41 | 45 | 54 | 62 |
| QMT (%) | 70.6 | 70.7 | 71.4 | 71.1 | 71.3 |

Note: "QMT" is the qualified majority threshold.

However, besides the apparent stability of the nominal voting system, EU enlargements have progressively shifted the initial balance of power to the advantage of small member States and to the detriment of the large members. Over time, at each enlargement, the share of the overall votes of the large member States tended to shrink significantly in comparison to the overall votes of smaller members. This is a consequence of the structure of enlargement, which have mostly encompassed small States. The increasing number of small States relative to large States implied a shift in the global power balance. Moreover, the resulting imbalance between large and small States constitutes a challenge to the democratic character of the EU and to the legitimacy of community decisions.

This challenge is reinforced by the prospect of further enlarging the EU to 12 new members, of which most are small States. EU enlargements to 27 member States is bound to deteriorate further the political balance among members States within the Council. It also affects the overall democratic character of the EU decision system. Without change in the current voting system, EU collective decisions could be made with less and less population representativity. The European Commission noted in that respect that Council decisions should be sufficiently representative of the EU population through the member States voting system. The minimal population represented in the votes has already decreased from 68% to 58% when the EU enlarged from six members to fifteen. Without adjustment of the voting system, enlarging the Union to EU-27 could bring this population representation close to or below 50%. In such cases, legitimacy of EU decisions would be questionable.

| QM in % of | UE-6 | UE-9 | UE-10 | UE-12 | UE-15 | UE-27a | UE-27b |
|---------------|------|------|-------|-------|-------|--------|--------|
| EU population | 67.7 | 70.6 | 70.1 | 63.3 | 58.2 | 50.2 | 46.4 |

Note: These are the *minimal population* required for a qualified majority decision. The UE-27 is calculated on the basis of the current weighted voting system, with a QMT of 70,90 % of the votes (UE-27a) or 70,15% (UE-27b). Sources: European Commission (2000).

Thus, the need to increase the nominal voting rights of large member States has progressively been felt in order to compensate for a growing democratic deficit within the EU Council. With this goal in mind, EU member States reached in Nice an agreement to reform the voting system of the EU Council.

I. Historical foundation of the weighted voting system in the European Union Council

Historically, when the initial negotiations took place to establish the European Economic Community in the 1950's, the power balance between large and small States was a critical issue. At this occasion, the six founding member States agreed on a set of guiding principles to define the Council decision voting system.³

A first principle was to reject any objective criteria as the basis for establishing voting rights. Such objective criteria, like relative economic weight, population or contribution to the Community budget, were considered inadequate not just for technical reasons, but mostly for far reaching political considerations. Recognizing the political nature of the European Community project, it was considered justified to search for a functional political equilibrium rather than to depend on contingent objective circumstances.

A second principle was based on a pragmatic approach. The empirical success of the weighted voting system of the existing Council of the Coal and Steel European Community compared very positively to the poor practical functioning of the One State/One vote rule (such as in the United Nations Organization). The very significant differences in weight between member States could not be artificially nullified by the Community institutions without implying serious dysfunctional risks. It then followed that the Community decision framework had to be based on a weighted voting system.

On the basis of these global orientations, specifying the exact weights of the respective votes and the decision-making rules happened to be a difficult process with intense negotiations between the six founding members. The negotiators' wish to equitably allocate power among them created a difficulty that was not arithmetic but political in nature. The main question was not to decide how much voting rights each member State would be endowed with, but to define which groups of countries should be able to block Community decisions. From that fundamental political decision would then be derived the actual arithmetic of the respective voting rights and the qualified majority threshold.

³ For a detailed historical analysis of treaty negotiations, see de l'Écotais (1996a, 1996b, 1996c).

Founding countries agreed that a blocking minority would be attained by the coalition of a large member (France, Germany, or Italy) with a small one (Belgium or the Netherlands), while the coalition of a large member with only a very small one (Luxembourg) was considered insufficient to block a decision. From that agreement could be identified the respective voting rights and the majority threshold. However, that agreement did not end the difficulty that had emerged between large and small members. The latter were concerned that their interests would not be sufficiently taken into account in future Community decisions. A compromise was finally found on the basis of that voting rights agreement by specifying the role of the European Commission: the Council would take decisions under this weighted votes system (*i.e.* qualified majority) only in the cases of a proposal from the Commission. For small member States, granting this power to the Commission was a safeguard that the Community's interest would be protected even when they would be out-voted in the Council. With this compromise on the Commission involvement rule, the initial voting rights agreement became a defining basis for the Community institutional system.

II. The EU Council voting system in the Nice Treaty

The Nice Treaty establishes new modalities for the EU Council decision system. The new system is for implementation on January 1, 2005, regardless of whether new members would have by then joined the EU or not. It includes three major changes compared to the current system:

- (i) New weighting of the respective voting rights.
- (ii) An increase in the qualified majority threshold from the current 71% to nearly 74% for the EU-27, with a 73.4% ceiling for all the transition rates that remain to be specified along the enlargement process.
- (iii) The addition of two supplementary decision criteria: the simple majority of member States and 62% of the EU population.

A careful analysis of the EU Council reform shows that the first change (i) is very satisfactory since it actually resolves the enlargement institutional challenge. On the contrary, the two others (ii) and (iii) introduce elements of regression in the Community system.

In accordance with the goal of the 2000 Intergovernmental Conference (IGC), the new weighting of the member States' voting rights significantly increases the role of the large members within the Council. The Nice Treaty gives large member States almost 10 times more voting rights than the smallest member. In comparison, large members would only have five times more voting rights than the smallest country if the current system were applied to the EU-27.

This new balance between the large and small member States is slightly less significant when measured in percentages of the total voting rights. The voting shares of large member States' voting shares will only increase from 7.5% to 8.4%. On this basis, the countries that benefit the most from the reform are Spain and Poland: their voting rights will increase from 6.0% to 7.8%.

The new weighted votes allocation in the EU Council for EU-27

| UE-27 | Voting rights | | Percentage of total | | | Gap to the smallest | |
|----------------|----------------|-------------|---------------------|-------------|------------------|---------------------|-------------|
| | Current system | Nice Treaty | Current system | Nice Treaty | Impact of reform | Current system | Nice Treaty |
| Germany | 10 | 29 | 7.5 | 8.4 | 0.9 | 5.0 | 9.7 |
| France | 10 | 29 | 7.5 | 8.4 | 0.9 | 5.0 | 9.7 |
| United-Kingdom | 10 | 29 | 7.5 | 8.4 | 0.9 | 5.0 | 9.7 |
| Italy | 10 | 29 | 7.5 | 8.4 | 0.9 | 5.0 | 9.7 |
| Spain | 8 | 27 | 6.0 | 7.8 | 1.9 | 4.0 | 9.0 |
| Poland | 8 | 27 | 6.0 | 7.8 | 1.9 | 4.0 | 9.0 |
| Romania | 6 | 14 | 4.5 | 4.1 | -0.4 | 3.0 | 4.7 |
| Netherlands | 5 | 13 | 3.7 | 3.8 | 0.0 | 2.5 | 4.3 |
| Greece | 5 | 12 | 3.7 | 3.5 | -0.3 | 2.5 | 4.0 |
| Czech Rep. | 5 | 12 | 3.7 | 3.5 | -0.3 | 2.5 | 4.0 |
| Belgium | 5 | 12 | 3.7 | 3.5 | -0.3 | 2.5 | 4.0 |
| Hungary | 5 | 12 | 3.7 | 3.5 | -0.3 | 2.5 | 4.0 |
| Portugal | 5 | 12 | 3.7 | 3.5 | -0.3 | 2.5 | 4.0 |
| Sweden | 4 | 10 | 3.0 | 2.9 | -0.1 | 2.0 | 3.3 |
| Bulgaria | 4 | 10 | 3.0 | 2.9 | -0.1 | 2.0 | 3.3 |
| Austria | 4 | 10 | 3.0 | 2.9 | -0.1 | 2.0 | 3.3 |
| Slovakia | 3 | 7 | 2.2 | 2.0 | -0.2 | 1.5 | 2.3 |
| Denemark | 3 | 7 | 2.2 | 2.0 | -0.2 | 1.5 | 2.3 |
| Finland | 3 | 7 | 2.2 | 2.0 | -0.2 | 1.5 | 2.3 |
| Ireland | 3 | 7 | 2.2 | 2.0 | -0.2 | 1.5 | 2.3 |
| Lithuania | 3 | 7 | 2.2 | 2.0 | -0.2 | 1.5 | 2.3 |
| Latvia | 3 | 4 | 2.2 | 1.2 | -1.1 | 1.5 | 1.3 |
| Slovenia | 3 | 4 | 2.2 | 1.2 | -1.1 | 1.5 | 1.3 |
| Estonia | 3 | 4 | 2.2 | 1.2 | -1.1 | 1.5 | 1.3 |
| Cyprus | 2 | 4 | 1.5 | 1.2 | -0.3 | 1.0 | 1.3 |
| Luxembourg | 2 | 4 | 1.5 | 1.2 | -0.3 | 1.0 | 1.3 |
| Malta | 2 | 3 | 1.5 | 0.9 | -0.6 | 1 | 1 |
| TOTAL | 134 | 345 | 100 | 100 | 0 | | |

Note: The last column shows the allocation of vote when compared to the smallest member (*i.e.* expressed as the number of times the vote of the smallest member).

The importance of the reform is confirmed by other types of measurements, such as allocation indicators (*e.g.* Gini index), which show that the new weighting system does compensate for the effect of enlargement on the voting system balance. In that respect, the overall goal of the Nice negotiation regarding the EU Council reform is fully achieved.

