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# **Why is the CAP resistant to reform?**

Applying Public Choice theory in the analysis of  
the Common Agricultural Policy

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## Abstract

Originating in the Treaty of Rome, the Common Agricultural Policy (CAP) is the European Union's largest and first supranational policy, well-known for its high cost, trade distorting effects and its reluctance to change. Despite being subject to three major reform attempts during 1992-2003 many of the original defects still remain. The aim of this thesis is to examine how far reaching the CAP reforms that have already been made are, and to analyse the reasons for why more fundamental changes have not been done. By applying the theory of Public Choice, i.e. economic analysis of political institutions, it becomes possible to analyse the political aspects that are forgone in pure economical studies of the policy.

The main findings of the thesis are that it is a combination of rational and self-interested behaviour of agents involved, and the institutional set-up of the CAP that causes the policy to be resistant to reform.

**Key words:** CAP, EU, the Commission, bureaucracy, reform, Public Choice, institutions, institutional set-up, rationality, collective action, lobbying

**“The EU is a system that privileges those with an intimate knowledge of how the Union’s policy process works and how business is conducted in the Council, the EP, and the Commission.**

Brigid Laffan and Alexander Stubb (2004:85)

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# 1 Introduction

For a great many of years economists have argued that the Common Agricultural Policy (CAP) has been expensive for taxpayers, consumers, the environment and third countries. However, while reforms of a policy may be justified by the economics, political considerations usually take precedence. The CAP is a great example of this fact.

Originating in the Treaty of Rome (1957)<sup>1</sup> CAP was initiated as a response to the signatories' commitment to form a customs union with complete free trade (Garzon 2006:21-22). Since Europe had just left a long period of war that had damaged its agricultural sector and made its population suffer from food shortage, and since the farm sector was economically important<sup>2</sup> at that time, most European nations adopted highly interventionist policies, as price controls and trade barriers (Baldwin & Wyplosz 2004:32). If agricultural products were to be included in the free movement of goods, national intervention mechanisms had to be removed and transferred to the community level - which was the basic reason to the foundation of the CAP (European Parliament Fact Sheets 2001). In particular France, the major agricultural producer in Europe, wanted - or rather could not afford to antagonize its powerful farm lobby - to maintain strong intervention in the sector. Germany, on the other hand, was in need of the free market in order to get its economy back on track. Hence the CAP became a "founding bargain" between these two countries, accepted as the price to be paid for further integration<sup>3</sup> (Baun 2000:144). Thus, the origins of the CAP have to be understood in the context of the European integration process. As Garzon (2006:21) describes it; *"the inception of the CAP was an important step in the unification of Europe..."*

There exist several justifications for a government to intervene in its agricultural sector. Firstly, since agricultural activities are heavily dependent on natural phenomena such as climate, the weather may cause large fluctuations in production volume. Coupled with inelastic demand of food, this leads to large price fluctuations (Senior Nello 2005:215). Hence, it is very important that both prices and farmers' incomes are stable, in order to ensure both food supply and a continuous growth of investments. Without any protection, farmers will not know how high their incomes will be, thus it is probable that

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<sup>1</sup> For key dates in the history of CAP see Appendix A.

<sup>2</sup> About one in five Europeans lived on farms during the time of the writing of the Treaty of Rome (Baldwin & Wyplosz 2004:212).

<sup>3</sup> The French government linked the acceleration of internal tariff removal to CAP adoption requirements. It threatened to block further tariff cuts if Germany did not give up its agricultural trade agreements.

investment and production will be suboptimal for the society. Secondly, in order to provide consumers the safety standards and information they require, labelling, certification and testing results need public intervention in order to be carried out correctly (ibid:216). Thirdly, agricultural activities imply both negative and positive externalities that are not internalized in farmers' costs and incomes. Governmental intervention is needed in order to stimulate the production of positive externalities, such as protection for the rural community, the landscape and animals, and to hamper the production of negative externalities, such as pollution (ibid:217).

The original purpose of the CAP was to facilitate agricultural production and increase productivity, and thereby secure food supply within the Union, but also to stabilise markets and guarantee affordable prices to consumers. In addition to the economic goals, a social aspect was also given great importance, namely to ensure fair standards of living for the agricultural community (Eurostat 2008:317). Thereby, the objectives of CAP sought to satisfy the needs of different groups in the society. Today, the CAP is still one of the most important policies of the EU and by almost any physical measure CAP has been successful. As Figure 1 shows, EU has indeed seen an increased production and obtained greater self-sufficiency. As a result Europe can now produce nearly all agricultural products (European Commission 2007:6).

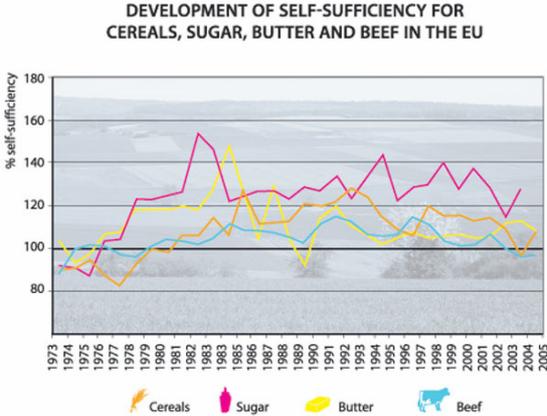


Figure 1: Agricultural self-sufficiency<sup>4</sup>

This growth in output is a result of CAP's production driving instruments, as price support, income transfers and production subsidies – instruments that are very costly. During the first decade of CAP, farm spending regularly took around 80 % or more in total budget expenditures, and at its peak in 1970, it made up 92% of the budget<sup>5</sup> (Baldwin & Wyplosz 2004:60). The projected CAP budget for 2008 was 55 billion Euros, with 5 billion going to market support, 37.2 billion going to direct payments

<sup>4</sup> Copied from the fact sheet published by the European Commission (2007:6).  
<sup>5</sup> See Appendix B for more details about the EU budget and the CAP's share of it.

to farmers, and 12.6 billion going to rural development (USDA 2008). To these nominal values the cost of lost efficiency and the impeded economic growth must be added. There is also a social loss which stems from higher consumer prices on food and a loss to society which stems from the resources retained by the agricultural that could be used more efficiently elsewhere (Drud Hansen (ed.) 2001:89). Moreover, the costs and benefits are unevenly distributed among both member states and inhabitants, e.g. the rate of protection is much higher for products produced in the northern part of the EU (Koester & Bale 1990:107) and despite that CAP accounts for almost half of the budget it does not manage to generate satisfactory incomes. As a consequence the agricultural labour force has decreased by 3-4% per year since 1983 (Drud Hansen (ed.) 2001:87). More and more farmers must take part-time jobs in order to supplement their family's incomes by off-farm work<sup>6</sup>. One reason for this fact is the European farmers' lack of ability to adapt to the global competitiveness. A second reason is the fact that fixing prices is not an efficient way to support farmers. Subsidies drive the prices of land and farm machinery, and as a consequence only about 25% of the money spent on price support actually ends up in the hands of farmers (Thurston 2005:3).

Clearly, the CAP is in need of reform. However, despite several attempts to reform the EU has still not resolved the fundamental problem of the agricultural policy; namely, that the policy creates incentives for farmers to engage in intensive farming which increases production to a level that demand cannot absorb. Consequently, agricultural spending has kept rising steadily and sometimes dramatically. No reforms have broken that trend.

## 1.1 Research question and methodology

The history of moderate reforms as responses to fundamental and serious policy problems suggests that we should examine the reasons why there have been no fundamental changes in the CAP, even though there would be welfare economic gains from so doing. Also the decline in the number of farmers justifies the question of why no radical CAP reform has taken place. The purpose of this thesis is to examine this puzzle. More specifically, the research question is the following

*How far-reaching are the CAP reforms already made and why have not more been done?*

In other words, this thesis seeks to present an answer to why the CAP is characterized by an institutional inertia. Since a lot has already been written about the CAP, but since most of the literature has taken an

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<sup>6</sup> See Appendix C for more details about agricultural incomes.

economical approach when analysing the policy, the point of departure in this thesis will be based on the political economical theory of Public Choice, which is “*the economic analysis of political institutions*” (Mueller 2003:501). By using this theory, it will be possible to analyse the otherwise forgone political aspects of the policy. Since Public Choice highlights the interaction between economic and political markets and can be used to answer whether political preferences, the influence of lobbying groups, voters and politicians are the reason of agricultural protection it seems to be a suitable theoretical model.

## 1.2 Delimitations

As stated, (only) the theory of Public Choice will be applied in the analysis of the CAP. Even though a political economical analysis of the policy seems to be suitable, Public Choice is only one theory of many. The best conclusion to why inertia is present in the institution of the CAP would be reached by the combination of various perspectives, e.g. by adding a comparative, a historical and some social and/or constructive approach to the analysis. This is said to be true because Public Choice is based on a rather restrictive set of assumptions about the nature of actors and institutions, assumptions that are possible to criticise as being too narrow. However, when analysing the complex relationships between politicians, bureaucrats, voters, consumers, third countries etc., simplifications are inevitable and due to time and space limitations a theoretical comparison cannot be made here.

A second delimitation of this thesis is that it will not include any in-depth studies of individual countries. Obviously, this will be a drawback, since the member states differ greatly in size<sup>7</sup>, power and wealth<sup>8</sup>, and may also differ in the size and type<sup>9</sup> of their agricultural sectors and in their speed to adapt to new markets and sectors. Hence, some countries will be more in need of CAP-support than others and thus push more for an intensification, rather than a liberalisation, of the CAP.

A third delimitation is that the analysis will not contain a discussion of what actually causes reform. This is an extremely important and interesting question - but it is beyond the scope of this thesis.

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<sup>7</sup> Only five (Germany, France, UK, Italy, Spain and Poland) of the Member States of the EU-27 are counted as ‘large’. Together these countries make up about 70% of the population. However, Germany, France and the UK are generally seen as the ‘big three’ (Laffan & Stubb 2008:76-77). Regarding farm sizes, there are significant differences between the Member States, ranging from an average of 171 acres in the UK to 7,2 acres in Hungary (USDA 2008).

<sup>8</sup> The Member States GDP in 2005 ranged from 64300 Euro in Luxemburg to 2800 Euro in Bulgaria (Laffan & Stubb 2008:79).

<sup>9</sup> E.g. French farms are mostly run by a corporation while Greek farms are likely to be family owned. French farms are also much larger and much more efficient and high-tech than Greek farms (Baldwin & Wyplosz 2004:215).

### 1.3 Outline of the thesis

Following this introductory chapter, the thesis will continue with a background in section two. The background will contain a description of the Commission, which is the answerable institution of the CAP and the sole initiator to policy making and policy reforming in the Union, and the CAP in more detail. Especially the main instruments of the CAP and the reforms that have already been made will be described and discussed in order to give the reader information of what has already been done, and why this is not enough.

The theory of Public Choice will be presented in section three. Focus will be put on the theory of collective action, lobbying activities and the political rationality of the maintenance of the current CAP.

The theoretical findings will be analysed in section five, where also the prospects for further reform will be discussed.

The thesis ends with conclusions in section five.

# 2 Background

## 2.1 The political system of the European Union

Political scientists often see the EU as a political system, where political interests influence the institutions, which in turn transform interests to politics (Tallberg 2004:12). Clearly, the institutions are the essence of the Union, hence, if we are interested in studying the politics of the EU, we have to study the institutions. How do institutions make a decision? How much are they affected by different interest groups in the society? What does the political and administrative environment look like? In other words, why are policies the way they are? All of these questions will be answered (more or less) in this and the following two sections.

To make sense of European politics, as the CAP, some understanding of how (or if) EU's key institutions work is necessary - however that is much easier said than done. The EU "*combines the attributes of a state with those of a traditional organization yet it closely resembles neither*" (Bomberg, Peterson & Stubb 2008:4) and its development is shaped by 27 member states, five EU institutions<sup>10</sup>, private interests, experts, foreign actors and citizens. Often the term multi-level governance is used to describe the EU. It refers to a system in which a policy process takes place at several levels simultaneously and in which power is shared between the supranational, national, and sub national levels (ibid:10). What makes the EU unique is that there is no overall ruler or government<sup>11</sup> or even a dominant actor, although the Council and the Commission are often referred to as the dual executive (Hix 2005:27). In this system, all actors must bargain and share power until they reach an agreement (Bomberg, Peterson & Stubb 2008:17). For this reason EU is sometimes described as the most advanced experiment ever in multilateral cooperation and integration.

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<sup>10</sup> See Appendix D for an overview of the European institutions and what they do.

<sup>11</sup> 'Governance without a government' is one way to describe the EU (Jönsson & Strömvik 2005:13).

## 2.1.1 The European Commission

The Treaty of Rome established the decision-making triangle of the European Union. We know it today as the Council of Ministers<sup>12</sup>, the Parliament and the Commission. These three institutions manages and runs the Union; the Commission proposes bills, the Parliament express its opinion and the Council decides by unanimity if it wants to enforce changes, either alone or together with the Parliament<sup>13</sup>. Then it is the task of the Court to interpret the established treaties and rules (Bomberg, Peterson & Stubb:66).

The decision-making in the EU is a very complex procedure. The Council of Ministers is the EU's main decision making body since almost every piece of legislation is subject to approval by it, but it is the Commission that has the solo task of initiating policies<sup>14</sup> and a monopoly on the right to initiate proposals for new laws (Bomberg & Stubb 2008:51). Hence, any reform of the CAP will have to emerge from there, implying that the Commission is the agenda setter of the EU. Regarding agricultural matters, the Parliament plays only a consultative role despite being the only directly elected body representing European citizens. However, it has exercised a strong influence over the CAP through non-binding means such as own-initiative reports and resolutions and conciliation procedures with the Council (European Parliament Fact Sheets 2001). Moreover, the Commission is always answerable to the Parliament<sup>15</sup>.