On the contrary, the increase in the qualified majority threshold (QMT) constitutes a weakness in the Council reform decided in Nice: EU decisions will be more difficult to reach. Traditionally, this threshold has been established at about 71% of the voting rights since the creation of the European Community. In the EU-27, it will be at almost 74%, and this higher level creates many more possibilities for the formation of blocking coalitions.

Depending on the course of future enlargements, QMT may take different values over time. The Nice Treaty defines three different cases in that respect: EU-15, EU-27, and a transition phase from EU-16 to EU-26.

- In the case of EU-15, *i.e.* in the hypothesis that no enlargement has occurred as of January 1, 2005, QMT is established at 169 votes of a total of 237, or 71.3%
- In the case of EU-27, the total number of votes is 345 and the treaty defines the blocking minority at 91 votes. This means a QMT of 255⁴ votes, or 73.9%.
- In the case of enlargement from EU-16 to EU-26, the treaty is less specific. At the occasion of each enlargement, ad hoc adjustments in the QMT percentages are likely to be negotiated, in order to evolve progressively from the current 71% to the planned 73.9% of the EU-27. In any case, the Nice Treaty prevents the QMT to be higher than a 73.4% ceiling during the transition period.

The Nice Treaty adds two new decision criteria to the existing weighted voting system: a simple majority of member States and a minimum of 62% of the EU population. In the new system, a decision is adopted if the member States supporting the proposal represent at least the threshold of weighted votes, half of the total number of members, and 62% of the EU population⁵.

⁴ This rule of a 91 votes blocking minority overrides the other indication in the treaty that the QMT is established at 258 votes in EU-27.

⁵ However, a few issues that are decided under the *qualified majority* rule by the EU Council won't be subject to the two new criteria for technical and legal reasons. For those issues, characterized by ad hoc definitions of the decision rule in the treaties, only weighted votes will be used for decision by the Council. They include: monetary policy and the euro (cf. TEC, article 122, §5), sanctions against a member State not respecting fundamental rights (cf. TEU, article 7, §4), some aspects of police and judicial cooperation in criminal matters (cf. TEC, article 34, §3), and closer cooperation (cf. Nice Treaty, articles 27 E and 40 B).

Three criteria for the EU Council decision-making

| UE-27 | voting rights | voting rights | simple majority | share of population |
|----------------|---------------|---------------|-----------------|---------------------|
| Threshold (%) | 71 | 74 | 50 | 62 |
| Threshold | 96 | 255 | 14 | 620 |
| Germany | 10 | 29 | 1 | 169 |
| France | 10 | 29 | 1 | 123 |
| United-Kingdom | 10 | 29 | 1 | 123 |
| Italy | 10 | 29 | 1 | 120 |
| Spain | 8 | 27 | 1 | 82 |
| Poland | 8 | 27 | 1 | 80 |
| Romania | 6 | 14 | 1 | 47 |
| Netherlands | 5 | 13 | 1 | 33 |
| Greece | 5 | 12 | 1 | 22 |
| Czech Rep. | 5 | 12 | 1 | 21 |
| Belgium | 5 | 12 | 1 | 21 |
| Hungary | 5 | 12 | 1 | 21 |
| Portugal | 5 | 12 | 1 | 21 |
| Sweden | 4 | 10 | 1 | 18 |
| Bulgaria | 4 | 10 | 1 | 17 |
| Austria | 4 | 10 | 1 | 17 |
| Slovakia | 3 | 7 | 1 | 11 |
| Denmark | 3 | 7 | 1 | 11 |
| Finland | 3 | 7 | 1 | 11 |
| Ireland | 3 | 7 | 1 | 8 |
| Lituania | 3 | 7 | 1 | 8 |
| Latvia | 3 | 4 | 1 | 5 |
| Slovenia | 3 | 4 | 1 | 4 |
| Estonia | 3 | 4 | 1 | 3 |
| Cyprus | 2 | 4 | 1 | 2 |
| Luxembourg | 2 | 4 | 1 | 1 |
| Malta | 2 | 3 | 1 | 1 |
| TOTAL | 134 | 345 | 27 | 1000 |

It may seem that the two new criteria will have important implications for the decision-making system and for the power balance between member States. This is not the case however. In an enlarged EU, Council decisions will actually be made almost exclusively on the basis of weighted votes, while the two new criteria will be mostly purposeless.

In the EU-27, when a coalition of member States reaches a total of 255 voting rights, the weighted votes threshold, it automatically has the required 14 members and 62% of the EU population in almost all cases. A very limited number of cases are exception to this general rule. This can be demonstrated by a simple analysis of winning coalitions (*i.e.* any combination of member States vote totaling the QMT). Among all the potential wining coalitions on the basis of weighted votes, only 16 different coalitions are affected by the simple majority criteria⁶ and only 7 are affected by the population

⁶ This can be demonstrated by a simple calculation. To measure the effect of the simple majority criteria on the system, one must first identify the wining coalitions (on the basis of the weighted votes) which has the smallest number of members, *i.e.* the wining coalition composed of the biggest members (from Germany to Portugal, in descending order). This wining coalition has only 13 members and is a case where the simple majority criteria does play a role: it turns this winning coalition into a loosing one. Identifying the second

criteria⁷. Compared with the total of about 3 million potential winning coalitions, the impact of the two new criteria is completely insignificant and bears no implication on the power balance. The effect of the two new criteria on the reweighted voting system is less than 0.001% in the EU-27 (share of the winning coalitions affected by either of the two new criteria in the total of winning coalitions).

As a consequence, the two new criteria have overall a negative impact because they introduce a higher complexity in the Council decision-making system. They also generate a lower transparency for the European citizens. For them, it will *appear* that the three criteria have the same political importance, while only the weighted voting system will really constitute the basis for coalition formations.

III. A game theory analysis of the Nice reform.

Game theory provides an analytical framework to identify EU member States' relative power and to measure precisely the implications of the Nice reform. A member States power is defined here as its capacity to affect EU Council *decisions* and not merely to affect Council *votes*. In this perspective, when a member State's vote does not affect the decision, it is not considered an expression of its relative power. To estimate how member States' votes affect decisions, a power index can be computed, as is extensively described in the cooperative game theory literature.

For the current analysis, we use the Banzhaf index, as is most common in the literature. The Banzhaf index measures member States' capacity to generate winning coalitions in the Council: it estimates the relative capacity of member States to transform losing coalition into winning ones by joining it. The Banzhaf index is preferred here to the other most common index, the Shapley-Shubick index, because it does not take into account the order of the votes. The order in which the votes are made is considered irrelevant in the case of the EU Council, considering the practical functioning of Council. Informal exchange of views always take place among members States before formally taking stand in voting situations.

The new power balance

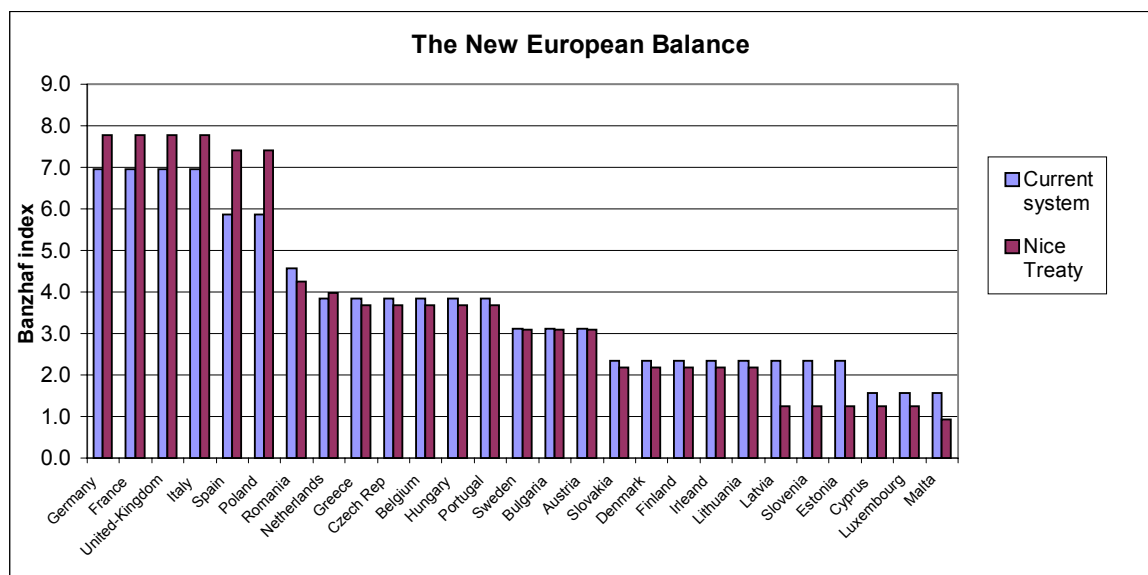
On the basis of Banzhaf index measurements, we present quantitative evidences that the reformed weighted voting rights compensate the power shift among member States resulting from enlargement to EU-27. Large member States' influence is significantly enhanced and stabilized, as intended. This can be shown in comparing the

biggest winning coalition shows that it also has only 13 members, as well as a few other of the biggest winning coalitions. Then, when one gets to the coalition that includes from Germany to the Netherlands, plus 4 of the 5 members with 12 votes, plus 2 of 3 members with 10 votes, this winning coalitions has 14 members and is not affected by the simple majority criteria. It can then be shown that any other winning coalition will necessary have 14 members or more and, thus, will not be affected by the new criteria.