The Commission<sup>16</sup> itself refers to the College of Commissioners and the administrative Commission<sup>17</sup>, which is also called the bureaucracy (EU 2009) and is headed by a President<sup>18</sup> (Senior Nello 2005:38). The College is the executive part of the institution, made up of 27 Commissioners, one appointed by

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<sup>12</sup> The Council of Ministers should not be confused with the European Council, which consists of the leaders of each Member State plus the President, or the Council of Europe, an international organization that is unrelated to the EU (Baldwin & Wyplosz 2004:47,50-51).

<sup>13</sup> Three main proceedings of legislation can be distinguished in EU: co-decision procedure (gives the Parliament equal standing with the Council), consultation procedure (the Parliament must give its opinion before the Council adopts the Commission's proposal – the procedure most used) and the co-operation procedure (the Parliaments right to ask for further amendments, a procedure that applies only in limited areas) (Baldwin & Wyplosz 2004:57).

<sup>14</sup> However, in practice the Commission develops policy proposals in cooperation with representatives from national administrations.

<sup>15</sup> A two-thirds majority of vote of the Parliament is necessary to dismiss the Commission. However, regarding the Parliaments power to amend the budget, which the Commission has as a task to prepare a preliminary draft on, the Parliament cannot touch so-called compulsory expenditures (about 40% of the budget, basically agricultural spending) (Baldwin & Wyplosz 2004:69).

<sup>16</sup> The total number employed by the Commission is approximately 28000 staff (Hix 2005:47).

<sup>17</sup> In practice there is no clear line between the administrative Commission and the College. The College is ultimately responsible for any decisions that emanate from the Commission, but many policy ideas are generated within the administrative Commission or even outside the Union (Bomberg & Stubb 2004:50).

<sup>18</sup> The President is nominated by national governments and approved by the European Parliament (Bomberg & Stubb 2008:46).

each member state's national government for a period of five years. However, the Commissioners are not supposed to act as national representatives and should make decision independently of the instructions from their home governments. Nevertheless, since the Commissioners do typically hold high political office in their home nations, they are naturally sensitive to issues important at home (Baldwin & Wyplosz 2004:52). In other words, the Commissioners are supposed to act for the best of the EU, but at the same time they can end up being criticized by their national governments for not protecting the national interests enough.

Each Commissioner is allocated a portfolio, such as agriculture or competition policy, and is also responsible for at least one Directorates-General<sup>19</sup> which is related to the portfolio. It is the President of the Commission that allocates the portfolios, but each allocation is based on heated arguments since the President is under constant pressure of his/hers national government to allocate the portfolios that are important for the country in question to the Commissioners from that country (Bomberg & Stubb 2008:47). Each Commissioner also has its own cabinet, i.e. staff of personal advisers. Like portfolio assignments, the appointment of the cabinets can be controversial, since Commissioners tend to fill its staff from their own country, which opposes the stated aim to act in the general interest of the union (ibid.). These two facts are possible threats for the maintenance of the impartiality principle<sup>20</sup>, which is the definition of 'good governance' according to Rothstein and Teorell (2008:169-170).

Once the College of Commissioners takes a decision, usually by majority vote, it becomes the policy of the whole Commission. This implies that the institution is characterized by collective responsibility and that no Commissioner can be held responsible for a decision made. One of the Commission's tasks is to manage the CAP. The Commission has substantial latitude in administering it, and it also has the exclusive right to propose agricultural policy for legislation - although it has to consult a committee consisting of the Member States before doing so. Even though it is the Council of Ministers that in the end agrees on (or turns down) an agreement, the Commission wields enormous influence because of its expertise and because of the intense lobbying which surrounds the draft work (Pelkmans 2001:14).

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<sup>19</sup> Equivalent of a national ministry (Baldwin & Wyplosz 2004:53).

<sup>20</sup> The authors refer impartiality to the way governmental power is exercised, the way policies are implemented, that civil servants must not be moved by certain sorts of considerations and that all recruitments should be based on merits and qualifications that are on beforehand stated.

### 2.1.2 The First Pillar

The Member States collaborate through what is commonly known as EU's Three Pillars of which the European Union is a roof. The First Pillar is called the European Community, and is the most comprehensive pillar since it consists of everything the EC was before the writing of the Treaty of Maastricht in 1992. The Second Pillar consists of the Common Foreign and Security Policy and the Third Pillar of Justice and Home Affairs.

The policy issues in the First Pillar relate to the single market and co-operation in the areas of agriculture, environmental, competition and trade policies, and it also encompasses the EMU. It is characterized by three primary objects; regulation - both positive and negative<sup>21</sup> - redistribution of economic resources - from one country to another or from a region to another - and macroeconomic stabilization - i.e. introducing outlines and rules for the economic policy (Tallberg 2004:67).

Preferably, any decision made in EU should be taken as close to citizens as possible in order to increase the legitimacy, however the increased number of Member States has made it more difficult for the Union to be efficient, i.e. to make any decisions at all (Senior Nello 2005:35). Therefore, more and more decisions are made and realized on a supranational level. Supranationalism means above states or nations, implying that decisions are made by a process or institution that is largely independent of national governments. The Member State governments are then obliged to accept these decisions (Bomberg, Peterson & Stubb 2008:10). Even though a growing number of questions are crossing the borders of nations and thus need united efforts to be solved, the cost for this cooperation is very high; pooling of sovereignty, decreased national independency and the national uncertainty that domestic interests will not be as dominating as wanted (Tallberg 2004:16-17). So far only the decision making in the First Pillar is supranational<sup>22</sup>.

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<sup>21</sup> Positive regulation refers to the introduction of common rules at the Union-level, and negative regulation implies removal of barriers of trade.

<sup>22</sup> This will change if the proposed Lisbon Treaty will come into force.

## 2.2 Objectives and principles of the CAP

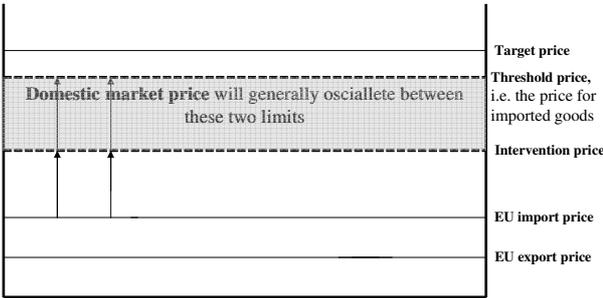
The CAP was the first supranational policy of the EC and its five policy objectives can be derived from Article 39 of the Treaty of Rome<sup>23</sup> (Senior Nello 2005:217):

- 1) Increase agricultural productivity through technical progress and optimal utilization of factors of production
- 2) Ensure fair standards of living for the agricultural community
- 3) Stabilise markets
- 4) Ensure availability of supplies
- 5) Reasonable prices for consumers

Moreover, the CAP rests on three fundamental principles which date back to the 1958's Stresa Conference. The first principle is *unity of markets* and refers to liberalized trade between member states and common prices for the main agricultural products throughout the Community. The second principle, *community preference*, implies that common barriers on imports from the rest of the world should be set up so that EU-producers could have advantage vis-à-vis third countries in selling their products at the European market. The last principle, *financial solidarity*, implies that spending resulting from the application of the CAP must be borne by the Community budget, and requires the maintenance of a fund that finances agricultural policy measures (ibid:218).

## 2.3 CAP's main instruments

Around April each year, EU farm ministers meet to fix prices for the coming crop year. First, they set a *target price* (a leader price level) well above the world market price. This price is then enforced by an *intervention price* that is typically set 12-20% lower than the target price. The intervention price

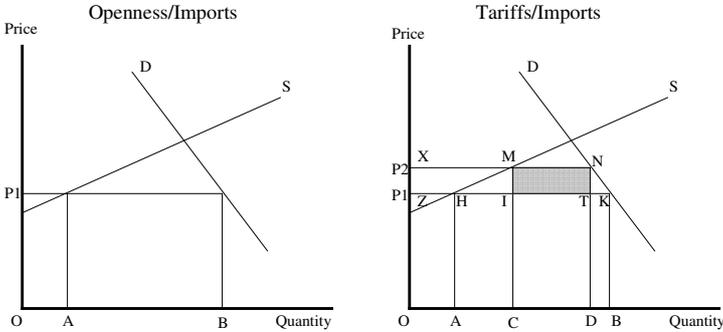


is a so-called price floor and implies that EU commits itself to intervene as buyers of last resort in order to not let the price fall below the floor level (Baldwin & Wyplosz 2004:212). Also a *threshold price* is set, which is a minimum entry price applied on imports

<sup>23</sup> Article 39 corresponds to Article 33 of the Treaty of the European Community which is one of the most relevant articles of today's agricultural policy (Garzon 2006:193).

from the rest of the world, i.e. it is a kind of tariff, where the tariff revenue is the difference between the threshold price and the EU import price (as the arrows shows). The threshold price is always higher than the intervention price in order to prevent the EU to spend budget money on buying imported agricultural products (ibid:213). The level of advantage that EU farmers have over producers from third countries is thus given by the difference between the intervention- and the threshold price (ibid:219). Due to various reasons, the EU domestic market price oscillates between the intervention- and the threshold price and is always somewhere in the shaded area. The lowest price in the figure is the EU export price, which shows that the EU exports its agricultural commodities very cheaply despite their high production cost (this is called dumping. - see section 2.4 and Figure 6).

The economic impact of a high price floor is that it induces EU farmers to produce more, which can be seen in Figure 3 below. If an economy is entirely open and the price is P1, domestic production equals OA and domestic demand equals OB. The quantity AB is thus imported at the price P1. However, with the by EU guaranteed price P2, domestic production rises to OC whereas domestic demand drops to OD. On the quantity imported, CD, an import levy is imposed in order to equalize world prices with EU prices. The shaded area is thus the tariff revenue. The area ZXMH represents an extra producer rent transferred from consumers to farmers and the area TNK represents the deadweight loss.



**Figure 3:** The effect of a price floor<sup>24</sup>

As long as the domestic production is below the equilibrium levels of domestic supply and demand, a price increase does not necessarily entail surplus production (compare price level P1 in Figure 3 with Pde in Figure 4). But due to the extensive price support, we can assume the initial EU price to be Pde in Figure 4. At Pde there is no surplus and no public budget expenses involved. However, since the EU raises the price to P3, demand drops to OE whereas supply rises to OF. EU must thus step in as buyers of last resort and buy the quantity OF-OE at the price P3. Since the quantity equals the excess supply on

<sup>24</sup> Reference: Molle (1994:252-254).

the European market, implying that it is unwanted by the EU consumers, it has to be sold at the world market at the price  $P_1$ . In other words, instead of receiving tariff revenues the EU has to pay subsidies to exporters to make them sell the goods at the world market (see section 2.4 and Figure 6) (Molle 1995:257). The shaded area in the right-hand part of the figure will thus be charged to the taxpayers. As will be described later on, this system has recently been changed.

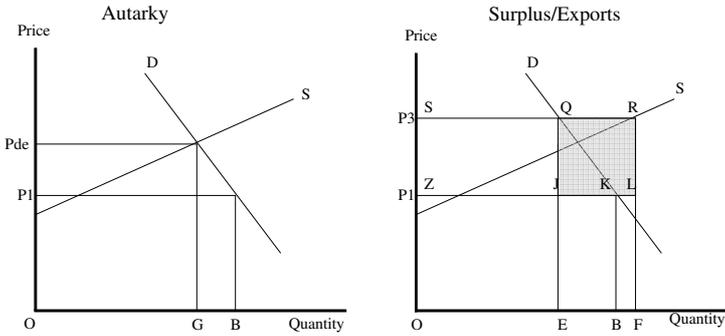


Figure 4: Market-regulation<sup>25</sup>

The cost of the price floor is paid by the consumers who have to pay higher prices for the goods they continue to consume - shown as area  $A+C_1+B$  in Figure 5 below. This implies that the consumer surplus falls by area  $A+C_1+B+C_2$ .  $C_2$  reflects what the consumers lose from tariff-induced drop in consumption. Producers gain a surplus equal to area  $A$ .

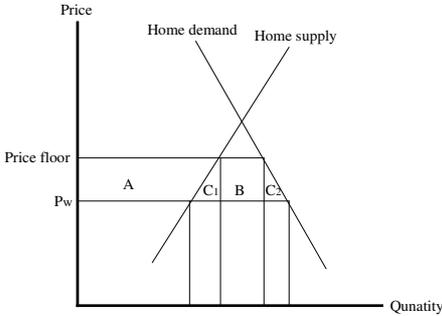


Figure 5: Effects on consumers and producers<sup>26</sup>

Since EU is assumed to be a large economic entity<sup>27</sup> and is the worlds largest importer of agricultural commodities, as well as the largest agriculture importer from developing countries (USDA 2008), a high level of price support for the Union’s farmers implies that CAP has significantly reduced EU’s imports from the rest of the world and the Unions expanded output has depressed world prices which negatively

<sup>25</sup> Reference: Molle (1994:252-254).  
<sup>26</sup> Reference: Baldwin & Wyplosz (2004:214).  
<sup>27</sup> Not counting intra-EU trade, the EU’s share of world trade (imports and exports) accounts for around 20% of all global trade and exceeds that of the US (Bomberg, Peterson & Stubb 2008:7).

influence the terms-of-trade of countries that export CAP commodities. Furthermore, since CAP increases the variability of world market prices, it raises uncertainty. Both exporting and importing developing countries are less able to bear additional uncertainty, and as a consequence production of domestically consumed products, rather than exportable, is favoured (Koester & Bale 1984:39). Since trade is a determining factor for development and for the possibility of achieving the millennium goals<sup>28</sup> (Larsén 2009), the problem is very serious. Moreover, as poor people spend a larger fraction of their incomes on food than rich people, a price floor can be thought of as a regressive consumption tax<sup>29</sup> which implies that the rate is higher the poorer you are (Baldwin & Wyplosz 2004:219). This transfer of money from poor to rich (a so-called inverted Robin Hood system) contradicts with the fifth CAP objective (reasonable prices for consumers) and has indeed been heavily criticized, but still the lobby for consumers' interest has not developed much (Artis & Nixon (ed.) 2007:83).

## 2.4 CAP during the post-war period

The post-war period brought a technological revolution, and since CAP rewarded (rewards) output, farmers switched to the new methods. Environmental problems<sup>30</sup> and worse animal welfare and food security came as a direct consequence of the industrialization of farming and the more intensive use of land and chemicals (Baldwin & Wyplosz 2004:226). Moreover, large farmers did (and do) purchase even more technology and physical capital, which combined with the intensive use of land increased its price. This created a bias of who started to farm.

For all that, production did rise rapidly, making EU a net exporter of agricultural products, but since food is characterized by low income elasticity the growth in output led to a fall in agricultural prices (Drud Hansen (ed.) 2001:87). Consequently, real prices of farm products and land decreased, causing farm incomes to fall in relation to other sectors and smaller farms had to increasingly rely on off-farm

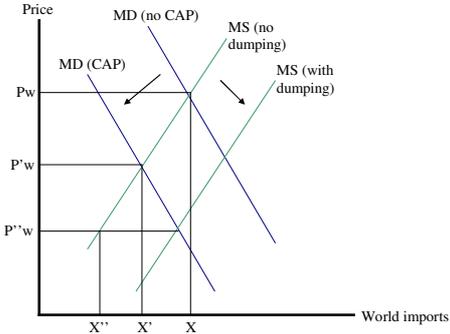
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<sup>28</sup> The goals are 1) Eradicate extreme poverty and hunger, 2) Achieve universal primary education, 3) Promote gender equality and empower women, 4) Reduce child mortality, 5) Improve maternal health, 6) Combat HIV/Aids, Malaria and other diseases, 7) Ensure environmental sustainability, and 8) Global partnership for development (FN 2008). According to Larsén (2009) it is the last goal that is threatened the most by the lack of free trade.

<sup>29</sup> An example: Say that a poor family spends 30% of its income on food whereas a rich family spends only 9%. If the price-floor is raised by one-third, the poor family will now spend 40% of its income on food whereas the rich family will spend 12%. For the poor family this increase would be equivalent to a 10% income tax but for the rich family the income tax would only be 3% (Baldwin & Wyplosz 2004:219).

<sup>30</sup> Such as pollution of rivers, lakes and groundwater, including sources of drinking water, erosion, pollution and impoverishment of soil, reduction of wildlife, damage to the atmosphere and to the rural landscape (Baldwin & Wyplosz 2004:226-227).

income to improve their household incomes<sup>31</sup> (Garzon 2006:28). EU did step in as a buyer of last resort, but since it did not have use for all the food it bought, storages filled quickly. Exporting was an alternative, but since EU prices were above world prices exporters bought the agricultural commodities expensively from the European farmers and sold them cheaply at the world market. To induce the exporters to maintain this disadvantageous activity, EU had to start paying exporters the difference. Despite that those so-called dumping activities depressed the world price of food and reduced the export volume of non-members, the surplus continued to grow<sup>32</sup>. Thus EU started to subsidize its exports (Baldwin & Wyplosz 2004:222).



**Figure 6:** Impact of CAP protection and dumping on RoW<sup>33</sup>

Figure 6 above shows the economics of CAP production. Without CAP tariffs and dumping activities the price would be  $P_w$  and total food exports would be  $X$ . As described above, CAP first reduced the demand for world by imports imposing a system of tariffs, which shifted the world import demand MD (no CAP) to MD (CAP). As a result the prices fell to  $P'w$  and the quantity dropped to  $X'$ , which implied lower export prices and less export for non-members. When CAP started to subsidize exports the market was further harmed by the shift of the MS curve to MS (with dumping). Since the EU pays whatever it takes to sell its surplus on the world market, the shift between MS (no dumping) to MS (with dumping) equals the amount of food dumped by EU. The price fall to  $P''w$  and non-members exports is reduced to  $X''$  (Baldwin & Wyplosz 2004:223). Obviously, such a policy creates conflicts with other countries<sup>34</sup> and is very costly - both for the EU itself<sup>35</sup> and for non-members, especially for the largest food-exporting nations that are dependent on the revenues from their exports<sup>36</sup>. The

<sup>31</sup> See Appendix C for more information about agricultural incomes.  
<sup>32</sup> See Appendix E for more information of the so-called food mountains.  
<sup>33</sup> Reference: Baldwin & Wyplosz (2004:223).  
<sup>34</sup> The first transatlantic trade dispute (the so-called chicken war 1962-1963) was over the CAP.  
<sup>35</sup> In 2000 EU spent 2 billion dollars in export subsidies (Senior Nello 2005:360).  
<sup>36</sup> It should be noted that a complete abolition of EU's protective system does not guarantee that the poor countries will be better off. One reason is that as soon EU does stop dumping its surpluses on the world market, prices will rise, and many poor countries are themselves importers of food. Moreover, the EU's everything but arms agreement gives the 50 least

Uruguay Round (see section 2.5.1) imposed restrictions on dumping but to date EU's food dumping still continues and the impact of this activity is huge. Especially its exports of sugar are very harmful for poor tropical nations (ibid:233). Great external pressure on reforming this trade distorting sugar regime made EU to decide on a price cut by 36% in 2006 (EU 2006), and it now remains to be seen how well enforced this reform will be<sup>37</sup>.

On the one hand, intervention was central to the output growth of the 1970-80s (Ackrill et.al. 2008:396) but on the other hand, since a price floor helps producers in proportion to production it is an inequitable policy<sup>38</sup> (Baldwin & Wyplosz 2004:216); large producers are often the ones who are already rich and yet between 1970-1990 about 80% of the support went to 20% of the farmers<sup>39</sup> (Senior Nello 2005:226). This fact contradicts with the second CAP objective, fair standards of living for the agricultural community, and gives an explanation to why so many Europeans have abandoned farming.

It should here be noted that all countries that do not heavily rely on agricultural exports engage in some form of protectionism. What has made the CAP so criticized however, is, first, that tariffs were variable (the Uruguay Round imposed fixation of variable tariffs, see section 2.5.1), consequently insulating the EU from the world market, and second, that export subsidies were automatic and without almost any budget constraint nor any maximum time for eligibility (Pelkmans 2001:217). Today, the export subsidies are somewhat smaller, as will be described in section 2.5.1.

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developed countries quota- and tariff-free market access, which allows the farmers to produce cheaply and then sell it at the artificially high price maintained within the EU's single market. A reduction in EU's tariff rates would reduce the value of the LDCs' preferential access (Thurston 2005:3).

<sup>37</sup> On the other hand, tariff cuts are damaging to many of the smallest and poorest countries since an import tariff reduction reduces the benefits of existing trade preferences.

<sup>38</sup> Area A in Figure 5 will be larger the larger the production of the farm. Since the benefit from owning a farm is the producer surplus it yields, the income generated by the large farm therefore tend to be larger than the income of the small farm. So even though a price floor helps all farmers, most of the gain go to farmers who are already rich (otherwise they would not own the large farm in the first place) (Baldwin & Wyplosz 2004:216).

<sup>39</sup> This implied that the 20% largest farms received about 13333 Euro per farm (or 52% of the whole EU budget) whereas the remaining 80% received only an average of 833 Euro per farm (Baldwin & Wyplosz 2004:217). In 2003 this had changed somewhat and 25% of the farmers got 70% of the supports (ibid:234).

## 2.5 Reforming the CAP

### 2.5.1 1992-2003: A decade of change?

All of the CAP's biggest problems have stemmed from the determination to keep EU prices above world prices – hence there is some degree of path dependency in the CAP and the inertia of reforms. On the one hand, Europe became self-sufficient and a net exporter, but on the other hand the surpluses quickly turned into grain and butter mountains that either had to be sold on world markets or be held in public storage. Public storage was expensive and posed a burden on the budget, while export subsidies antagonized other agricultural exporters. Moreover, the increase in EU-exports reduced world prices and less-developed countries accused EU of protectionism, increasing instability and lowering prices (Senior Nello 2005:226). CAP's stated aim has been to ensure fair living standards for farmers, but clearly the costs has been proven untenable and constantly growing, and this fact has motivated several reforms<sup>40</sup>.

During the first twenty years or so, reform of the CAP was a taboo subject, because it was thought that undermining the policy would make European integration to tumble down (ibid.). The number of farmers was (is) small, but their political power has always been enormous. In addition, large commercial farmers had become used to the extra money they were receiving from CAP spending, and they had also invested and restructured their farms so they could focus on the goods most heavily supported by CAP. Small farmers earned little from CAP; but without high prices they would probably be driven out of farming altogether (Baldwin & Wyplosz 2004:229).

Up to the mid 1980s the primary way of dealing with the rising CAP costs was to increase the contribution from the Member States. However, when Spain and Portugal joined in 1986 things started to change. The climate in Spain and Portugal prevented the countries to produce the goods that CAP supported the most, and therefore the newcomers were reluctant to see their contributions to the budget rise in order to help the already rich northern European farmers. Together with Ireland and Greece, the newcomers forced the first general programme aimed at limiting the cost of the CAP. The reform did however not solve the problems of excess supply - the ultimate trigger for a large reform came from outside the EU (Baldwin & Wyplosz 2004:230).

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<sup>40</sup> This section presents just a brief summary of past CAP reforms. However, for the interested reader, there is an extensive literature dealing with the subject, presenting in-depth details and different theories of 'why and how'. See e.g. the work of Garzon (2006).

In 1986, the Uruguay Round began with the goal to reduce protectionist farm policies. This was the first time that agriculture was included in GATT negotiations in more than a marginal way (Senior Nello 2005:357). However, EU refused to liberalize, which led to a world trading system crisis. USA and the Cairns Group<sup>41</sup> proclaimed that it would not sign an agreement without a solution on agriculture (ibid.). When the final meeting came EU's refusal to liberalize led to a walk-out by the Cairns Group, a crisis that threatened the future of the world trading system. As EU faced enormous pressure from their own industrialists and export-oriented sectors they eventually agreed on the MacSharry reform in 1992 (Baldwin & Wyplosz 2004:231). This was the first time international agricultural trade concerns entered CAP policy making (Ackrill et.al. 2008:394). The MacSharry reform decreased price support by cutting prices<sup>42</sup>, but to make the cuts acceptable for farmers they started to receive direct income payments<sup>43</sup> that are decoupled from production, implying that a production constraint was imposed. This policy also decreased the profits of farmers. However, since direct payment were calculated in a way to offset the loss of price cuts, and since big, rich farmers were selling most before the reform, the inequality of farm support did not diminish, on the contrary, this kind of system maintains the inequity (Senior Nello 2005:231). The MacSharry reform also contained an agreement on blue-box measures<sup>44</sup> to which farmers can qualify only by adopting certain supply-restricting measures, such as setting aside some percentage of their land to get direct payments<sup>45</sup> (Drud Hansen (ed.) 2001:85). However, and ironically, since the compensation offered to the big farmers was so generous, the reformed CAP actually cost more than the original. In sum, the MacSharry reform can hardly be called radical. It did not question the use of subsidies but rather altered the way in which those subsidies were paid, suggesting path dependency being the reason of the inertia of reforms.

The latest WTO round, the Doha Development Round, began in 2000, but despite that EU instituted the Agenda 2000 reforms (adopted in 1999) to pave the way for the possibility of a successful conclusion, the round has yet not ended. During the Agenda 2000 discussions, the pressure for an agreement was large, since a failure could mean a new crisis similar to the one in 1992 and also endanger the EU enlargement. This was said to be because the candidate countries are relatively poor and have

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<sup>41</sup> Argentina, Australia, Bolivia, Brazil, Chile, Colombia, Costa Rica, Guatemala, New Zealand, Paraguay, the Philippines, South Africa, Thailand and Uruguay (Baldwin & Wyplosz 2004:222).

<sup>42</sup> Called Amber-Box policies and refers to policies permitted within the limits agreed in international negotiations.

<sup>43</sup> Direct income support is the socially least-cost form of agricultural support (Pelkmans 2001:222). Direct payments are composed by transfers from taxpayers to producers, in contrast to price support that are composed by transfers from consumers to producers.

<sup>44</sup> Blue box measures are measures temporarily allowed as a result of the EU-US deal that was the result of the compromise reached in the negotiations in 1992. It mainly refers to direct payments under production-limiting measures.

<sup>45</sup> A measure that has been and is questioned. For one thing, if EU is to pay farmers for not farming it should pay industries for not polluting etc. Such a policy quickly becomes extremely expensive.

relatively large agricultural sectors, hence their participation in the CAP on the same terms as EU-15 could have bankrupted the EU.

The Agenda 2000 reforms contained, among others, the reduction of price floors at the cost of more compensation through increased direct payments (more decoupled than the MacSharry Reform), and also a budget commitment to fix total CAP spending in real terms (Baldwin & Wyplosz 2004:231). Furthermore, they included cross-compliance, which is a form of conditionality that implies that farmers have to introduce appropriate environmental measures in order to receive payments in full (Senior Nello 2005:233). Thus EU could provide resources that could go into the Green Box<sup>46</sup>. New legislation was also introduced in order to promote environmentally friendly measures and encourage products for which there is a market rather than those in surplus (ibid.). The reform also contained increased flexibility for the Member States in the use of funding, which was introduced by modulation that allowed the Member States to reduce the size of payments a farm can receive. One of the largest changes was the establishing of the Second Pillar of the CAP, namely rural development. The introduction of the second pillar required all states to produce rural development plans, which allowed EU to shift a greater proportion of farm supports on the finances of the member states (Artis & Nixon (ed.) 2007:97). Tighter conditions were also imposed on the member states administration or rural development schemes (Senior Nello 2005:233).