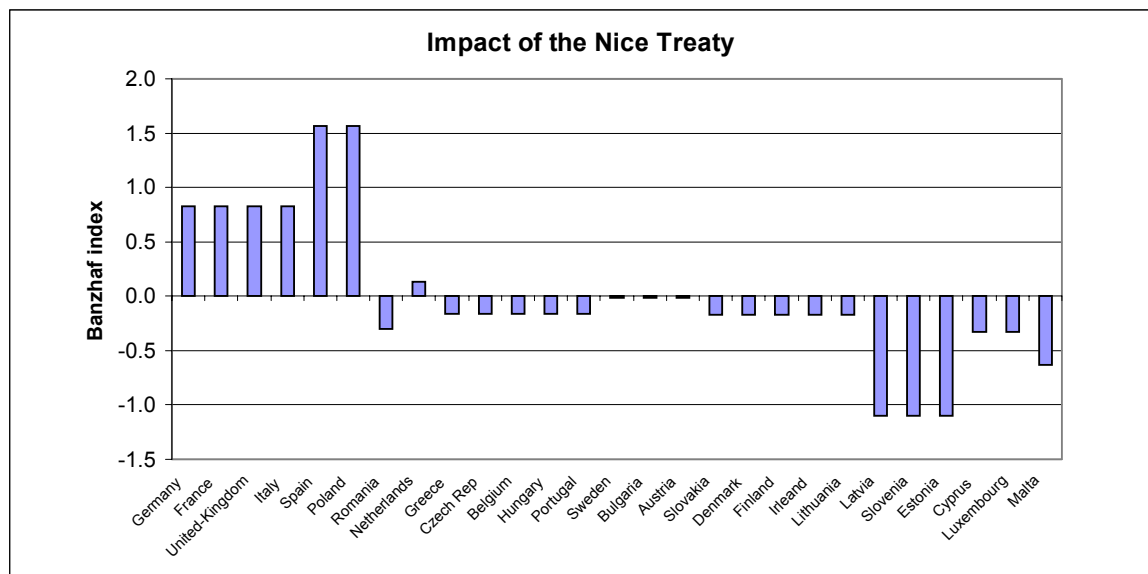
⁷ The same kind of demonstration can be made with respect to the population criteria. In that case, one has to start from the smallest winning coalition (the coalition formed with the smallest member States). However, this result may be subject to variations in the coming years depending on the relative demographic evolution of member States (a population forecast is presented in the annex).

Banzhaf indexes for both the Nice Treaty voting system and the current system applied to UE-27.

**Power allocation among member States
Comparison between the current system and the Nice Treaty for EU-27**



Impact of the reform for the EU-27



Furthermore, the Banzhaf index can be used to compare the Nice Treaty voting system to the five other reform scenarios officially considered at the Nice IGC. This comparison shows that the Nice Treaty system performs as well as the second best scenario of the official five.

From the same analytical framework, we can also measure the impact of the increased qualified majority threshold on the EU Council decision system. Increasing the QMT implies that the collective decision capacity of the EU Council will likely be reduced. This is due to the fact that more countries will be able to block EU decisions in more voting situations when the QMT is higher. This can be measured with an index that represents the collective capacity of the Council to take a decision. This index is computed as the number of winning coalitions compared to the total number of coalitions

(winning and loosing). Under the current voting system, 2.4% of the coalitions are winning coalitions in the EU-27. This index drops to 2.0% with the Nice Treaty reform applied to EU-27. This reduction in the collective decision capacity of the EU results directly from the QMT difference (71% for the current system compared to 73.9% for the Nice Treaty). This reduction is certainly a drawback for the EU, but its effect remains limited in importance.

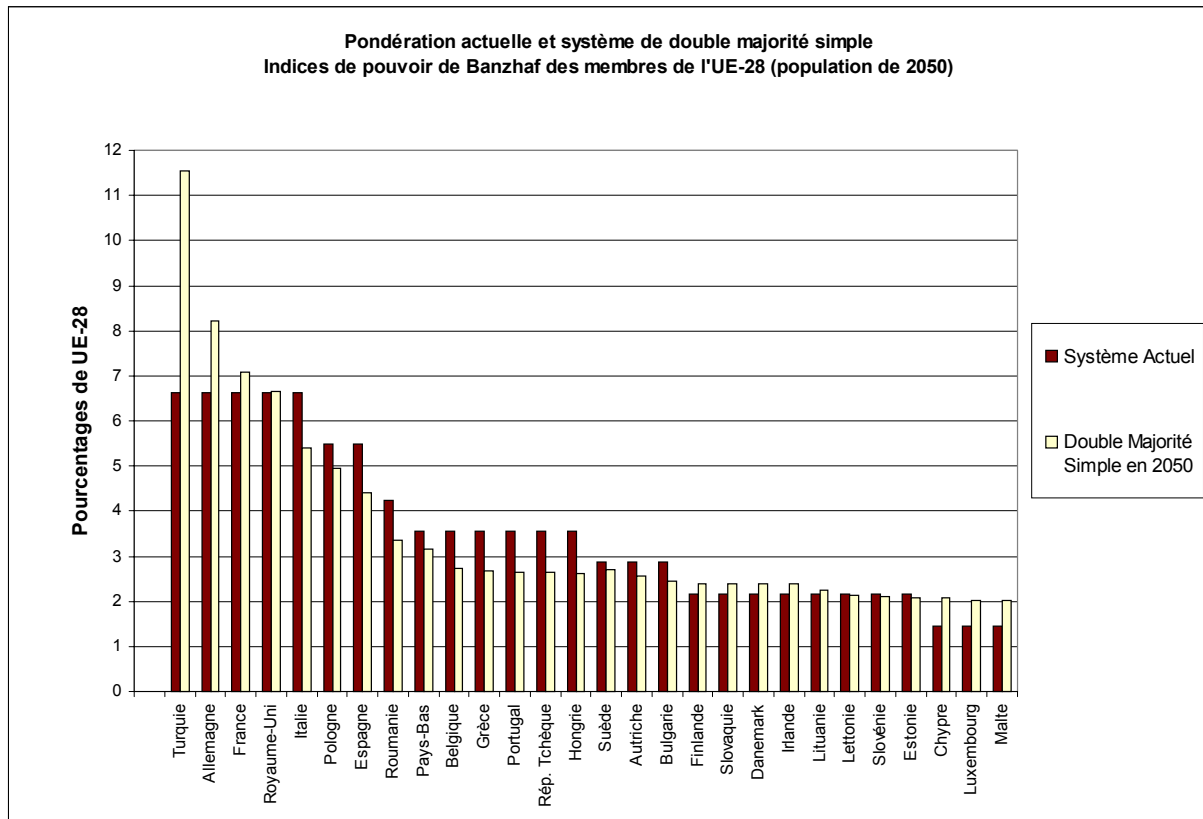
The dangers of the dual simple majority system

One of the official scenarios considered during the IGC is the dual simple majority system (DSM), which combines a simple majority of member States with a simple majority of EU population. This proposal received support from some countries because of some of its features. Especially, simplicity and transparency of the decision-making have been regarded as relevant advantages of this system.

However, game theory analysis shows major and unexpected downsides of this scenario. The DSM would have three significant negative consequences on the EU decision system. None of these important problems of the DMS have been explicitly address or even presented in the public debate on the EU Council reform.

- a) It can be shown that the DSM increases the power of the large member States and that of the smallest members as well, to the detriment of medium-size members. This peculiar effect on the power balance of the EU Council is the result of the internal working of the DSM: large countries benefit from the "simple majority of population" side of the DSM and smallest countries benefit from the "simple majority of States" side of the DSM, while medium-size countries benefit from neither. This shift in the power balance was not justifiable vis-à-vis medium-sized countries, nor was it legitimate or in accordance with the goal of the IGC (to increase the influence of the large members to compensate the effects of enlargements).
- b) In the case of the DSM, the decision threshold is reduced from 71% to 50% (for both decision criteria), which sharply facilitates the collective decision capacities of the Council. This has two major political consequences. First, the higher easiness of the Council to adopt the Commission's proposal reduces the member States' incentives to work on compromises when disagreements occur among themselves. This situation is then likely to lead to permanent conflict within the Council. Second, the traditional institutional equilibrium between the Commission and the Council is deeply modified, with a very significant shift of power from the Council to the Commission. The Commission would overpower the Council because it would be in a position to fully design all Community decision without much opposition from the Council: most Commission's proposals are unlikely to be rejected by the Council, even when many member States oppose them (in comparison to the current equilibrium).
- c) On the long term, under the hypothesis of Turkey joining the EU, the DSM would have the consequence of alienating Community decision to the dominant influence of

Turkey. With its sharp demographic growth (100 million inhabitants in 2050⁸), Turkey would automatically be placed as a dominant player in the EU Council, since it would directly benefit from the "simple majority of population" side of the DSM. Turkey would have a very high capacity to form blocking minorities.



Sub-game among large member States on the parity issue

The game theory analysis also suggests some explanations for the IGC negotiation structure and provides some insights on the underlying reasons leading to the shaping of the Nice agreement.

The IGC can be formalized as a global game among the 15 member States. That global game is structured primarily as a game between two groups with divergent interests, respectively the large and the small member States. Besides the global game, a sub-game with fewer players is another driving force in the IGC negotiations. In this sub-

⁸ UNO estimate, cf. annex.

game, only the largest members fully took part, with divergent interests. The focus of the players in this sub-game was the parity issue and their respective capacity to form blocking coalitions in an enlarged EU. Spain and Germany in particular have been active players in this sub-game.

The request from Spain to obtain a blocking power in parity with the four large members (France, Germany, United-Kingdom, and Italy) is the main driving force behind the high qualified majority threshold in the Nice Treaty. The new weighted vote allocation gives 27 votes to Spain (and Poland) and 29 votes to the four large members. This two-vote difference, combined with a high QMT establishes a quasi-parity of power between these six countries. They are in a quasi-parity since they almost⁹ have the same capacity to form a blocking minority: any coalition of 3 of the larger members (among any of the 4 large members or Spain or Poland), plus any one additional smaller country, including the smallest.

Another offensive player in the sub-game was Germany with its undertakings to gain a breakup of parity with the rest of the large members (France, United-Kingdom, and Italy). This is the underlying reason behind the addition of the population criteria in the Council decision-making system. Furthermore, since this supplementary criteria was not convergent with the interests of small member States, this addition in turn affected the equilibrium in the global game, and gave further ground to the small members' request for the addition of the criteria of simple majority of member States.

The German government's aim at breaking the traditional parity among large member States is neither in line with the Community heritage, nor with today's German democratic system.

Parity among large member States is a fundamental base of European integration. It is a founding principle of the Community, established at the very origin of the initial agreement creating the European Community. In its *Mémoires*, Jean Monnet describes in details this founding agreement:

- *"I [Jean Monnet] am authorized to propose you [Konrad Adenauer] that the relationship between Germany and France within the Community be governed by the parity principle in the Council, as well as in the Assembly and in all European institutions, current or future, whether France's participation includes or not the Union française [i.e. overseas territories] and whether Germany be that of the West or reunified. I would personally add that it is in this spirit that, since the beginning, I have considered the offer of union at the origin of this treaty, and I believe I understood during our first meeting that you had the same view."*

⁹ During the Nice negotiations, Spain supported that the QMT be defined on the basis of a 88 votes blocking minority threshold. This would have granted Spain parity vis-à-vis large member States (without taking into account the population criteria). However, for EU-27, this would have meant a QMT of nearly 75%, much higher than the current 71%, and it was eventually agreed that the blocking minority would be established at 91 votes instead. That reduces the relative capacity of Spain to form blocking minority, as compared to the four large member States.

- "I [Konrad Adenauer] am happy to give you my full agreement to your proposal, because I don't conceive the Community without total parity[...]"¹⁰

The reason behind the parity principle rests on a consciousness of European history. Over centuries, the temptations for one or another large European country to dominate Europe have been the cause of many wars. European States' domination intentions, or the fear of the threat of domination from a neighbor, have been strong incentives to build heavy armaments and to wedge war against one-another. In that perspective, institutionalizing parity between large European States is a way to dismantle this incentive. The parity principle makes impossible any domination attempt. Parity further serves as an insurance against domination risks, and thus creates the conditions for building mutual trust, both between States and between populations, which is a recurrent necessity for political integration.

The parity principle is also at the heart of the German federal system itself. In the Bundesrat, the institution where the government of the Länder are represented, weighted voting rights are allocated to groups of Länder, in a parity system of group of Länder (just as in the EU Council). The four large Länder have each the same number of votes, despite a very significant gap between their respective population, the largest having more than twice the population of the smallest of the group, a far bigger difference than that among the four large EU member States.

Democratic representativity in the EU Council and in the German Bundesrat

| Germany Large Länder | Voting rights in the Bundesrat | Population | | |
|-------------------------|-----------------------------------|---------------|------------|----------------|
| | | M inhabitants | Percentage | Index |
| North Rhine-Westphalia | 6 | 17,975 | 37 | 229 |
| Bavaria | 6 | 12,066 | 25 | 154 |
| Baden-Württemberg | 6 | 10,397 | 22 | 133 |
| Lower Saxony | 6 | 7,845 | 16 | 100 |
| | | 48,283 | 100 | (Lower-Sx=100) |

| EU Large Member States | Voting rights in the EU Council | Population | | |
|---------------------------|------------------------------------|---------------|------------|-------------|
| | | M inhabitants | Percentage | Index |
| Germany | 29 | 82,038 | 32 | 142 |
| France | 29 | 60,186 | 23 | 104 |
| United-Kingdom | 29 | 59,247 | 23 | 103 |
| Italy | 29 | 57,612 | 22 | 100 |
| | | 259,083 | 100 | (Italy=100) |

Sources: European Commission; Statistisches Bundesamt, *Statistical Yearbook*, 1999.

This parity among the four large EU member States will remain an essential component of the functioning of the future EU Council, since the new criteria of population (and simple majority) will hardly have any influence on the decision-making system. Overall, in the future EU-27, only one case of a winning coalition formation will be affected in a way to create an asymmetry between Germany and the other 3 large

¹⁰ Meeting between Jean Monnet and Konrad Adenauer on April 4, 1951, in Bonn, for the preparation of the European Coal and Steel Community treaty. Jean Monnet, *Mémoires*, Fayard, 1976, pp. 414-415.

member States. This is one case of suspension of parity in a total of about 3 millions of winning coalitions, where parity remains the rule.

For the coming EU-27, the Nice Treaty will generate a new European power balance. First, the increased influence of large member States will fully compensates the effect of EU enlargement to many small States with collective over-sized power, and thus the new weighted voting system does resolve the democratic challenge generated by enlargement. Second, two medium size countries, Spain and Poland, will emerge with an influence very close to that of the four large members. Third, taking into account the lack of effect of the two new decision criteria, the prevailing parity among the four large member States will remain a feature of the EU Council decision-making process.

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Annex

Population of European States: évolution 1999-2050

In thousands and in comparison to (France = 100)

| Countries | 1999 | | 2020 | | 2050 | |
|----------------|-----------|-------|-----------|-------|-----------|-------|
| | Thousands | F=100 | Thousands | F=100 | Thousands | F=100 |
| Belgium | 10,213 | 17 | 10,017 | 16 | 8,918 | 15 |
| Denemark | 5,313 | 9 | 5,283 | 8 | 4,793 | 8 |
| Germany | 82,038 | 139 | 80,996 | 130 | 73,303 | 120 |
| Greece | 10,533 | 18 | 10,141 | 16 | 8,233 | 14 |
| Spain | 39,394 | 67 | 37,627 | 60 | 30,226 | 50 |
| France | 58,966 | 100 | 62,495 | 100 | 60,941 | 100 |
| Ireland | 3,744 | 6 | 4,302 | 7 | 4,710 | 8 |
| Italy | 57,612 | 98 | 52,913 | 85 | 41,197 | 68 |
| Luxembourg | 429 | 1 | 464 | 1 | 430 | 1 |
| Netherlands | 15,760 | 27 | 15,876 | 25 | 14,156 | 23 |
| Austria | 8,082 | 14 | 8,279 | 13 | 7,094 | 12 |
| Portugal | 9,980 | 17 | 9,515 | 15 | 8,137 | 13 |
| Finland | 5,160 | 9 | 5,266 | 8 | 4,898 | 8 |
| Sweden | 8,854 | 15 | 9,099 | 15 | 8,661 | 14 |
| United-Kingdom | 59,247 | 100 | 59,845 | 96 | 56,667 | 93 |
| Bulgaria | 8,230 | 14 | 7,282 | 12 | 5,673 | 9 |
| Cyprus | 752 | 1 | 886 | 1 | 913 | 1 |
| Estonia | 1,446 | 2 | 1,170 | 2 | 927 | 2 |
| Hungary | 10,092 | 17 | 9,167 | 15 | 7,488 | 12 |
| Latvia | 2,439 | 4 | 1,999 | 3 | 1,628 | 3 |
| Lithuania | 3,701 | 6 | 3,465 | 6 | 2,967 | 5 |
| Malta | 379 | 1 | 427 | 1 | 421 | 1 |
| Poland | 38,667 | 66 | 39,318 | 63 | 36,256 | 59 |
| Czech Rep. | 10,290 | 17 | 9,743 | 16 | 7,829 | 13 |
| Romania | 22,489 | 38 | 20,530 | 33 | 16,419 | 27 |
| Slovakia | 5,393 | 9 | 5,446 | 9 | 4,836 | 8 |
| Slovenia | 1,978 | 3 | 1,871 | 3 | 1,487 | 2 |
| Turquy | 64,385 | 109 | 84,187 | 135 | 100,664 | 165 |
| Norway | 4,465 | 8 | 4,777 | 8 | 4,758 | 8 |
| Switzerland | 7,386 | 13 | 7,624 | 12 | 6,745 | 11 |
| Iceland | 281 | 0 | 321 | 1 | 341 | 1 |
| Lichtenstein | 31 | 0 | 31 | 0 | 31 | 0 |
| Albania | 3,113 | 5 | 3,663 | 6 | 4,322 | 7 |
| Bosnia-Herzeg. | 3,972 | 7 | 4,372 | 7 | 3,767 | 6 |
| Croatia | 4,473 | 8 | 4,279 | 7 | 3,673 | 6 |
| Macedonia | 2,024 | 3 | 2,226 | 4 | 2,302 | 4 |
| Yugoslavia | 10,640 | 18 | 10,841 | 17 | 10,548 | 17 |

Sources : European Commission; UNO, *World Population Prospect*, 1998, (medium variant).

The Future of European Agricultural Policies

Winfried von Urff

1. Issues of the present debate

The Common Agricultural Policy (CAP) of the European Union (the European Economic Community at the time when it came into being) is a never-ending subject. On the one hand it was a driving force in the process of integration - although this role is often over-estimated – on the other hand it was a permanent source of conflict that sometimes brought the Community at the edge of collapse. In an area as densely regulated as agriculture, conflicts of national interests are quite natural. Underlying subjects were the level of protection and the way in which protection takes place, both affecting the agricultural sectors of Member States in a different way, production quotas, common subsidies, national subsidies etc. A major source of conflict that unduly dominated the debate during the 1970s and the 1980 was the system of Monetary Compensatory Amounts, strongly defended by Germany and attacked by others. A permanent issue for Germany is the distribution of financial resources brought about by the CAP in which Germany has the position of a net payer.