Despite the agreement on Agenda 2000, it was criticised by many, especially the Berlin summit's dilution of the CAP reforms - e.g. no plan for reducing direct payments was made (Baun 2000:156-162). Furthermore, by 2001 only France, UK and Portugal had implemented modulation which implied that spending on the environment and related measures was minimal (Senior Nello 2005:233). Moreover, the EU used enlargement to justify a reform of the CAP, and although insisting on radical reform of the Central and Eastern Europe, EU did not launch an equally large overhaul of its own institutions and policies. France and Germany, as a result of national farm lobbying, had agreed already before the opening of the summit to not cut farm spending<sup>47</sup>. The other leaders were eager to conclude the negotiations and hence agreed on maintaining the same rate of agricultural spending for at least another ten years. Once again the EU missed an opportunity to curb CAP spending (Dinan 2004:309-310). Generally, Agenda 2000 is viewed as a deepening of the MacSharry reforms, and since it did only

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<sup>46</sup> Green box measures are measures decoupled from production and can be freely adopted and are not generally negotiated at the international level. Measures include training, research, environmental measures etc. It is believed that these forms of support cause less distortion in trading patterns.

<sup>47</sup> At the time of the Agenda 2000 negotiations, which took place during Germany's presidency, Schröder was a relatively new leader who lacked experience of EU summitry. As a president-in-office of the Council he wanted the summit to end successfully (Dinan 2004:311).

adjust existing policy instruments, it could also be viewed as a sign of path dependency. It should however be noted that the Commission was considered as the main mediator in the negotiation process, but internal divisions on the CAP and the strong national interests put significant limitations on their role (Rosén & Jerneck 2005:73).

The agreement of Agenda 2000 was reviewed and reformed in 2003 and is sometimes called the Fischler Reform due to the personal efforts of the Commissioner for agriculture, Franz Fischler (Senior Nello 2005:234). It was of great significance that the reform was introduced before the forthcoming accession of the Central and Eastern European countries, since any agreement would have been even more difficult to be approved with more member countries. The 2003 reform brought radical change to the CAP by proposing an elimination of production subsidies and introducing a system of Single Farm Payments (SFP) that is decoupled and green-box compatible (Ackrill et.al. 2008:405). These payments are to be based on an average of what farmers have received in recent years and the plan is to reduce the payments by 3% a year over a certain period of time. The money saved are said to be going to rural development (Poole 2003:107). By emphasizing rural development EU puts more responsibility on the Member States for paying part of the cost.

SFP's are also linked to a number of objectives, such as environmental, food safety and animal health, and failure to fulfil them will entail a reduction of payments (Senior Nello 2005:235). Consequently, farmers will have to look more at market needs and signals when deciding on output, hence the support is less trade distorting than previously. Member states now also have the option to regionalize payments, i.e. all farmers in a particular region will receive the same basic payment. The 2003 reform also strengthens the Second Pillar of the CAP and envisages a reduction in total payments by making modulation compulsory for the member states (Senior Nello 2005:234-236). Furthermore, the reform made CAP more flexible in order to let the member states decide more on how the CAP is to be applied, thus CAP can now better adapt to national and local conditions (ibid:235).

### 2.5.2 Beyond the Fischler Reform

CAP was reformed in a major way once again during the years of 2005-2007. The goal was to adapt the agricultural policy to the market and to the European consumers. The reform involved, among other things, that farmers must fulfil a number of objectives, such as environmental, food safety measures and animal welfare, in order to receive support. Also a one-size support was introduced, that is to be paid

independently of the volume of production. Moreover, the reform decided to reallocate some money to strengthen the environment and the rural development (EU Upplysningen 2009).

In 2008 the EU agricultural Ministers reached a second post-Fischler agreement on the so-called 'Health Check of the CAP'. According to the European Commission (2009b) "*the Health Check will modernise, simplify and streamline the CAP and remove restrictions on farmers, thus helping them to respond better to signals from the market and to face new challenges*". The 'restrictions of farmers' refers to the objectives that the farmers must fulfill in order to receive support and the removal of this requirement is a part of the Commissions' current work with simplifying the CAP<sup>48</sup>. The 2008 agreement involves a range of measures and a decision on increased modulation, whereby direct payments to farmers are reduced and the money transferred to the Rural Development Fund, in order to allow a better response to the new challenges and opportunities faced by European agriculture.

## 2.6 Summing up so far: arguments for further reform

Even though three large reforms were carried through during the period of 1992-2003, and two agreements were reached between 2005-2008, the agricultural policy has to date not developed enough. Since the CAP is still a protectionist policy, the agricultural sectors' long-term adjustment has been slowed down, which causes a drag on the growth potential on the EU economy. Compared with the rest of the EU economy, the CAP is an unsustainable policy. By being heavily protected and subsidised, farmers are still shielded from market signals, hence they do not adjust to world competition. The world competition is also hurt, since third country farmers have less ability to export, a fact that is an origin to trade conflicts and tensions between the EU and other nations. Since EU is an exporter of many agricultural products, the Union should have great political and economical interests to reduce the problems on the world market.

Third countries, taxpayers (who pay for production that nobody wants) and consumers (who pay more for their products than necessary) are the big losers of the policy, but also industries that use agricultural commodities as inputs, since high European prices prevent them to develop quickly. The Union lose efficiency since the CAP consumes resources that could be better used elsewhere. Also some of the agricultural land could be better used, example for growing trees.

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<sup>48</sup> For more information about this work, see e.g. [http://ec.europa.eu/agriculture/simplification/index\\_en.htm](http://ec.europa.eu/agriculture/simplification/index_en.htm) and [http://ec.europa.eu/agriculture/healthcheck/index\\_en.htm](http://ec.europa.eu/agriculture/healthcheck/index_en.htm).

When the CAP was initiated, the stated aim was to increase farmers' incomes. However, the CAP mechanisms have been proven inequitable, and although being reformed a number of times, the inequality of the CAP's farm support has continued. In other words, farmers' incomes do not rise and as a consequence farmers are leaving the sector. Besides, since there exists three major sources of leakage, EU farmers receive less than half of the CAP's supports. First, to get the payments farmers have to do things that are costly, so the net benefit is lower than the gross benefit. Secondly, the transfers to farmers raises the demand for inputs, hence input prices tend to rise (Ackrill et.al. 2008:406). Thirdly, quite large shares of the payments go to other groups such as input suppliers and non-farming landowners<sup>49</sup> (Baldwin & Wyplosz 2004:235). Furthermore, since direct payments are based on hectares and tied to the land it is the land price that receives most of the subsidy (ibid).

It can be concluded that promoting efficiency and income objectives by using price mechanisms is both costly and ineffective, and therefore the CAP must continue to reform.

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<sup>49</sup> About 40% of EU farmland is not owned by the people who farm it. The OECD has calculated that about 45 cents of every Euro of direct payments do not benefit farmers. The other major CAP policy, i.e. market price support, does even worse (Baldwin & Wyplosz 2004:235).

# 3 Theory

One main conclusion can be drawn from the preceding section, namely that CAP has a long history of immobility and inertia. This section will present a number of possible answers to the question ‘why is that so’, and to ‘why have not more been done’ which is the question asked in the introduction. The point of departure is the assumption that the institutional set-up is a key variable in the process of any policy change. In the case of the CAP the institutions directly affect the ability of the different players - member states, bureaucrats and special interest groups - to influence the decision making process and the extent to which a decision can intervene in the agricultural policy.

## 3.1 Defining institutions

The importance of institutions and their significant effect on economic performance is nowadays widely acknowledged by scholars, whose research has confirmed that differences in institutions greatly affect the way governments and societies are organized and that they “*have enormous implications for the structure of incentives faced by politicians, bureaucrats, investors, and workers, which in turn determines the level of a nation’s material well-being*” (Knack (ed.) 2003:2). In this section the institutional set-up of the CAP will be described, but before continuing any further, we first have to define what an institution actually is.

When people talk about institutions they normally mean organizational establishments, as the United Nations or the OECD. Some economists follow this convention and identify institutions as specific ‘players of the game’, as courts, associations and government agencies - albeit with a specific status, since these players can influence and/or modify the rules of the game and the outcome (Pénard 2005:2). Institutions can also be analysed in a game-theoretic framework. In that case institutions are viewed as the equilibrium outcomes of a game (Aoki 2001:2). A third definition of institutions is that of Douglass C. North (1991:97) who argues that institutions should neither be identified as players nor as equilibrium, but rather as the rules of the game; “*Institutions are the humanly devised constraints that structure political, economic and social interaction. They consist of both informal constraints (sanctions, taboos, customs, traditions, and codes of conduct) and formal rules (constitutions, laws, property rights) . . . Together with the standard constraints of economics they define the choice set and therefore determine transaction and production costs and hence the profitability and feasibility of engaging in economic activity . . . Institutions provide the incentive*

*structure of an economy; as that structure evolves, it shapes the direction of economic change towards growth, stagnation, or decline*". The theory presented in this section is based on this definition.

North's definition implies that institutions are the main constraints on actors' behaviour. Institutions are however not fixed. Actors act upon their institutional preferences in the same way as they do on their political preferences. This implies that if an actor thinks that he/she will be better off under a different type of institution, he/she will seek to change the existing institutional arrangement (Hix 2005:13). As a result, the institutional equilibrium might produce different policy equilibrium. On the other hand, "*once a particular institutional or policy equilibrium has been reached, these institutions and policies are often 'locked in' ... despite the emergence of new actors or changes in actors' preferences, certain actors invariably have incentives to prevent any change from the new 'status quo'. These actors are said to be 'veto-players', and the more veto-players there are in a bargaining situation, the harder it is for policies or institutions to be changed*" (ibid:14). Moreover, since policy and institutional options are compared with the existing equilibrium rather than with the situation that prevailed when the equilibrium was first agreed, politics is often path dependent (ibid.).

### 3.1.1 External institutions

As was described in the previous section, it is the Commission who manages the CAP. The Commission is an external institution which implies that it is "*designed and enforced from the top down on the basis of constitutions by authorities with political power*" (Kasper & Streit 1998:395). The Commission is formally enforced by the EU and its institutional rules are designed and imposed by people who are selected by a political process and who act from outside the society (since it is a supranational institution). Any change in an external institution requires political action, but as was described in the previous section, collective decisions are clearly difficult to bring about. Consequently, external rules are often rigid, even when circumstances change. Changes that actually happen do mostly occur in small steps, and every step is greatly disputed since it "*often affect the distribution of incomes and economic opportunities*" (ibid.). As we will see in section 3.4 this is one explaining factor to why groups of people form interest groups. When such groups manage to defend the existing institution against any adjustment, even though that might be advantageous for the rest of the community, we say that institutional inertia is present.

## 3.2 Introducing the theory of Public Choice

The theory of Public Choice was developed in the 1960's<sup>50</sup>, and can be defined as the application of economics to political science, or as the economic study of non-market decision making (McNutt 1996:1). The subject matter is the same as that of political science but the methodology is that of economics. Economists belonging to this school apply logical reasoning and try to work out what a rational actor would do in order to maximise his chance of getting his wants. From the analysis, a picture of what an economy would look like if everybody acted rationally can be constructed (McLean 1987:1). Rationality can refer to either 'self-interested' or/and to an individual that is able to arrange his/hers options into a coherent order of preference (ibid:3), which is the same as knowing what outcomes one wants from the political process (Hix 2005:12). By in particular studying the behaviour of politicians and civil servants, Public Choice theory is often used to explain how political decision-making results in outcomes that conflict with the preferences of the general public – hence it seems to be a theory well-suited to analyse the CAP. The question at issue in the Public Choice literature is whether regulation can *“plausibly be explained by reference to ‘public interest’ considerations . . . The claim is that a better explanation lies in the interests of the bodies subject to regulation”* (Brennan 2004:75).

## 3.3 The political rationality of institutional inertia

If a community learns that an institutional arrangement, Z, which should here refer to a more liberalised CAP<sup>51</sup>, is more wealth enhancing than the current system (the current CAP), Y, but does not switch to Z, an inertia is said to exist. The CAP is well-known for its reluctance to change. How could that be possible in a society of rational and goal-oriented individuals?

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<sup>50</sup> James M. Buchanan and Gordon Tullock are usually viewed as the founding fathers. Later on also Mancur Olson contributed greatly to the school.

<sup>51</sup> Few issues seem to elicit greater agreement among economists than the proposition that a society's welfare is maximized through free trade. Trade liberalisation tends to boost economic growth, which on average is distributional neutral (Winters 2005:324). Moreover, a liberalization of the CAP could induce developing countries to become net exporters, but the net effect on poverty due to higher world prices would depend on the magnitude of price changes, how that affects factor prices and incomes and on domestic reactions of supply and demand (Koester & Bale 1984:38). Furthermore, a CAP liberalization would increase the stability of world market prices, but it will affect developing countries differently, depending on whether the country is a net exporter or importer and whether the country has a comparative advantage in an EU protected commodity (ibid:37). Liberalisation would have the strongest effect in the most heavily protected commodities (ibid:38) and according to Winters (2005:334) developing countries would be the major beneficiaries of a price increase of cereals, oil seed and sugar. The author also states that EU would gain from a liberalisation because a removal of trade distortions will only affect income a little since agriculture is only about 3% of EU GDP (ibid.). Besides, the real wages would probably increase as the consumer food prices would fall (ibid:335).

Institutional economics usually emphasizes transaction costs when answering such a question (Eggertsson 2005:29). In the case of the CAP the analysis could go as follows: since decisions on reforming the CAP are taken by unanimity, the Commissioners anticipate very high transaction costs of negotiating and/or coercing a transition from Y to Z. Not only the different opinions the citizens and interest groups in all member states, but also the interests of the Commissioners' home governments contribute to those high costs. When high transaction costs make it impossible for the potential winners, i.e. third countries and consumers, to credibly commit (before the transition from Y to Z) to compensate the losers, i.e. the farmers, the expected losers will fight the proposed changes. And the farmers sure do fight – and they do it successfully (the reason for their success will be described later on in this section). Consequently, the CAP has evolved to be an “imperfect” institution, meaning that it causes a relative economic backwardness of an economic unit (ibid:47).