At the core of the present debate about the CAP is the question, whether the actual problems of BSE (Bovine Spongiform Encephalopathy) and FMD (Foot and Mouth Disease) should be used for a fundamental reform, which is the official position of Germany, or whether more targeted measures should be implemented to directly treat these problems with some revisions but no fundamental change of the CAP, which seems to be the position of France. The direction in which Germany wants to see a fundamental change in the agricultural policy can be summarized as “greening“ in combination with more emphasis on consumer protection and on employment (more support for organic farming and less for large-scale production, high food safety standards, support for labour demanding farming practices, more emphasis on animal welfare) under the implicit assumption that there is a strong positive correlation between the underlying objectives¹. One possible way to bring about the desired changes is seen in re-assigning more responsibility to the national or to the regional level, simplified as “re-nationalisation” of agricultural policy, another alternative being a change of the CAP

towards the new priorities (or a combination of both). From the German point of view “re-nationalisation” would have the advantage of reducing Germany’s net-payer position. France is against “re-nationalisation” and questions the need for drastic changes before 2006, by arguing that the CAP after the Agenda 2000 decisions offers sufficient possibilities to take ecological and social aspects into account by “cross compliance” and “modulation”². One should, however, not forget that France is among the winners of the financial redistribution resulting from the CAP in its present form and therefore will lose advantages if fundamental changes take place.

The following paper tries to analyse the chances and limitations of a re-allocation of responsibilities in agricultural policy between the EU and Member States and to change the content of agricultural policy in connection with such a re-allocation. This is done in the light of the historical evolution of the CAP, with particular emphasis on the 1992 reform and the Agenda 2000, taking into account the international framework set by the results of the Uruguay-Round and the ongoing WTO negotiations as well as the requirements of the eastward enlargement of the EU.

2. Is re-nationalisation an option? - Lessons taught by history

As a point of departure it may be helpful to go back in history to the time when the European Economic Community was established. If preliminary considerations included the idea to exempt agriculture from the Common Market such idea was dropped very soon, primarily for two reasons. One reason was the impossibility to differentiate between agricultural and industrial commodities. Food is mostly traded in processed form, i.e. as an industrial commodity. It would have been completely unrealistic to have a common market that included food but excluded the primary agricultural products used as raw material for food commodities, thus allowing Member States to stabilise agricultural commodity prices at different levels by national interventions. Another reason was the vital interest some of the founding members had in a common market for agricultural products. Besides the Netherlands, a major exporter of animal products, France had such an interest. The agricultural sector played an important role within the French economy, making France to expect a lot from unrestricted agricultural trade within the Community, whereas the French

¹ Bundesministerium für Verbraucherschutz, Ernährung und Landwirtschaft: Agrarbericht der Bundesregierung 2001.pp.9/10.

industry felt threatened to be exposed to competition by the strong German industrial sector. In Germany it was the other way round. Industrialists were looking forward to the common market with great expectations, whereas farmers had the feeling of being sacrificed for the sake of overall economic growth³. Even at present one sometimes gets the impression that this constellation still prevails in the minds of some of the actors.

Given the situation just outlined it was quite logical that Art. 38 of the Treaty of Rome (Art.32 after the revision of Amsterdam) clearly states that the Common Market includes agriculture and trade in agricultural commodities. It continues by stipulating, that the creation of the Common Market should go hand in hand with the introduction of a Common Agricultural Policy. For other sectors of the economy common policies are not mentioned. The special treatment of agriculture is due to the fact that in the national policies of all founding members the agricultural sector was largely exempted from the market economy by sophisticated systems of regulations and interventions, which gave national agricultural policies a special role. The Treaty of Rome implied a continuation of such situation. Art.39 (now Art.33) defines the objectives of the CAP, i.e. (a) to increase agricultural productivity by promoting technical progress and the optimal utilisation of the factors of production, (b) thus to ensure a fair standard of living for the agricultural community, (c) to stabilise markets, (d) to ensure the availability of supplies, and (e) to ensure that supplies reach consumers at reasonable prices. With regard to market regulations three options were offered by Art.40 (now Art.34): (1) coordination of national market organisations, (2) common rules for competition, and (3) common market organisations. Experience showed that for practical reasons only option 3 was feasible, given the intensity and the complexity of market interventions that already existed within the Member States.

The Common Market Organisations, which form the core of the CAP were designed and implemented between 1962 and 1969. They were built on three principles: (1) free movement of goods within the Community, (2) preference for production within the Community against imports, and (3) common financial responsibility.

In most of the market organisations prices (target prices) are fixed annually by the Council of Ministers and to a large extent guaranteed to the producers by an intervention mechanism.

² See Agra-Europe 17/01, Europa-Nachrichten, pp.10/11.

Quantities that are not absorbed by the market can be sold to intervention offices at intervention prices that are also fixed annually by the Council of Ministers. During the last decade the mechanism, that formerly offered a complete price guarantee to the producers, was modified by making intervention purchases dependent on the condition that the market price dropped below a specified level and by lowering the prices paid for interventions below the official intervention prices. In the market organisation for sugar the price guarantee was limited to specific quotas from the beginning, in the market organisation for milk a similar system was introduced in 1984. The intra community price level was protected against the world market by variable levies, which as a result of the Uruguay-Round of the GATT were converted into tariffs in 1995. In order to allow exports on the world market at prices below the internal prices, export restitutions are paid, whose amount corresponds to the import tariffs. Some of the market organisations, including those for poultry meat, pig meat and several varieties of fruits and vegetables, do not include interventions or limit them to extraordinary situations. For perishable commodities, which cannot be stored, quantities purchased through intervention can either be processed (e.g. wine to alcohol, often not for human consumption), distributed to charitable organisations or destroyed, which creates high costs and problems of acceptance. Other market organisations like those for olives, tobacco, durum wheat and (since the reform of 1992) oilseeds include direct payments as a means to increase farm income putting the financial burden on the taxpayer instead of the consumer. The same principle was applied in the common market organisations for hops, flax, cotton, silk worms, and seeds, all products of minor general importance but for various reasons important enough to justify an interest of the Community to prevent the discontinuation of their production⁴.

It seems self-evident that in a single market in which on the one hand the principle of free movement of commodities is guaranteed, while producers are heavily protected against outside competition and their income is largely influenced by price support and by direct payments the options offered by Art. 40 (now Art. 34) other than common market organisations are infeasible. This part of the CAP therefore does not allow re-nationalisation. That past decisions of the Council of Ministers do not exclude reverting to the other options

³ For a more detailed description see v.Urff, W.: Agrarmarkt und Struktur des ländlichen Raumes, in: Weidenfeld, W. (Ed.): Europa-Handbuch, Bonn 1999. p.445.

⁴ v. Urff, W.: Agrarmarkt und Struktur des ländlichen Raumes,.....p.446.

mentioned in Art.40 is true from a juridical point of view⁵ but from a practical point of view it seems impossible. Politicians who advocate for re-nationalisation of agricultural market and price policy do not acknowledge the lessons taught by history.

3. The principle of common financial responsibility – How to deal with its implications?

A question closely related to re-nationalisation is that of co-financing the expenditures originating from the market and price policy. Parallel to the implementation of the common market organisations the European Agricultural Guidance and Guarantee Fund (EAGGF) was established in order to finance the costs originating from the market organisations. This is completely done by the Guarantee Section of the EAGGF. The Guidance Section was established in order to co-finance structural measures within the Member States. In the beginning the EAGGF absorbed more than 70 p.c. of the EEC budget because there were no other common policies leading to expenditures. In 2000 total expenditures of the EAGGF were 45.5 billion Euro (40.4 billion for the Guarantee Section and 5.1 billion for the Guidance Section), still 51 p.c. of the EU budget⁶.

Besides the importance of the total amount the distributional effect of the market and price policy is the object of strong criticism. In 1999 an amount of 10.0 billion Euro of the Guarantee Section originated in Germany whereas expenditures in Germany were only 5.7 billion Euro resulting thus in a German net contribution of 4.3 billion Euro. Other net payers were the UK, the Netherlands, Austria, Sweden, Finland, Belgium, and Italy. Net beneficiaries were Denmark, Greece, Spain, Ireland, Portugal and France⁷. The main criticism is that the distribution effects do not follow the principle that comparatively rich countries support poor countries, but are accidental, sometimes benefiting rich countries with a strong agricultural sector.

⁵ Seidel, M.: Rückführung der Landwirtschaftspolitiken die Verantwortung der Mitgliedstaaten? Rechts- und Verfassungsfragen des Gemeinschaftsrechts, Zentrum für Europäische Integrationsforschung, Policy Paper B00-17, Bonn 2000.

⁶ Bundesministerium für Verbraucherschutz, Ernährung und Landwirtschaft: Agrarbericht der Bundesregierung 2001, p.91.

⁷ Bundesministerium für Verbraucherschutz, Ernährung und Landwirtschaft: Agrarbericht der Bundesregierung 2001, Annex, p. 81.

It is not surprising that most criticism comes from Germany. Following German requests in the past several models were calculated and discussed within the political bodies but without results. The general answer to the German plea for co-financing the market expenditure was that the financial burden resulting from jointly decided policies has to be financed jointly. Moreover one has to take into account that the incidence of expenditures of the market and price policy is not as straightforward as they seem to be. If surpluses are withheld from the market by interventions and thus prices stabilised, the beneficiaries are all farmers who produce the respective commodity within the single market and not only those of the country in which the intervention actually takes place. If surpluses are reduced by exports with the help of export restitutions the beneficiaries are European farmers and not the country in which the exporter resides.

4. Changes brought about by past reforms

By the CAP reform of 1992, the so-called Mac Sharry reform, the level of price support for major commodities was reduced (for cereals by 33 p.c., for beef by 15 p.c. over a period of three years) and per hectare or headage payments introduced or increased in order to compensate farmers for the income effects of price cuts. The compensation payments were calculated in such a way that on average full compensation was achieved, except for beef where upper limits for the number of animals per farm and for the stocking density were introduced with the effect that farmers received premiums only for a part of the cattle they kept for fattening⁸. From a budgetary point of view the reform led to the result that the costs for market interventions decreased from 95 p.c. of the total expenditure of the Guarantee Section of the EAGGF to about 50 p.c. and the amount of direct payments increased from 3 p.c. to 45 p.c. the rest being expenditures for agri-environmental programs.