### 3.3.1 A theory of bureaucracy and bureaucrats

No government policy comes into existence merely by people wanting them to, somebody has to supply it, and most often the supplier is a government bureau (Mueller 2005:523). In the case of the CAP “the bureau” is the Commission and “the bureaucrats”<sup>52</sup> are the Commissioners (Christiansen 2001:97). In Public Choice theory however, a bureau is not viewed only as a quiet supplier - on the contrary, the literature views the bureaus as powerful units with bargaining power and resources to affect the outcome. The reason for this is, according to Niskanen (1994:24), that “*the sponsoring organization [the EU] is usually dependent on a specific bureau to supply a given service, and the bureau [the Commission] usually does not have a comparable alternative source of financing ... the relation between the bureau and its sponsor is that of “bilateral monopoly”*”. Moreover, as a rule, a bureaucrat knows more about the factor costs and production processes for the bureau's service than the sponsor organization, which gives the bureau the overwhelmingly dominant monopoly power (ibid:29-30).

The usual reason for granting a bureau monopoly on the provision of a public good is to avoid wasteful duplication (Mueller 2005:363). In some cases, as in the case of the supranational institution of the CAP, there does not even exist a competing supplier. This fact frees the bureau (the Commission) from competitive pressure to be efficient. The inefficient production of a bureau is further induced by the scheme of compensation. As Mueller (ibid.) writes; “*public bureaucrats' salaries are either unrelated or indirectly ... related to improved efficiency. Thus, the public bureau is characterized by weak external control on*

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<sup>52</sup> Especially the individual Directrates-Generales are associated with bureaucracies (Christansen 2001:105).

*efficiency and weak internal incentives*". In other words, the bureaucrat (the Commissioner) has no financial incentive to pursue a more efficient CAP. As a consequence, there is a risk that the Commission is supplying more than the socially optimum level, which we from know from microeconomics is when the marginal value of each goods and service supplied to each individual is equal to the price charged to each individual (Niskanen 1994:132).

Public Choice theorists believe that *"bureaucrats as individuals are neither more nor less efficient, honest, hard-working, thorough, public-spirited, a generally worthy of admiration than non-bureaucrats"* (ibid:23). In other words, Public Choice theorists assumes that a bureaucrat, like anyone else, tries to maximize his/her personal utility, and that it probably exists some elements in the bureaucrats utility other than the general welfare and the interest of the state (ibid:36-37). Niskanen lists the following possible goals of a bureaucrat; salary, prerequisites of the office, public reputation, power, patronage, output of the bureau, ease of making changes, and ease of managing the bureau. All but the last two are positively related to size of the budget (ibid:38). Hence the bureaucrat is interpreted as a person who wishes to maximize the bureau's budget. There are undoubtedly some bureaucrats who try to serve the public interest, but in a bureaucratic environment, *"one person who serves his personal interests or a different perception of public interest is often sufficient to prevent others from serving their perception of the public interest"* (ibid:39). Since one single bureaucrat cannot acquire all of the information that would be needed to divine the public interest, and since he does not have the authority to order an action that is beneficial for the public interest, the only rational for the bureaucrat is to act in his own self-interest too, regardless of his personal motives (ibid.). For some bureaucrats, budget maximization may not be rational, but the nature of a bureaucrat's relations with the other bureaucrats and the sponsor are *"such that bureaucrats who do not maximize their budget will have an unusually short tenure"* (ibid:41).

The fact the CAP expenditures has escalated throughout its existence may seem to prove the budget-maximisation theorem, but certainly there do exist some constraint that limits a bureau's size. One such constraint is that the bureau must supply what it promises, otherwise it might be penalized by lower budgets in the future (ibid:42). Moreover, if there is a well-functioning legislature that exercises control over the budget, the power of the bureaucracy to expand the budget should not be exaggerated (Mueller 2003:523). Besides, in the case of the CAP, the bureaucrats (the Commissioners) are politically appointed and stay at the bureau (the Commission) for a limited length of time. Thus, expanding the size of the budget must not necessarily benefit the bureaucrat who brought about the increase. The Commissions' ability to maximize the budget is also constrained, since it has been decided to amount 1,25% of the total GDP of the member states (Hix 2005:68). Furthermore, the Commission is not a

delivery agency that provides public services - it is composed of regulatory agencies, control agencies, transfer agencies and contract agencies which are not particularly interested in increasing the budget. On the other hand, bureaucrats that spend more money are generally considered to be more important which may give incentives to spend a lot of money. Still, we should assume that the Commission is more interested in increasing the control over the policy agenda (ibid.) rather than increasing the size of the budget.

### 3.4 Special interest groups and lobbying

Section 3.3 presented the institutional set-up of the supply side of the CAP and described the behaviour of the bureaucrats (the Commissioners) in order to examine whether the institutional inertia depends on the “suppliers” of the CAP. It is now time to turn to the demand side of the CAP, which consists of the member states and the farmers’ interest groups around the EU.

Watson and Shackleton (2008:93-96) have identified three broad overlapping categories of interest groups in the EU. These are:

- *Private interests*, pursuing specific economic goals (the largest category, includes the Committee of Agricultural Organizations, COPA).
- *Public interest bodies*, pursuing broader non-economic aims (e.g. Greenpeace, WWF).
- *Governmental actors* (e.g. local authorities, cities, or regional governments).

These three groups together account for more than 2500<sup>53</sup> organizations based in Brussels, ranging in size from one to two people, to large offices. Like-minded national interest groups form trans-national organizations that lobby the EU institutions directly. Such organizations have to coordinate the positions taken by their national members (Hix 2005:224), thus the organizations tend to function as clearing houses of national interest rather than as the aggregators of those interests. As a consequence, politicians and bureaucrats are met by complex set of various interests.

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<sup>53</sup> How large the size of the lobbying industry actually is, is difficult to estimate. It depends on how the number of lobbyists is counted and if individuals who are not seated, but visit Brussels sometimes, are counted. Since there were no fewer than 22 flights per day from London to Brussels in 2001, we can assume that a large number of people fly into Brussels on a regular basis, but are not based there (Mazey & Richardson 2001:225-226).

Whatever their type, non-institutional actors seek to shape EU-decision making through lobbying<sup>54</sup>. Lobbying “*is essentially a one-way transmission of information*”<sup>55</sup> *from an interest group to members of the government*” (Mueller 2005:496). As the EU continues to widen and the integration to deepen, more legislative responsibilities are transferred to the Union. As a result, national organizations have to lobby harder for their cases and therefore lobby activities have been intensified during the last decade. On the one hand, this development helps to ensure that many issues of public concern are now discussed at the highest level of EU decision-making, but on the other hand there is the risk of imbalances, since there are now so many organizations that the EU politicians and bureaucrats do not have time to listen to them all. As a consequence, the oldest and the most institutionalized organizations are heard the most, even if they are inert and resistant to change (just as the COPA is).

### 3.4.1 The logic of collective action

The driving force behind the formation of an interest group is the belief that the members share interests and goals (Mueller 2005:473). In fact, there is no group without interest, and there is no group interest that includes everyone in society (Olson 1965:120). The common goals and interests makes the achievement of the goals a public good<sup>56</sup> in the interest group, giving the same incentives to free-riding as exist in all public good situations (Mueller 2005:473). It is therefore much easier to form an interest group when the number of members is small, because “*when a person in a small group stops paying for the collective good he enjoys, the cost rises noticeably for each of the others in the group. As a result, the other members may refuse to continue paying and the good may no longer be provided. However, if the first person realizes that he is better off when the good is provided, he might continue making a contribution to the purchase of the public good*” (Olson 1965:43). This argument is supported by the fact that farmers receive more protection in the developed countries where they are small in number than in developing countries where they are often many in number<sup>57</sup> (a so-called numbers paradox) (Mueller 2005:475). Also the fact that farmers are concentrated to rural areas (compared to consumers who live all over the EU) helps to explain their successful organization.

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<sup>54</sup> Lobbying may also be about minimising surprises. Knowing what is going on may be just as important as trying to influence what is going on (Mazey & Richardson 2001:220).

<sup>55</sup> Information refers to the preferences of the interest group or, what Mueller (2005:496) calls it, “states of the word”.

<sup>56</sup> CAP can be viewed as a public good. For example, once the intervention price is increased for a particular good, all farmers producing that good will benefit. Similarly, no EU farmer can be excluded from the CAP.

<sup>57</sup> This does *not* imply however that there does not exist any free-riding among farmers, or among member states. For econometrical estimates and discussion on this subject, see Furtan, Jensen and Sauer (2008).

Small groups usually express narrow interest and “often request government favours or programs that benefit these groups but hurt the national economy” (Eggertsson 2005:63). It is a fact that the political influence of farmers’ organizations exercise a strong influence<sup>58</sup> on both the national governments and on the EU and that their lobby activities has managed to discourage reform (Field 2002:228).

#### 3.4.1.1 Why consumers do not unite

In the light of the EU farmers’ successful lobby activities we have to ask; why do not consumers form an interest group? Firstly, they are many in number, hence the free-rider problem is large. Secondly, the benefits of agricultural subsidies to each individual farmer are much larger than the costs to each individual consumer or tax payer. Consequently, while many consumers are unaware of the CAP’s effect on the prices, farmers have a great incentive to lobby (Hix 2005:275). And since resources and time to obtain information is costly, most people mostly choose to be rationally ignorant (Kasper & Streit 1998:54). What this means is that as long as the cost of educating oneself sufficiently to make an informed decision can outweigh the potential benefit that could be gained from that decision, it is rational to be ignorant. This implies that the largest group in the EU, i.e. the consumers, which has some of the most vital common interests, exert no pressure. Nor can the consumers be expected to organize simply because the gains from group cooperation would exceed the cost – no rational individual will spend money and time to prevent the protection of the agricultural sector, when he/she knows that his/her own efforts would not have a noticeable effect. Moreover, all consumers know that they would get the benefit of a more liberalised CAP that others achieve even if they do not contribute themselves, hence nobody does anything (Olson 1965:166).

As long as there is no interest countervailing the farmers’, the European agricultural network is dominated by the farm lobby, implying that there is a “large degree of consensus” which gives the member states the capacity to defend status quo (Rosén & Jerneck 2005:74). This theory gives one answer to how the farmers manage to grab such a large share of resources and get some much protection, claiming it to be public good for their members, although being public bad for everybody else.

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<sup>58</sup> The COPA is the most well-resourced, well-staffed and well-organized of all supranational associations in the EU (Hix 2005:286). It was founded in 1958 and in 2007 it was made up of around 58 organisations from the 27 EU countries representing around 11 million farmers. It also has partner organisations from Iceland, Norway, Switzerland and Turkey (Furtan, Jensen & Sauer 2008:4). The largest European consumer group, on the other hand, has only 7 employees (Elliott & Heath 2000:44).

### 3.4.2 Rent-seeking

“Rent-seeking mirrors the implicit or hidden costs attributable to the creation of artificial scarcity initiated in many instances by government issued monopoly rights and includes the subsequent expenditure of real resources by aspiring monopolists and citizens alike through bribery and the lobbying of government”.

**McNutt 1996:137**

Citizens and interest groups represent the supply side in Public Choice theory, because they are the ones that provide the votes that politicians seek to win by providing policies or legislation. Legislation may be a public good with characteristics that appeal to a given group of voters (as protection of the agricultural sector), or income transfers from one sector of the population to another (as from the consumers to the farmers) (Mueller 2003:333). In the case of the CAP, national governments, the Commission and the Council – since they do not agree on reforms - also help to increase and protect the monopoly position of the farmers’ organization. By doing so the government increases the monopoly rents of that particular group.

When the farmers are trying to pursuit these rents they are said to be rent-seeking (ibid). The most common way to rent-seeek is by lobbying, and as long as lobby activities will be cheaper than changing production and making it more efficient, it will be profitable for a firm to spend resources on lobbying. From a societal point of view rent-seeking is a waste of resources, but clearly it could be economically rational for an organized group. In the case of the CAP strong lobby forces have managed to maintain the system of expensive subsidies, and as long as those subsidies keep in business farmers who would otherwise quit, they are both trade distorting and not fully decoupled (Artis & Nixson (ed.) 2007:101).

The cost of rent-seeking is called social waste and refers to the opportunity cost of resources devoted to rent-seeking (McNutt 1996:138), to “*the efforts of the government officials to obtain or to react to the expenditures of the potential recipients*” and to third-party distortions induced as a consequence of the rent-seeking activity (Mueller 2003:334). Measuring that cost is, however, very difficult (McNutt 1996:140).

#### 3.4.2.1 Modelling rent-seeking

Most studies of rent-seeking have been focused on special interest groups’ effort to capture monopoly privileges, such as government regulation of free competition. A good example of such an activity is a farm lobby that seeks tariff protection. Figure 7 below represents a basic monopoly privilege rent-

seeking diagram<sup>59</sup>. A monopolist regulates the output to  $q_m$  to secure price  $P_m$  which is higher than the price under perfect competition,  $P_c$ , under which the producer does not gain any economic profits. This implies that under successful monopoly rent-seeking, an amount is transferred from the consumer surplus to the monopolist at the cost of inefficiency, which is the net loss of monopoly pricing.

What the European farmers have done is that they have formed an interest group which lobby for restricting output to secure monopoly gains. When there are many producers (the farmers are relatively many), producers would not like anything better than making the government to restrict the output for them, which is what happens when EU provides subsidies. As was described in 2.4, one effect of subsidies is that they depress the output from the rest of the world on the world market. World production is reduced and the monopoly profit (the rent) is split between the European farmers (McKenzie 2007). The rent represents the consumers' forgone utility which is transferred to the farmers (Mueller 2005:498). If the farmers will use real resources up to the amount of the monopoly profit, the inefficiency steaming from this activity equals area  $P_cP_mAB$  (McKenzie 2007).

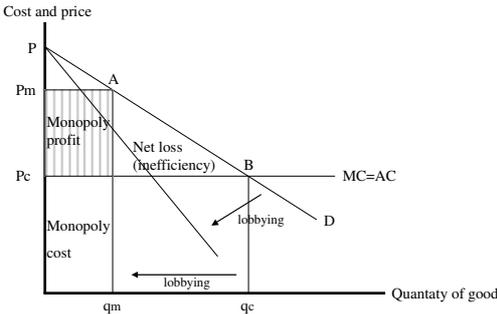


Figure 7: Rent-seeking<sup>60</sup>

3.4.2.2 How can rent-seeking be possible?

The reason why the farmers' organization is so successful in lobbying and rent-seeking depends on a number of variables. Firstly, when the farmers seek protection, it is beneficial for the politicians and bureaucrats to engage in the rent creation, hence it is rational for them to do so. This is said to be because when creating rent, the politicians and bureaucrats can gain influence as well as support from powerful groups.

<sup>59</sup> This is a very simplified way in which rent-seeking can be modelled. Problems such as incomplete information on the level of monopoly price and non-price barriers make it difficult to accurately evaluate social costs of monopoly and rent-seeking. The interested reader is referred to chapter 6 in Patrick McNutt (1996) and to page 335-343 in Mueller (2005) for a detailed discussion of rent-seeking measures and models.

<sup>60</sup> Reference: McNutt (1996):148

Secondly, if we assumed that 1) the primary goal of leaders is political survival, 2) all governments face budget constraints, and 3) leaders minimize the cost of buying support, it follows that *“all else being equal, the supply of (growth-friendly) public goods by the government is an increasing function of the size of the winning coalition, whereas the supply of private goods is an inverse function of coalition size”* (Eggertsson 2005:63). This reasoning is intuitive - a ruler who relies on a small number of supporters (as the small number of farmers), minimizes costs by buying their support mainly with private goods if compared to supplying public goods to the whole society.

Thirdly, as has been stated, the Commission is an external institution. In such institutions, principal-agent problems often arise. This implies that it becomes easier for the political agents working in the institution to exceed their mandate and use their positions for their own benefit (Kasper & Streit 1998:31). This is said to be because in contrast to business, where agents are disciplined by competition, the Commissioners know that they act relatively opportunistically since they know that the citizens are not well informed and would incur high costs if they wanted to find out. Consequently, governments and institutions can be involved in rent creation. However, when specific industries are protected, these industries become unprofitable and have to receive more protection in order to survive. To avoid political criticism, the politicians and bureaucrats have to raise the intensity of the industry protection, implying that a spiral of protection is created. This is what has happened in the European agricultural sector.

### 3.4.3 Lobbying the Commission

Since the Commission is the EU institution that initiates policies and drafts proposals, most lobbyists direct their lobbying towards the Commission (Watson & Shackleton 2008:100). In the case of the CAP however, in addition to lobbying through COPA, farmers also lobby through their national farmers' union. Then the target of the lobbying is the farmers national governments and their representatives in the Council of Ministers (Furtan, Jensen & Sauer 2008:4), since it is the Council that accepts, rejects and refines policy proposals (Senior Nello 1984:273). Yet, the COPA's (which is the European lobby group that includes all farmers) prime focus is the Commission (Furtan, Jensen & Sauer 2008:4-5).

The Commission claims that it maintains an open and wide dialogue with all interested parties, but in reality it has been showed to display a preference for dealing with pan-European groups, such as the COPA (Watson & Shackleton 2008:101). Agrarian interest groups early became an integral part of the

work of the Commission, in fact the COPA was found on the request of the Commission (Senior Nello 1989:101). This was possible because the EC had no administration of its own during the early days of the CAP and because it was a policy in need for legitimacy<sup>61</sup> (Rieger 1996:110). Hence COPA was of crucial importance in securing the acceptance of the CAP in the sixties (ibid:117), which cleared the way for future agricultural lobbying, implying that the “feedback mechanism” became path dependant. Besides, the Commission relies on the COPA for help in overcoming opposition from national governments (Senior Nello 1989:105), which gives the COPA a special role in overcoming disputes but also lies the way for the farm lobby to influence the decision making.

The contact between various interest groups and the Commission is either formalized in the shape of advisory committees or expert groups, or “conducted on an *ad hoc* basis” (ibid.). One issue for the Commission to solve is the exact moment when interest groups should be consulted. If consultation happens before meeting the Parliament, it could be viewed as usurping the role of the democratically elected Members of the Parliament. But if consultation happens afterwards, the opportunity to take account of outside views may be small (ibid.). Another issue is that of ethics and propriety. The Commission has always been an institution open to outside input but it has traditionally not had a formal rule regulating outside interest groups (Rieger 1996:102). As for now, since there only exist very basic written rules in the form of guidelines and voluntary codes of practice (Mazey & Richardson 2001:228), the lobbyists are controlled mostly by non-governmental organizations such as LobbyControl and Spinwatch. As more and more groups are coming to Brussels this has become a problem.

As has been described, most Commissioners are faced with re-election constraints. Since we assume them to be just as self-interested as anybody else we do not expect any bureaucrat to introduce policies that could diminish the possibility of re-election – such as radical changes of the CAP. On the contrary, maintaining the redistribution scheme might be a rational strategy of the Commission since it buys support. Besides, the Commissioners, especially from large agricultural nations, know that subsidies are part of a deep-seated culture, implying that pressures at national levels for maintenance of status quo can be very strong. Since we assume that the Commissioners wants to be re-elected, he/she has no other choice than to satisfy the will of his/hers country (since the Commissioners are chosen by their national governments). In other words, if the national government is reluctant to reform, the Commissioner will

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<sup>61</sup> Or rather, it was the Commission that was in need of external support and legitimacy, since it, in the 60s, was a new bureau. Given the size and the complexity of the tasks assigned to the Commission today, it should still be viewed as a very small bureaucracy with limited resources. Consequently, the Commission is in constant need for information across the member states, which allows the lobbyists to have such a strong influence over the Commission.

be so too. Consequently inefficient policies are maintained, such as the subsidy system in the European agricultural sector. In the Public Choice literature this situation is referred to a government failure<sup>62</sup>

### 3.4.3.1 Redistribution to special interests

“The state can be envisaged as coming into existence either to satisfy the collective needs of all members of the community, or to help gratify the wants of only a part of it. The first explanation corresponds to the achievement of collective efficiency; the second to redistribution”.

**Mueller 2005:44**

The result of the farmers’ lobbying and the consequence of the inertia in the institution of the CAP is that the European agricultural policy continues to be redistributive<sup>63</sup>. In fact, since one of the stated aims of the CAP is to increase the living standards of the farmers the policy is stated to be redistributive in its nature. Wealth is transferred to the agricultural sector from consumers, taxpayer and third countries, but since the transfers occur through a tax/subsidy scheme paid by the consumers, we could think of the process as involuntary redistribution. Involuntary redistributions are usually thought of as money flowing from one group to the government and out to a second group, with the first group being made worse off and the second group being made better off, and where the second group expends resources (by lobbying) to win the subsidy in question (Mueller 2004:55).

The redistribution scheme of the CAP is locked by the unanimity rule that prevails in CAP decision making. Consequently, progress halts. A concern about using the unanimity rule is that “*under the unanimity rule, those who gain from the maintenance of status quo always succeed in preserving it*” (ibid:144). In the Commission, usually politicians/bureaucrats/civil servants from large agricultural countries holds the positions in the Agriculture Directorate-General, hence there has always been possible to favour the European farmers.

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<sup>62</sup> An analogy to market failure and occurs when a government intervention causes a more inefficient allocation of goods and resources than would occur without that intervention.

<sup>63</sup> Obviously, all government expenditures have a redistributive component. A road built here but not there is also redistributive.

# 4 Analysis and discussion

Reform of the CAP is back on the table again - not that it has ever been absent for long. In fact, as described in section two, ever since its establishment, the CAP has been subject to an ongoing process of reform attempts. Clearly, those attempts have not been successful enough. This thesis asks the question 'why is that so', meaning why have more not been made, and in the previous section the theory of Public Choice was used to present one possible answer to the question. In this section the theory findings will be analysed and the prospects for future reform will be discussed.

## 4.1 The answer to 'why is that so': a Public Choice perspective

The theory of Public Choice takes its point of departure in a short and clearly expressed assumption of the individual behaviour - the assumption of individuals as rational decision-makers, interested in maximizing their own utility. With the risk of omitting the role of values, ideas, principles, paradigms and other institutional factors, Public Choice offers us an alternative approach to analyse the institutional inertia of the CAP and brings into light factors that are most often forgotten in pure economical analyses. Still, it should be remembered that no theory can ever represent the whole story, implying that the analysis presented here is only one of a number of possible answers to the question why more have not been done when it comes to the reforming of CAP.

One of the main advantages of Public Choice theory is that it does not treat the government simply as "black box", rather it emphasizes the fact that policies are assessed not only on the basis of their likely effects, but also in terms of the costs and benefits of deciding on those policies and implementing them. We know that the cost of negotiating reform proposals in the EU, at least regarding to supranational CAP, is very high due to the national differences in preferences among the member states. Also the cost of implementing a reform proposal has been suggested to be very high, since it could imply a significant decrease in the farmers' support, which was assumed to be vital for the politicians and bureaucrats working with agricultural policy. A second advantage of using Public Choice theory is that it explains how it can be possible for an institution to operate differently than is intended by the society. First, it was assumed that bureaus have their own culture, agenda, goals and wants. Secondly, it was assumed

that bureaucrats, as a rule, have an information advantage over its sponsor/principal, which gives the bureau monopoly power. This power did in theory allow a bureau to pursue its agenda and wants.

#### 4.1.1 Rationality and institutional set-up

Public Choice assumes *all* agents to be rational. Rationality referred both to self-interest and to the assumption that individuals know their preferences, which was equivalent to knowing what one wants from the political process. We know that the farmers wants sectoral protection and we assumed that politicians and bureaucrats wants (among other things) power and to be re-elected. The expression 'a rational individual' did furthermore refer to an individual who acted in a way that maximized the possibilities of getting his/hers wants. All those assumptions together answered why bureaucrats and politicians responded to the lobby efforts of the farmers. It is particularly rational for the members of the Agricultural Committee and the Council of Agricultural Ministers, who are dependent on the farmers' votes and support (Senior Nello 1984:272), to support the farmers, which in this case is equal to be resistant to change.

However, an answer that only looks to the rational and self-interested behaviour of politicians and bureaucrats is not sufficient. The Commissioners, the Ministers, the experts, the advisory groups and all the other people that are related to the agricultural policy, work and react in an institutional set-up that affects and put constraints on the behaviour of the agents involved. As North said (see section 3.1), it is the institutions that structure political, economic and social interaction and that provide the incentive structure of an economy. This implies that the behaviour of politicians and bureaucrats cannot alone explain why protection of the agricultural sector is supplied.

If we agree on that the response of the political system depends on the institutional set-up, that must imply that (besides from the agents behaviour) the voting rules and procedures that are used are a key factor to why the CAP has not been reformed much. The unanimity rule, which is applied in the decision making process in the Council, makes EU a tough bargainer. No negotiating opponent can obtain more then what the most conservative member state is willing to concede. This implies that a single member state can prevent all reform attempts and protect status quo. As a consequence, the current CAP must necessarily be viewed as reflecting the power of the largest and most powerful agricultural countries. Also, the supranational nature of the CAP lays the ground for a bias towards ever greater spending. Instead of co-operating to limit spending, each member state seeks new policies from

which it will benefit most. This is why successive reform attempts have preserved transfers to existing farmers. In sum, while it is true that the Commission is a bureaucracy on its own, with both power and agenda, the institution set up allows the member states to also play a very important role in the institutional inertia of the CAP.

#### 4.1.2 Collective action and lobbying

Since it is costly (time, information and signalling costs) to form and express a preference, it is only rational for a voter to reveal his/hers preferences if there is some advantage in doing so. The time, information and signalling costs are reduced for the farmers because they already have established organizations that can provide them with information about the complexities around CAP and that already communicate with the Commission and the Council (Senior Nello 1984:271). Moreover, since the impact of the CAP is larger on each individual farmer than on each individual consumer, it is much more advantageous for the farmers than it is for the consumers to gather information and signal their preferences. Besides, the theory of collective action suggested that since the farmers are relatively few, they manage to organize themselves in a way that consumers will not. As the number of European farmers continue to decline over time, their organisations might become even more efficient, since the free-rider problem may decrease. In addition, as transport and communication infrastructure becomes more developed over the Union area, the organisation efficiency increases further since it becomes easier for farmers to meet and communicate even though they live in distant rural areas. On the other hand, as concern for the environment, developing countries, and food safety rises, alliances between other (non-farming) interest groups, that are currently small and relatively powerless, might develop. This has already happened at least once, namely during the Fischler reform negotiations when alliances between environmental, consumer and development organisations were formed (Garzon 2006:113). It is possible that such alliances will grow stronger over time, with the result of diminished farmer organization power.

Another factor that contributes to the farmers' success is the relatively declining share of agriculture in GDP. This implies that the cost of support of the agricultural sector should gradually fall. Moreover, when the income of the EU citizens rise, the price of food becomes less important which should decrease the opposition to raising farm prices. Consequently, free-riding within the consumer group will grow. This might imply that the agricultural lobby becomes more effective, visible and/or powerful.

It should here be noted that lobbying activities, in general, must not necessarily be viewed as 'bad'. On the contrary, there is a probability that policy outcomes could be worse without lobbying, because it is the lobbying activities that force the decision makers to listen to the people that are actually affected by their policies. Consequently, politics and policies may be regarded as more legitimate, which in turn can increase the acceptance of the EU. The problem is when one or a few groups are larger, more powerful and receive more attention, just as in the case of the farm lobby. Then politicians' decisions are often biased against that particular group at the cost of the rest of the society.