The shift from market interventions to direct payments will continue following the decisions of the Agenda 2000. The negotiations and the tensions coming up within the process are certainly still fresh in everybody's memory⁹. On the German side the net-payer position was one of the issues, on the French side it was the wish to shield agriculture against too drastic changes. The EU was under the pressure to honour the commitments of the Agreement on

⁸ Bulletin der EU 5 (1992) p.55.

Agriculture of the Uruguay-Round and to prepare the ground for the WTO-negotiations starting in November 1999. There was a general consensus to limit EU expenditures, particularly those for the CAP and of the structural funds. Decisions had to take into account the requirements originating from the eastward enlargement of the EU. Fundamental decisions were taken at the Berlin Summit of 24/25 March 1999 and later on converted into a series of regulations by the Council of Ministers on 17 May 1999.

Concerning the common market organisations it was decided to reduce the level of support prices for cereals by 15 p.c. over two years and to increase the per hectare payment in a way that compensates 50 p.c. of the income effect of price cuts. The per hectare payments for oilseeds, which were about 35 p.c. higher than those for cereals, will be reduced to the same level over a period of three years. For beef the level of support prices will be reduced by

20 p.c. in three annual steps and the headage payments increased accordingly, but also in this case - except for suckler cows - full compensation will not be achieved even with the inclusion of slaughter premiums which were introduced as a new element. The ceiling of 90 animals per farm was abolished. Its re-introduction is one of the issues presently debated. For milk the quota system was extended until 2006. A further extension of the system will depend on a mid-term review in 2003. The quotas were increased by specific amounts for Greece, Spain, Ireland, and Italy and by 1.5 p.c. over a period of three years, for all other Member States. Beginning in 2003/04 the support prices for milk will be reduced by 15 p.c. over a period of four years and compensation payments based on the milk quota per farm will be introduced and increased correspondingly. They will, however, compensate only 40 p.c. of the effects of price cuts. Another 20 p.c. may be compensated by lump sum amounts put at the disposal of the Member States who will be free to distribute them, as they consider appropriate¹⁰.

The increasing importance of direct payments in comparison to the costs of market interventions has initiated a debate whether these payments could and should be co-financed by the Member States, which Germany strongly advocates. The main argument is that in contrast to market interventions these payments directly benefit farmers within the respective Member States. It would therefore be fair – so the argument – to put part of the burden on the

⁹ For a more detailed description see v. Urff, W.: Agrar- und Fischereipolitik, in: Weidenfeld, W. / Wessels, W. (Eds): Jahrbuch der Europäischen Integration 1998/1999, p.125-134.

national budgets. Among the German “Länder” Bavaria goes further by arguing that even the amount of the compensation payments should be left to the decision of national or regional authorities, allowing them thus to maintain small farms under unfavourable conditions if they give high priority to traditional farm structure and are prepared to pay for it in addition to EU payments.

One may, however, have serious doubts whether such nationally co financed or national payments are feasible from a juridical and a political point of view. Would it really be possible that the Council of Ministers decides on the level of payments, which have partly to be paid by the Member States? Most probably the answer is no¹¹. Would it be possible that EU compensation payments are topped-up by national payments? Does this not imply a violation of the principle that national subsidies, which may distort competition, are forbidden? With the help of national payments more farms are kept in production than would have been otherwise which makes economic survival more difficult for farms in other Member States that do not grant additional payments from their own budget.

Of fundamental interest are two possibilities introduced by the so-called “Horizontal Regulation” as part of the Agenda 2000. Member States are permitted to reduce the level of compensation payments for a farm if (1) the number of work units is lower than a certain level, (2) farm income exceeds a certain level, or (3) the total amount of compensation payments exceeds a certain amount (“modulation”). Member States also have the possibility to link compensation payments to environmental standards and to reduce their level in accordance with the degree of violation of these standards (“cross compliance”). The total amount saved by modulation and cross compliance is available for agro-environmental programs, which are nationally co-financed. Contrary to France and UK, Germany has so far not yet used these possibilities but obviously the present Minister of Consumer Protection, Food and Agriculture wants to make use of them as part of a new policy. Co-financing was a problem not least because of the financial burden resulting from BSE and FMD but this problem seems to be solved after an intervention of the German Chancellor.

5. Agri-environmental measures

¹⁰ Deutscher Bauernverband: Situationsbericht 2000. pp.92-109.

¹¹ Seidel, M.: Rückführung der Landwirtschaftspolitik in die Verantwortung der Mitgliedstaaten?.....

Agro-environmental measures are a more and more important element of the CAP. They are a reaction to the fact that modern highly intensive farming may cause environmental damages such as percolation of plant nutrients (primarily nitrate) and chemicals into the groundwater, loss of natural and semi-natural habitats, loss of bio-diversity, erosion, soil compaction etc. At the first time the “Efficiency Regulation” of 1985 introduced the possibility for Member States to pay premiums to farmers for environmentally friendly farming practices. They were subjected to strict rules in order to prevent that they became national subsidies of a competition distorting nature. Later on the Community decided to co finance such premiums.

In the context of the CAP reform of 1992 so-called “accompanying measures” were introduced

consisting of agro-environmental measures, an early retirement scheme, and an afforestation programme. All these measures are co-financed by the EU and Member States, normally on a 50 to 50 basis. Most important of them is Regulation 2078/92 concerning agricultural production methods that are in line with environmental requirements and protect natural habitats. It stipulates that programmes designed by member states and accepted by the Commission may include granting premiums to farmers who on a voluntary and contractual basis undertake:

- to reduce substantially, or maintain a reduction, in the use of fertilisers and /or plant protection products, or to adopt or continue with organic farming production methods;
- to change to, or maintain, more extensive forms of crop production, or to convert arable land into extensive grassland;
- to reduce the stocking rate of sheep and cattle per forage hectare;
- to use other farming practices compatible with the protection of the environment and natural resources, as well as the maintenance of the countryside and the landscape;
- to rear animals of local breeds in danger of extinction or plants endangered by genetic erosion;
- to maintain abandoned farmland or woodland for reasons of environmental protection;
- to set aside farmland for at least 20 years with a view to its use for purposes connected with the environment, in particular for the establishment of biotope reserves or natural parks for the protection of hydrological systems;
- to manage land for public access and leisure activities.

Farmers participating in the schemes are paid a compensation for the associated loss of income plus an incentive, which should not exceed 25 p.c. of the premium. For each kind of activity

upper limits for the premiums are defined by the Regulation. The premiums are paid on an annual basis. The scheme requires that farmers commit themselves for a period of five years except for the set-aside scheme, where the period is twenty years. The Regulation offered different forms for implementing agro-environmental programmes, which were used by the Member States in different ways.

Taking into account the different ways in which the Member States made use of the opportunities offered by Regulation 2078/92 it is no surprise to see large differences in the allocation of EU-contributions between Member States. The lion's share went to Germany, followed by France, Austria and Italy. Greece, Belgium and Denmark are countries whose share did not exceed 1 p.c. By and large the programme was quite successful. It was largely accepted by farmers so that for the period 1994-1999 the average annual amount spent out of the EU budget was nearly 0.9 billion ECU¹². The Agenda 2000 offers the possibility to continue agro-environmental schemes along the same lines within a different institutional arrangement. Member States who want to give more emphasis to environmental aspects have the opportunity to do so.

6. Structural Policies

Compared to the market and price policy structural policies receive less recognition in the public debate, which – taking into account the real importance this part of the CAP has – is a wrong perception. In the early years, i.e. from 1962 to 1972 the Common Agricultural Policy limited itself to co-ordinating and supplementing national structural policies. In the light of the Mansholt Plan of 1968 a more active approach to structural policies was adopted. The Community began to co-finance certain measures of the Member States, provided they fulfilled certain conditions laid down in common directives or regulations. Most of these measures aimed at structural improvements in farming including small scale processing and marketing of farm products. Horizontal measures applicable in all Member States, such as modernisation of farms, re-training of farmers and retirement supports for older farmers were introduced by the so-called structural directives (Directives EEC 159 to 1961 of 1972). They were complemented in 1975 by the Directive EEC 268/75 on mountain and hill farming and farming in less favoured areas¹³.

¹² Schramek, J. / Biehl, D. / Buller, H. / Wilson, G. (Eds.): Implementation and Effectiveness of Agri-environmental Schemes Established under Regulation 2078/92, Final Consolidated Report, Frankfurt, June 1999.

¹³ v. Urff, W.: Agrarmarkt und Struktur des ländlichen Raumes,.....p.451.

A fundamental change was brought about in 1988 by the decision laid down in Regulation (EEC) 2052/88 to bring together the three major structural policy instruments, the European Regional Development Fund (ERDF), the European Social Fund (ESF), and the Guidance Section of the EAGGF. The resources made available to the structural funds were doubled in real terms from seven billion ECU in 1989 to 14 billion ECU in 1993. For interventions of the structural funds the following objectives were defined:

- Objective 1: Promoting the development and structural adjustment of regions whose development is lagging behind;
- Objective 2: Converting the regions seriously affected by industrial decline;
- Objective 3: Combating long-term unemployment and facilitating the occupational integration of young people and of persons threatened by exclusion from the labour market;
- Objective 4: Facilitating the adjustment of working people to industrial changes and changes of production systems;
- Objective 5a: Speeding up the adjustment of agricultural structures to the reform of the CAP,
- Objective 5b: Facilitating the development and structural adjustment of rural areas¹⁴.

Three of the six objectives refer to agriculture itself or regions, where agriculture has an above average economic and social weight. Objective 1 supports the development of - mainly - rural areas, which substantially lag behind the Community's average gross domestic product per capita. Regions eligible for objective 1-support were Greece, Ireland and Portugal in total, and Northern Ireland large parts of Spain and southern Italy. In 1994 the new Länder of Germany (the former German Democratic Republic) also became eligible for objective 1-support. Objective 5b supported the development of rural areas, characterised by an above average proportion of people employed in agriculture, a below average gross value added per labour unit in agriculture, and a relatively low gross domestic product per capita. Objective 5a included the so-called "horizontal structural measures", i.e. all activities destined to facilitate and accelerate structural adjustments in agriculture without regional limitation. Out of the total financial resources of 58.3 billion ECU

¹⁴ Akademie für Raumforschung und Landesplanung: Regional Aspects of Common Agricultural Policy: New Roles for Rural Areas, Hannover 1996, pp.65-70.

provided for the Community's structural funds for the years 1989-93, more than 64 p.c. were assigned to objective 1, about 6 p.c. to objective 5a and 5 p.c. to objective 5b¹⁵.

At the Edinburgh summit in December 1992 the European Council decided again a doubling of the financial allocations to the structural funds that brought the average amount available per annum from 13 billion ECU to 25 billion ECU for the period 1994-1999. Total allocation for that period was 153 billion ECU (at 1994 prices). The objective structure remained unchanged and the percentage amounts allocated to the various objectives by and large corresponded to those of the previous period. Following the accession of Austria, Sweden, and Finland in 1995 a new objective 6 was introduced providing support similar to that of objective 1 in certain areas in the northern parts of the Scandinavian countries with extremely low population density.

In the Agenda 2000 this policy was continued, however with smaller increases in the financial allocations. The Berlin Summit did not follow the Commission's proposal to allocate 275 billion Euro to the structural funds for the years 2000 to 2006, which would have been 75 billion Euro more than the amount of 200 billion Euro that was available for the period 1993 to 1999 (both at 1997 prices) but reduced that amount to 258 billion Euro. Out of that total an amount of 45 billion Euro was earmarked for the accession countries of Central and Eastern Europe, leaving for the EU-15 an amount of 213 billion Euro¹⁶.

Following the Commission's proposal the number of objectives was reduced from 7 to 3. Among this three objective 1 remained more or less unchanged. The regions lagging behind in development and thus facing most serious difficulties were given the same priority as in the past. About two thirds of the total amount were allocated to this objective. In future, however, the threshold of a per capita income of 75 p.c. of the Community average should be applied more strictly. By this the population living in areas eligible for objective 1 will be reduced from 25 to 20 p.c..

The newly defined objective 2 „supporting the economic and social conversion of areas facing structural difficulties“ brought together measures for other regions suffering from structural problems. These are areas undergoing economic change (in industry or services), declining rural areas, crisis-hit areas dependent on the fishing industry or urban areas in difficulty. The new

¹⁵ European Commission, Directorate-General for Agriculture: Rural Developments, CAP 2000, Working Document, Brussels 1997.

programmes to support the objective 2 areas, to which 11 p.c. of the total financial means were allocated, will favour economic diversification, particularly in regions heavily dependent on a single economic sector. As compared with the previous objective 2 covering an area in which 16 p.c. of Europe's population were living and objective 5b-regions with 9 p.c. of the population, the new objective 2-regions will only comprise 18 p.c. of the population (5 p.c. within the rural areas). A new objective 3 "supporting the adaptation and modernisation of education, training and employment policies and systems" will be implemented horizontally.

Taking into account the impact of the changes in the Common Market Organisation on rural areas and the increasing importance of environmental and recreational needs that would offer new development opportunities from which farmers and their families should be able to benefit the following reorganisation of the existing rural policy instruments was proposed by the Commission¹⁷:

- Existing accompanying measures financed by the EAGGF, Guarantee Section should be supplemented by the Less Favoured Areas scheme including its application in the objective 1 regions and implemented horizontally in a decentralized way.
- For those rural areas, which are located in objective 1 regions, the approach of integrated development programmes should be maintained.
- In rural areas eligible under the new objective 2, operations (formerly objectives 5a and 5b) will be financed by the EAGGF Guarantee Section as accompanying measures together with measures of other structural funds within the same region.
- In all rural areas outside objective 1 and the new objective 2, rural development measures to accompany and complement market policies will be co-financed by the EAGGF Guarantee Section. They will embrace all types of measures supporting structural adjustment and rural development as formerly co-financed by the EAGGF Guidance Section.

The Berlin Summit followed the Commission's proposal and, based on that decision, the Council of Ministers adopted on 17 May 1999 the Regulation No 1257/99 on Support for Rural Development from the EAGGF, which is considered as the „*second pillar*“ of the CAP and to which 30 billion Euro were allocated for the period 2000-2006 within the Guarantee Section of the EAGGF. It includes the activities that were introduced as „accompanying measures“ by the

¹⁶ EU-Kommission: „Agenda 2000. Eine stärkere und erweiterte Union“, Bulletin der EU, Beilage 5, 1997.

¹⁷ EU-Kommission: „Agenda 2000.....“

1992 reform (i.e. agro-environmental schemes, early retirement, and afforestation), measures for less favoured areas, adjustment of production and processing structures in agriculture and forestry (former 5a-measures), development of rural areas (former 5b-measures) and a long list of new measures including soil amelioration, consolidation of farms, marketing of quality products, village renewal, improvement of living conditions in rural areas, protection and preservation of rural heritage, diversification of agricultural and non-agricultural activities, improvement of rural infrastructure, promotion of tourism and handicraft. The new regulation offers a broad spectrum of activities out of which national and regional authorities can select and combine those that they consider most appropriate to achieve their objectives of rural development and environmental protection. Such rural development plans should include, amongst other things, a quantified description of the current situation, the strategy proposed and indicators for evaluation in order to allow transparency and democratic control.

7. Why does the CAP have to continue to evolve?

The previous sections of this paper have shown a remarkable evolution of the CAP from a set of market organisations to complex and comprehensive policy with increasing emphasis on environmental aspects and on rural development. The question therefore arises whether the heated debate about the future of the agricultural policy is justified and whether the CAP really needs fundamental changes? Only if the answer to these questions is yes one can tackle the question into which direction changes should go.

The reasons why changes in the CAP are needed are manifold¹⁸. The following seem to be the most important ones:

There is a continuing and perhaps even growing *domestic dissatisfaction* with the CAP. Consumers are more and more concerned about *food safety* particularly after the incidence of BSE and FMD. One may argue that from a scientific point of view never in history food has been safer than at present but the perception of the public at large is completely the other way round. There is the general suspicion that intensive production is itself a threat to food integrity and food

¹⁸ European Commission, Directorate-General for Economic and Financial Affairs: Towards a Common Agricultural and Rural Policy for Europe, European Economy, Reports and Studies No. 5, 1997, p.6

safety¹⁹. Availability of food is taken for granted and food prices that are at a historically low level are not a major issue in public awareness. That there are *environmental problems* caused by agriculture is beyond dispute. There is a fundamental conflict between many systems of intensive crop and animal production and many aspects of the environment. The impact of agro-environmental measures is by far less than what environmentalists want to see. *Animal welfare* is also a growing concern for many people mostly seen in connection with the number of animals kept on a farm and the intensity of production. *Farmers are frustrated* because the CAP has failed in achieving its aim of enabling farmers to earn an income that by and large reflects the general income development and allows them a standard of living comparable to other groups of the society. Moreover they feel discriminated by the visibility of the compensation payments and discouraged by increasing restrictions on farming practices for environmental reasons. European citizens, first of all politicians, are concerned about the *high expenditures of the CAP*, which – despite the upper limit of 40.5 billion Euro per annum (at 1998 prices) imposed by the Berlin Summit - still absorb 51 p.c. of the EU budget. Economists regret the misallocation of resources resulting from distorted incentives and the low efficiency of the expenditures²⁰. Public expenditures and transfers from consumers resulting from price support exceed the income effect of policy measures for European farmers, primarily because of the low efficiency of export subsidies, by which consumers in the countries that import EU surpluses are subsidised. Efficiency of the CAP is also less than satisfactory with regard to the *development of rural areas*. Many rural areas are still lagging behind in economic development despite high CAP expenditures, due to the fact that these expenditures are not adequately geared to development purposes but mainly distributed depending on the volume of production. It is largely felt that the unsatisfactory results are related to a wrong allocation of responsibilities: too much centralisation and too little responsibilities assigned to the national and the regional level.

A need for re-assessing the adequacy of the present CAP also results from the *WTO negotiations*. In the Agreement on Agriculture of the Uruguay-Round the EU accepted (1) to reduce its internal level of support by 20 p.c. as compared to 1986-88 over a period of six years, (2) to replace variable import levies by tariffs and to reduce the level of protection by 36 p.c. within the same period, (3) to reduce the amount of export subsidies by 36 p.c. and the quantities exported with

¹⁹ European Commission, Directorate-General for Economic and Social Affairs: Towards a Common Agricultural and Rural Policy for Europe.....p.8.

²⁰ Wissenschaftlicher Beirat beim Bundesministerium für Ernährung, Landwirtschaft und Forsten: Zur Weiterentwicklung der EU-Agrarreform, Schriftenreihe des Bundesministeriums für Ernährung, Landwirtschaft und Forsten, Reihe A: Angewandte Wissenschaft, Heft 459, Bonn 1997.

the help of export restitutions by 21 p.c., (4) to open up a minimum access to the internal market of 3 p.c. of domestic demand at the beginning, increasing to 5 p.c. at the end of the transition period, (5) to subject its area under oilseeds to a ceiling of 5.128 million hectares²¹. It is only now at the end of the transition period that some of the restrictions start to become binding. The EU must, however, be aware of the necessity to honour these commitments in the future, which may require additional actions to prevent production from increasing beyond levels in line with exports within the agreed limits²².