Both the Commission and the Council are hot targets of the farm lobby which might explain why these institutions oppose reform proposals. Furthermore, COPA has a constitutional right to consultation on all decisions regarding the CAP (Elliott & Heath 2000:46), so the bureaucrats and politicians working with the agricultural policy probably fear both political costs, union-induced disruptions and administrative and implementation problems if they do not take the farmers preferences under consideration when drafting policy proposals. On the other hand, it would be wrong to only accuse the Commission for being anti-reform without looking to the facts. For example the Fischler reform in 2003 (which is one of the most controversial reforms so far<sup>64</sup>) was conceived at the initiative of Commissioner Fischler and the Commission has called for reforms several times both since then, but also prior to 1992. However it should be remembered that new ideas take time to be institutionalised and that the EU is an extremely complex place for drafting reform proposals. Even though some politicians do want reform, the stakeholders and many of the member states fight hard for maintaining status quo. Moreover, CAP is an old policy characterised by a strong consistency in the agricultural policy direction which makes it path dependant. Therefore, pro-reform Commissioners are not so visible in the discussions.

### 4.1.3 Institutional openness

The link between the farmers' success and the EU's response lies in the openness of the institutions (Senior Nello 1984:270). As already described, in particular the Commission is open to the civil society. Being an institution constantly dependent on information, the Commission has created consultative committees that have fostered institutional opportunities and lobbying activity for interest groups. The cooperation with farmers' organizations has been present since the establishment of the CAP and the Commission, and there are close links between COPA experts and the Commission which take the form of working groups, meetings, proposals etc. Moreover, the COPA presidium meets the Commissioner

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<sup>64</sup> Remember, that it was initially planned as a mid-term review but tuned out to be a substantial reform package.

for Agriculture regularly (Senior Nello 1989:103). However, one of the main aims of the COPA is to influence Commission officials in their draft work for agricultural legislation (*ibid.*), and since the farm organizations are better organised both in Brussels and in the member states than the consumers, and also have plenty of possibilities to influence EU decision making, there is an apparent risk that the draft work of the Commission is influenced more by the farmers and biased against their preferences. Furthermore, the agricultural Commissioner, who is responsible for initiating reform proposals and changes to the CAP regime, has always come from a farming state, and usually from a political party with close links to farming interests, and the agricultural Directorate-General is staffed predominantly by officials from the main farming member states (Hix 2005:285-286). Obviously, such conditions facilitate lobbying activities for the farm organizations.

On the other hand, we should not forget that since 20% of the farmers receive 80% of CAP subsidies (Elliott & Heath 2000:45), agricultural interests in reality only concern a privileged group. This disproportionate allocation provides a special incentive for an elite group of farmers to defend status quo on the behalf of the consumers, third markets and the other farmers. In fact, COPA is sometimes referred to the elite of farmers, since most members of COPA's presidium have land holdings in excess of 100 hectares (*ibid.*). On the other hand, it is a fact that farmers do unite and that those groups are larger than the 20% of elite farmers. This must imply that the farmers are organized also for some other purpose, as e.g. some social function (agricultural unions offer insurance policies and pension plans). However, since it is in the task of the agricultural unions to administer the agricultural programmes (*ibid.*), membership should probably be viewed as a necessity rather than an option.

## 4.2 Prospects for future reform

Having the theory and analysis in mind, it is of interest to also briefly discuss the prospects for future CAP reform. The EU and the member states seem to have started down a path of which the cost of reversal is very high. First of all, the fifty years of agricultural support has made the European agricultural sector ineffective and uncompetitive at the world market. Liberalising CAP at this point would force a great many farmers to leave the sector and enter unemployment. Obviously, a structural change of the agricultural sector should have happened a long time ago, but with governmental intervention in the sector, the support has become welfare politics for many farmers and rural areas. This implies that the farmers stand to lose much if a reform is to be agreed on. Secondly, this thesis suggests that one reason for the politicians and bureaucrats to supply the demanded protection is that

they win votes and support from the farmers by doing so. This implies that also the political cost of a reform is very high for the people working with agricultural policy.

One of the main problems with CAP is that it has been put on a supranational level with the principle of common financial responsibility, but left some decisions in national hands, such as control over farm-investment aids and taxation (Swinnen & Van der Zee 1993:274). Consequently, each member state has the incentive to prevent reform since it will not be solely responsible for the cost of an inefficient policy. It has to be concluded that the member states are a significant factor for the CAP's resistance to change. This, again, depends on the institutional set-up. National bureaucrats working with the agricultural sector do also welcome the maintenance of the current CAP. After all, the more important the agricultural sector, the more secure is their job and the greater are their opportunities to advance in career and salary. Besides, a reform could change the nature of the work assignments which in turn may imply that some parts of the work force have to go, which obviously is not in the interest of the bureaucrats.

The member states are split on the issue of reform and come to the negotiation table with different preferences. France<sup>65</sup> leads the CAP defenders, which includes Spain, Portugal, Ireland, Austria, Greece and Belgium, while the pro-reform camp includes the UK, Sweden, Denmark, and at times also Italy, the Netherlands and Germany (Thurston 2005:5). Germany's decisions are path dependent, since it still feels that its close relationship with France may crumble if too controversial proposals are supported. At the same time, Germany is the EU's chief paymaster. It is difficult for the Commission to draft proposals which are accepted by all states. Even if there is a will for radical change, each state can use its veto right if the proposal seems to hurt the national interest. Hence, the Commission is locked in a joint decision-making trap, which causes the CAP to remain as it is - even in the face of ever-growing agricultural surpluses or other pressures.

It is an unquestionable fact that the Commission is a bureaucracy with its own agenda and power, but it has tried, at least in the Agenda 2000 and in the 2003 Fischler reform, to shift more resources from Pillar 1 (market support) to Pillar 2 (rural development), but, as we know, with limited success. Such a shift is, and will be even more, necessary as the Union is enlarged and poorer countries enter as members. Besides, as the role of the agriculture in the economy is all time decreasing and citizens become richer, public concern grows for the conservation of natural resources, the environment, animal

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<sup>65</sup> A substantial part of the French population still has connections with the countryside and farming. Besides, France is a net receiver.

welfare, food safety etc. In other words, the farming of today is much more than just economic activity. Farmers guard the countryside and the rural culture and traditions. However, the apparent consensus that it would be correct to switch to Pillar 2 crumbles when it comes to actually shift resources from Pillar 1. It is the Council of Agricultural Ministers that takes final decisions on the Commissions proposals, and up to now the Ministers have tended to overlook large reform proposals. This probably depends on the fact that the agricultural Ministers are often from parties supported by farmers and/or represent rural regions (Hix 2005:285).

Luckily, the limits to reform are not as absolute as they appear in theory. The world is much more dynamic than any theory assumptions. Development and pressure from consumers and the international arena should catch up eventually, even within such an inert institution as the CAP. Most probably coming shocks (or the current shocks that will be discussed below) will destabilize the system and create “window of opportunities” for institutional reform. The EU should also expect more pressure from third countries. As the world becomes more and more globalize, pursuing a protectionist policy becomes more criticized. Moreover, the more globalized the world becomes, the more interested should the EU be to increase the competitiveness of its sectors. As the number of people in the world and their incomes grow, a larger quantity, better quality and more variety of food will be required. The ability to compete effectively will thus be even more important in the future than it is today. If the EU does not manage to reform the CAP, the largest policy area within the Union, in time, that may have a strong negative impact on the public opinion. In the worst case scenario, the Commission can lose its credibility.

#### 4.2.1 The shadow of the Union enlargement

Politicians and bureaucrats are in a constant conflict between the need of reforms and their political acceptability. So far, the EU has often been ill adapted to make the necessarily adjustments. As Rosén and Jerneck (2005:76) states: “[A] transformation can take place in times of crisis. In the case of the CAP, however, thus far every critical moment or window of opportunity for major reform of the prevailing policy paradigm has been lost”. Rather it seems that something has to trigger reform, or that the situation must be such that the cost of no agreement is higher than the agreement itself. For example during the Agenda 2000 negotiations, the cost of no agreement would be very high, since it would endanger the future union enlargement and involve high costs for the European integration project.

Agenda 2000 was however not a sufficient reform and the CAP is currently standing in front of the challenge to face the aftermath of the 2004<sup>66</sup> and 2007<sup>67</sup> Union enlargements – and to prepare for possible future enlargements. Future reforms may be more difficult to agree on as the EU widens. The increase in the number of countries, the divergence in income levels, differences in preferences and the different roles of agriculture in the economy are factors that may slow down the reform process even more. But reforms have to be done, because the two latest enlargements have already had dramatic impacts on the EU agriculture - 7 million farmers and 55 million hectares of agricultural land have been added to the existing farming population of 6 million living on 130 million hectares agricultural land in the old EU-15 (European Commission 2007).

Since a larger fraction of the newcomers' population works on the land than the population of the EU-15, it means that the newcomers are more reliant on agriculture than the old Member States. The largest recipients are however still all older members – in 2005 France received 20% of CAP spending while Poland<sup>68</sup> only got 3% (Sbragia & Stolfi 2008:130). This differential treatment has been heavily criticized by the Central and East European countries. On the one hand, to promise the newcomers the same treatment received by EU-15 would have bankrupted the EU, and on the other hand to exclude the newcomers from the policy altogether was not viewed as an option; it would be politically unacceptable and violate the principles of solidarity and cohesion (Baun 2000:145). Nonetheless, the current system will probably not be accepted for long.

A second problem following the enlargement is that the newcomers are low-wage economies. At the entry they increased the population of EU by 30% but GDP by only 4%. Since contributions to the EU budget are based on GDP, it implies that the newcomers would be net beneficiaries without any reform (Field 2002:241). The old members have been unwilling to see their contributions increase at the same time as many nations are unwilling to accept any reduction in their benefits (ibid:242). Moreover, land prices in the newcomers are cheaper than in the western EU, implying that there is a large potential for increase in output if prices increase (ibid.), which would imply more surplus production and more costly subsidies. Therefore, the CAP instruments that are production driving will have to be abandoned. A solution would be to strengthen the second pillar of the CAP before any further enlargements so that the EU could move into the direction of greater co-financing by the member states. However, a CAP

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<sup>66</sup> Cyprus, Estonia, Lithuania, Latvia, Malta, Poland, Slovenia, Slovakia, Czech Republic and Hungary.

<sup>67</sup> Bulgaria and Rumania.

<sup>68</sup> Poland has the largest group of farmers in Europe. About 19%, which corresponds to 4 million people, work in the agricultural sector (Levinsson 2004:147).

based on the priority for rural development, environmental objectives and safe and quality food will probably not cost less – on the contrary, administrative costs may well rise as a result of tougher labelling and more strict tracing of production stages.

#### 4.2.2 The current world financial crisis

Another driving ‘shock’ that could open a window of opportunity may be the current world financial crisis. Since the financial crisis has already been very costly for the union, with fast rising unemployment, it will probably be impossible for the CAP to ignore further reform. Only the fact that the CAP absorbs around half of the EU budget, while the agricultural sector produces less than 2% of the EU GDP (Secondo 2002:241) should provoke a reform when resources are so desperately needed in other sectors. The same fact should make it more difficult for the EU to justify an annual spending over 1.2 billion Euro to subsidise farmers for not cultivating arable land in order to reduce domestic supply and maintain high food prices (ibid:242). It could not be asked from the citizens to first pay higher taxes and/or prices, and then to also spend and consume more in order to get the economy going. On the other hand, neither the budgetary cost of the CAP nor its effects on food prices has seemed sufficient to lead to profound questioning so far.

#### 4.2.3 Summing up: how pessimistic is the outlook?

Both the theory of Public Choice and past experience suggest a pessimistic outlook. The 1992, 2000 and the 2003 reforms all promised large steps forward, but somewhere in the implementation process, the interest of lobbyists and bureaucrats managed to keep status quo. This thesis suggests that the shadow of the Union enlargement and the current world financial crisis could constitute windows of opportunity to reform, however this far not much has happened.

In conclusion, it is time for leaders to get going and to start acting. Ideally the Doha round should be finished. When this happens, we cannot know. The current CAP is in equilibrium – or rather in Nash equilibrium – and a change may take long time to realize. In theory, Nash equilibrium does not change, because a change would imply that somebody will get it worse off. And since we assumed all people to be rational utility-maximizers, we should not expect the losers to voluntarily be pro-reform.

## 5 Conclusions

Reform of the CAP continues to be one of the major challenges facing the EU. Despite three larger reform attempts during the 1990s, the CAP remains largely what it was when it was first created. In this thesis it has been suggested that the inability of the Commission and the Council to reform the policy properly is a case of political and institutional failure, which depends on the rational, self-interested behaviour of agents, the effective farm lobby and the institutional set-up.

The inability to reform the CAP has led to three major failures. Firstly, the effects on the average agricultural labour income is ambiguous while the wealth effects are highly unequal, benefiting the already well-off farmers at the cost of poorer farmers, consumers and third countries. Secondly, it provides incentives to overproduction sold at third markets for costly subsidies that distort trade, decrease world market prices but raises EU prices, which lessens the competitiveness of the European farmers. Thirdly, it results in deterioration of the rural environment and natural resources. In other words, the inability to reform the CAP has led to inefficiency and waste of resources. For all this, it can not be said that CAP has been a complete and total failure. It succeeded in providing the post-war Europe with food and has probably contributed to the political stability within the Union since it allowed the creation of the single market. The problem is that the world has developed while the institution of CAP has remained and become out of date, inflexible and inert.

As outlined in the introduction the purpose of this thesis has been to answer the following question;

*How far-reaching are the CAP reforms already made and why have not more been done?*

Regarding the reach of the reform already made, it should now be evident that they have not reached far enough. The movement away from coupled production subsidies toward more decoupled support is one of the most important reforms so far, but as long as there are payments that keep farmers in the sector that would otherwise quit, the policy “eats” resources that are needed and would be more efficient elsewhere. This thesis suggested that this might change if there is something that triggers the need for reform, as the current world financial crisis or the shadow of the two latest Union enlargements. It remains to be seen whether a large reform will be agreed on in the nearest future, but the theory of Public Choice, which was applied in the analysis and used to answer the question ‘why have not more been done’, suggests a rather gloomy prospect for the future.