Part of the Agreement on Agriculture was the decision to start new negotiations early enough before the end of the so-called peace clause at the end of 2003 in order to reach an agreement for the following period. These negotiations were due to start in 1999, which they did with the Ministerial Conference in Seattle at the beginning of December. That the conference ended with a complete failure does not mean an end of the process. Practical work started at working group level and very soon it became clear that there is a strong and continued pressure on the EU from the United States and the Cairns Group (a group of countries interested in agricultural exports) to further reduce and in the long-run eliminate export subsidies to reduce the level of support and to increase market access.

The EU was partially successful in introducing the concept of multifunctional agriculture also called the European model of farming. It emphasizes the functions of agriculture in addition to food production such as preserving the cultural landscape and contributing to the economic and social viability of rural areas. In the beginning it was strongly rejected by the Cairns Group who suspected a new justification for subsidies but finally it was at least accepted to include non-trade concerns into the negotiations.

Another important reason for having a critical view on the CAP and for looking for more options is the *eastward enlargement of the EU*²³. As in previous enlargements the accession countries will have to accept the „acquis communautaire“. If this includes the CAP in its present form, additional surpluses of some major agricultural products would be the result. To dispose of these

²¹ v. Urff, W.: Agrarmarkt und Struktur des ländlichen Raumes..... p.450.

²² Tangermann, S.: Implementation of the Uruguay Round Agreement on Agriculture: Issues and Prospects, Journal of Agricultural Economics 47, No.3, 1996, pp.315-337.

²³ Wissenschaftlicher Beirat beim Bundesministerium für Ernährung, Landwirtschaft und Forsten: Die Entwicklung der Landwirtschaft in Mitteleuropa und mögliche Folgen für die Agrarpolitik in der EU, Schriftenreihe des Bundesministeriums für Ernährung, Landwirtschaft und Forsten, Reihe A: Angewandte Wissenschaft, Heft 458, Bonn 1997.

surpluses on the world market would be difficult because of the restrictions on subsidised exports resulting from the Uruguay-Round. The permitted quantities that the accession countries will add to those of the present EU are small in relation to their production potential²⁴. Additional export restitutions require *additional financial resources* thus opening the question whether the financial ceilings that were part of the Berlin decisions would be sufficient to allow the accession of the Central and Eastern European Countries. To avoid increasing problems of surplus disposal a strict application of supply controls might become necessary. In the case of sugar and milk the debate on the *quotas* to be allocated to the accession countries has already started. These countries demand quotas that take into the account their production potential on the basis of historical levels of production before the collapse of the socialist system, whereas the EU tries to orientate the quotas on the much lower present production. Most controversial is the issue of *direct payments*. Whereas the EU argues that these payment are nothing else than compensations for price cuts as part of the 1992 CAP reform and the Agenda 2000 and therefore not applicable to the accession countries, these countries argue that they have become an essential element of the CAP and can therefore not be denied to the accession countries. They violently reject what they call second-class citizenship. In order to facilitate eastward enlargement one has to explore whether a different mix of policy measures within a revised CAP is more appropriate²⁵.

8. How to change the CAP in order to respond to the new challenges?

From price support to market stabilisation

Art. 39 of the Treaty of Rome mentions market stabilisation as one of the objectives of the CAP, which means protection of producers (and consumers) against overly and unnecessary price fluctuations. In the course of time this has become price support, which means that producer prices were fixed above equilibrium prices and interventions and export restitutions were used to enforce the politically decided prices. Price support was the most important means to achieve farm income goals, which became more and more costly and less efficient. With the CAP reform of 1992 direct payments were introduced as a more efficient means to influence farm incomes and price support was decreased. The Agenda 2000 was a second step in the same direction. There is certainly scope for further steps. If the WTO negotiations lead to further restrictions and

²⁴ Tangermann, S. and Josling T.: Pre-accession agricultural policies for central europe and the European Union, report prepared for the European Commission, DG I, Brussels 1994.

²⁵ European Commission, Directorate-General for Economic and Social Affairs: Towards a Common Agricultural and Rural Policy for Europe.....p.24.

in the long run the elimination of export subsidies, import tariffs will become the only instrument to defend the level of internal prices. For commodities that EU farmers cannot produce at the world market price the quantity produced can no longer exceed domestic consumption and the internal price will be determined by the equilibrium between supply and demand, assuming that for such commodities tariffs will be set at a level that limits imports to minimum market access. Market interventions will have to be strictly limited to stabilisation. Farmers will be under the pressure to increase productivity of production. Food prices will decline. Food safety and environmental aspects will be taken care of by regulations to the extent necessary without jeopardizing competitiveness. For the support of farm incomes other measures will have to be used.

The future role of compensation payments

A crucial question of the evolution of the CAP is that of the future scope and role of the compensation payments, the central elements of the reform of 1992 and the Agenda 2000. Evidently they will have to be maintained for some time for the reason of protection of confidence. Farmers have made decisions, for example investment decisions, confident that the economic environment determined by policy parameters will continue for a foreseeable future, and it would therefore be unfair to suddenly expose them to the effects of drastic policy changes. The validity of this argument has, however, a time limit; it cannot last forever. The longer the policy change took place back in history, the more difficult it becomes to justify compensation payments that have the only justification to compensate farmers for the income losses originating from price cuts as a result of policy change. There is therefore a tendency to use cross compliance and modulation to make compensation payments more acceptable.

From a logical point of view it seems, however, better to consider compensation payments and payments to farmers for other services, such as maintaining the cultural landscape and contributing to the viability of rural areas, as two different instruments²⁶. Instead of linking compensation payments for price cuts to environmental conditions, which was not the case when they were introduced, a clear distinction should be made between compensation payments strictu sensu and payments for other services. The first ones should be phased out over a specified period of time in a clearly defined manner, the second ones should be phased in by broadening

²⁶ Wissenschaftlicher Beirat beim Bundesministerium für Ernährung, Landwirtschaft und Forsten: Zur Weiterentwicklung der EU-Agrarreform.....

the scope of already existing programmes and allocating more money for this purpose. With regard to the eastward enlargement it may be acceptable for the accession countries to see farmers in the present EU receiving compensation payments for a limited time and in decreasing order of magnitude knowing that they fully participate in all programmes aiming at environmental protection and rural development.

Strengthening of the „Second Pillar“

As described earlier in this paper rural development was an integral part of the CAP from the very beginning and environmental policy became one of its components when negative impacts of highly intensive farming and the need to maintain the countryside and the rural environment became obvious. In the course of time both components gained more and more importance. Functions of agriculture in addition to food production are sometimes even more important than food production itself²⁷. The Agenda 2000 brought these two elements together in the Regulation on Support for Rural Development. The concept, of offering a broad list of optional measures to national or regional authorities, thus giving them the possibility to choose and to design tailor-made programmes for specific regions according to their priorities and their willingness to co-finance such programmes (outside objective-1-regions at a rate of 50 p.c.) corresponds to the principle of subsidiarity. If unnecessary bureaucracy in the decision making process can be avoided it is difficult to see a need for re-nationalisation, if one accepts the principle that a common framework is necessary to avoid distortion of competition and to execute financial solidarity with less wealthy countries and regions within the Community. The latter is of particular importance for the Central and Eastern European Countries. These countries certainly have a need for rural development and environment protection but their own budgets will not allow financing the necessary measures. Since probably many of their rural areas will be classified as objective-1-regions the respective measures will be co financed by the EU at a rate of 75 p.c. Channelling funds into development measures will be more appropriate than paying farmers compensation payments on the basis of historical production.

Concerning the evolution of the CAP the most appropriate way would be to strengthen the “second pillar“. Such strategy can make a major contribution to the development of rural areas, for which there is a real need in many European countries. The multifunctionality of agriculture can be better taken into account by measures of the „second pillar“ than by purely protective

measures. Taking into account that some measures, which were formerly, financed by the Guidance Section of the EAGGF the yearly amount available of 4.3 billion Euro (30 billion Euro for the period 2000-2006) is practically the same as it was in the period 1994-1999 for the measures that are now part of the Regulation on Support for Rural Development. The narrow financial restrictions do not correspond to the importance of the task. Financial resources that will be released by a reduction of price support - which will probably be unavoidable under the influence of the WTO - should be used to increase the financial basis. The same should be done with financial resources resulting from reductions of compensation payments²⁸.

Measures of animal welfare can easily be included in the concept if the society so wishes and is prepared to pay for it. Experience shows that the consumer's willingness to pay higher prices for commodities produced under higher animal welfare standards does not bring about the results that society wishes. Organic farming is already part of the concept. Specific promotion of this type of farming should, however, take place with great care. Basically production should be driven by demand. If supply increases faster than demand because of promotion, prices may collapse to the detriment of farmers who already changed to organic farming. Correct labelling should give the consumer the choice between types of food produced by different practices. Food safety has to be guaranteed by adequate standards. Compliance with the standards has to be checked by controls. The perception that food quality is the direct result of farming practices or of farm size does not stand scientific tests. Attempts to maintain a farm structure primarily based on small farms or to split-up larger units into small farms, and to put an upper limit on production intensity coupled with price support may be counterproductive. Most probably they will not be successful because isolation from the world market will not be tolerated by the WTO. If nevertheless efforts are made in that direction, for example by offering compensations to WTO members whose export interests will be violated, one has to aware that it would mean strengthen the „first pillar“ to the detriment of the „second pillar“, the contrary of what a long-term solution requires.

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²⁸ European Commission, Directorate-General for Economic and Social Affairs: Towards a Common Agricultural and Rural Policy for Europe.....p.55.

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