The entrenched position of the farm lobby has probably been the biggest barrier to change. The reason for the farm organizations success depends on i) the logic of collective action, ii) the fact that price distortions caused by subsidizing exports and taxing consumption affect the losers less relative to the gainers as the economy develop, which makes the consumers rationally ignorant and gives them incentives to free-ride, and iii) the exclusive position of the farm organizations in the EU political process, as the establishment of the Commission of committees has institutionalised the role of the COPA. Since consumers are rationally ignorant politicians are able to support the farmers without fear of retribution from the majority

A second large obstacle to reform is the balance of power between the member states which benefits the larger agricultural countries and makes them unwilling to agree on a reform, which depends on the political cost a reform would imply (in terms of lost votes and support). It was assumed that politicians and bureaucrats are utility maximizers that want to be re-elected. Since all member states have a veto right, everyone must feel that they win in order to make a reform agreement possible. The inertia is self-reinforcing as it is difficult for the parties to make any retreats from their positions. Compromises are built upon each other, implying that further compromises are becoming increasingly difficult to reach (Rosén & Jerneck 2005:64) and breaking up old ones are associated with significant political costs (ibid:71). Besides, the Commission's role as an agenda setter implies that the Commission can choose a proposal that coincides with its preferred position and the institutional constraints in the Council make it easier to block reform initiatives than to endorse them.

In conclusion, agricultural policy reform in the EU is a complex process. The slowness of the process of reaching agreements on reforms, and the fact that reforms fall short of what is actually needed, suggests that there is a 'resistance to reform' in the institution of the CAP.

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# Appendix A - Key dates in the history of CAP

- 1950** The Schuman Plan<sup>69</sup>
- 1952** The establishment of European Coal and Steel Community
- 1957** European Economic Community, EEC, is established by the Treaty of Rome
- 1958** The Stresa Conference<sup>70</sup>  
The Treaties of Rome enters into force<sup>71</sup>
- 1962** Key decisions on the CAP are taken – agreement on regulation of cereals, pig meat, poultry meat, eggs, fruits and vegetables, and wine
- 1963** The Council agrees on regulation of dairy products, beef and rice.
- 1964** Decision on common prices are taken
- 1967** Common prices comes into operation
- 1973** First enlargement - Denmark, Ireland and the United Kingdom joins the EC
- 1975-87** Period marked by sharp disputes over the budget and the expanding CAP
- 1975** The European Fund for Regional Development is established
- 1981** Second enlargement - Greece joins the EC
- 1985** The EC Commission publishes the Green Paper
- 1986** Third enlargement - Portugal and Spain joins the EC
- 1988** Inclusion of the Structural Funds in the policy
- 1992** The Maastricht Treaty is signed, creating the EU  
Agreement on the MacSharry reform of CAP  
Agreement on further reform of the Structural Funds  
Introduction of the Cohesion Fund
- 1993** Introduction of the Single Market

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<sup>69</sup> The French Foreign Minister Robert Schuman proposes the establishment of the European Coal and Steel Community.

<sup>70</sup> Generally recognized to be one of the milestones in the creation of the EC.

<sup>71</sup> The Treaty of Rome was signed in 1957 by France, Germany, Italy, Belgium, Luxemburg and the Netherlands and constitutes the founding document of the European Community.

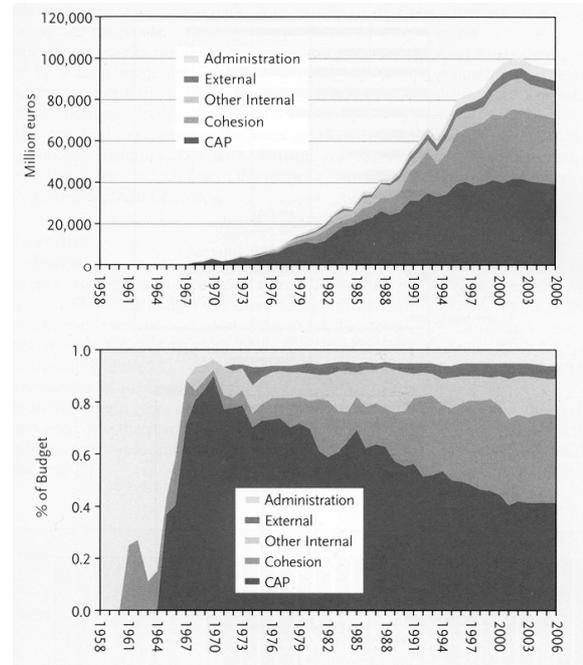
- 1994 The Uruguay Round is signed at Marrakech
- 1995 Fourth enlargement – Austria, Finland and Sweden joins the EU
- 1997 Agenda 2000  
Opening for enlargement negotiations with Czech Republic, Estonia, Hungary, Poland, Slovenia and Cyprus
- 1999 Berlin agreement on Agenda 2000
- 2000 Accession negotiations begins with Bulgaria, Latvia, Lithuania, Malta, Romania and Slovakia
- 2001 The Doha Development Agenda begins
- 2002 Copenhagen European Council (Copenhagen Summit)
- 2003 Mid-term review of Agenda 2000, sometimes called the Fischler reform  
Doha negotiations break down in Cancún
- 2004 Fifth enlargement - ten new member states joins the EU  
Agreements are reached for continuing negotiations in the Doha Round
- 2005-07 Further reform of the CAP
- 2007 Sixth enlargement – Bulgaria and Rumania joins the EU
- 2008 The ‘Health Check’ agreement is reached

**Reference:** Baldwin & Wyplosz (2004):28-29, 64 - Senior Nello (2005):29-32, 234, 364 – Garzon (2006):23 – EU Upplysningen 2009.

# Appendix B – The EU Budget

## i) The EU budget spending, 1958-2006<sup>72</sup>

The EU budget has grown very rapidly, but it started at a very low level. Until the late 1960s the EU spending amounted to less than 10 Euro per citizen, which the introduction of the CAP changed. The top panel shows us that the level of spending and spending priorities have changed enormously since 1958.

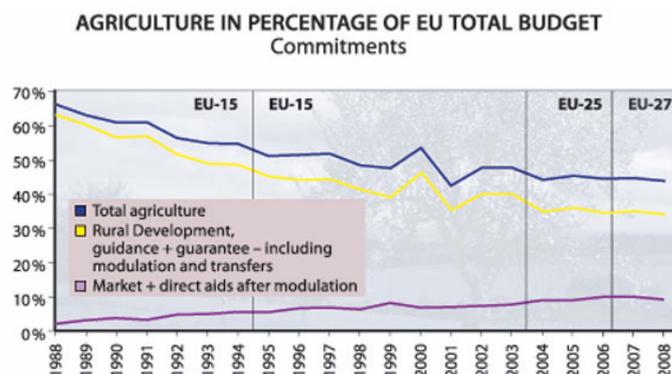


The bottom panel illustrates how the EU budget priorities have changed over the last half century. Not surprisingly, until 1965 the budget was mainly spent on administration. That was the time when all European institutions were set up and the Customs

Union was implemented. However, when CAP spending began in 1965 they soon dominated the budget. Since 1973 the sum of agricultural and cohesion spending have remained stable, ranging between 80-85% of the budget.

## i) Agriculture in percentage of EU total budget<sup>73</sup>

The table shows us that agricultural spending has remained relatively stable the last five years. Due to the limits imposed for CAP market measures and direct aids for the period 2007-2013, CAP expenditures have declined and are



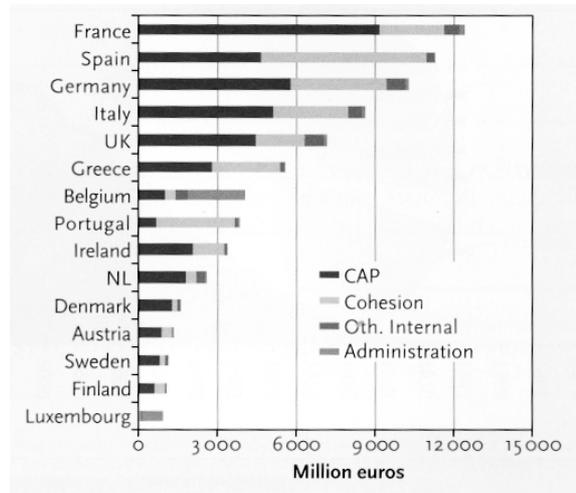
<sup>72</sup> Baldwin & Wyplosz (2004:60-61). The figure is scanned from the textbook.

<sup>73</sup> European Commission (2007:16). The figure is copied from the fact-sheet.

now frozen. Furthermore, expenditures will become tighter each year as the direct aid payments payable in the 12 new Member States are increased progressively towards the aid levels already applicable in the former 15 Member States. Future spending will be more controlled than previously since a new financial discipline has been established.

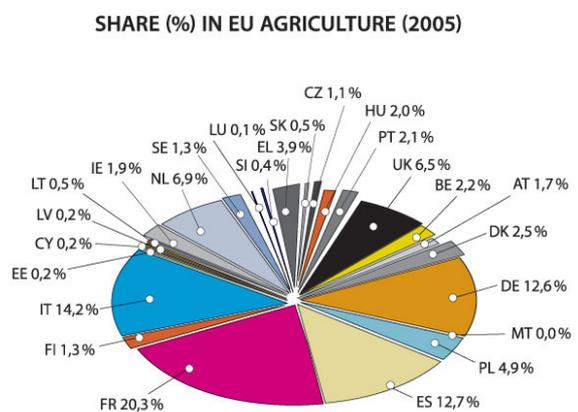
### iii) The EU spending by member, by type and per capita, 1997<sup>74</sup>

The whole budget is about 1% of total EU GDP, implying that financial transfers involved in budget spending are relatively minor. The amount of EU spending varies across members, both in terms of amount and nature. The rightward panel shows that France was the main recipient in 1997 with most of its receipts coming from the CAP. For the second main recipient, Spain, Cohesion spending is the most important source. It should be noted that these figures will be entirely different when looking at receipts per capita. By far, the largest receiver per capita is Luxembourg.



### iv) Percentage share in EU agriculture, 2005<sup>75</sup>

This table shows us that France had the largest percentage share in EU agriculture 2005, which explains why French politicians and farmers lobby so hard for a continuance of CAP payments. As shown in the perceiving table, French also did get the most receipts from CAP. The years of examination differ indeed, but the fact still remains true.

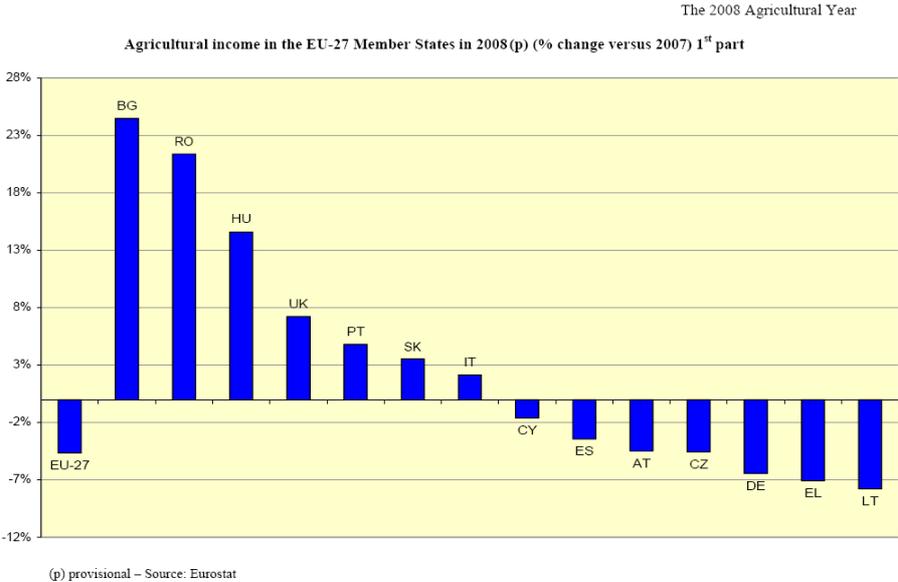


<sup>74</sup> Baldwin & Wyplosz (2004:61-62). The figure is scanned from the textbook.

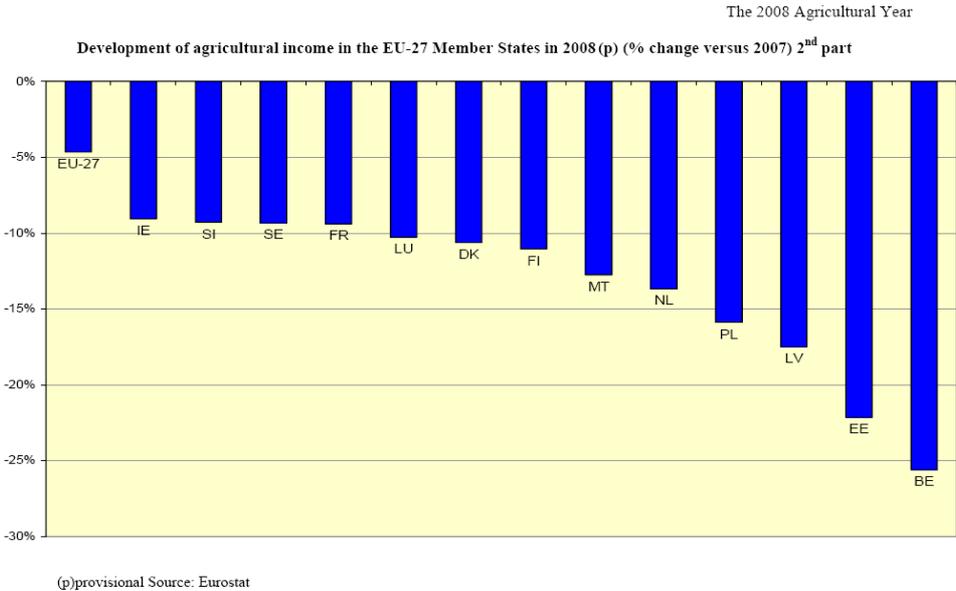
<sup>75</sup> European Commission (2007:2). The figure is copied from the fact-sheet.

# Appendix C – Agricultural incomes

## i) Agricultural income in EU-27, 2008<sup>76</sup>



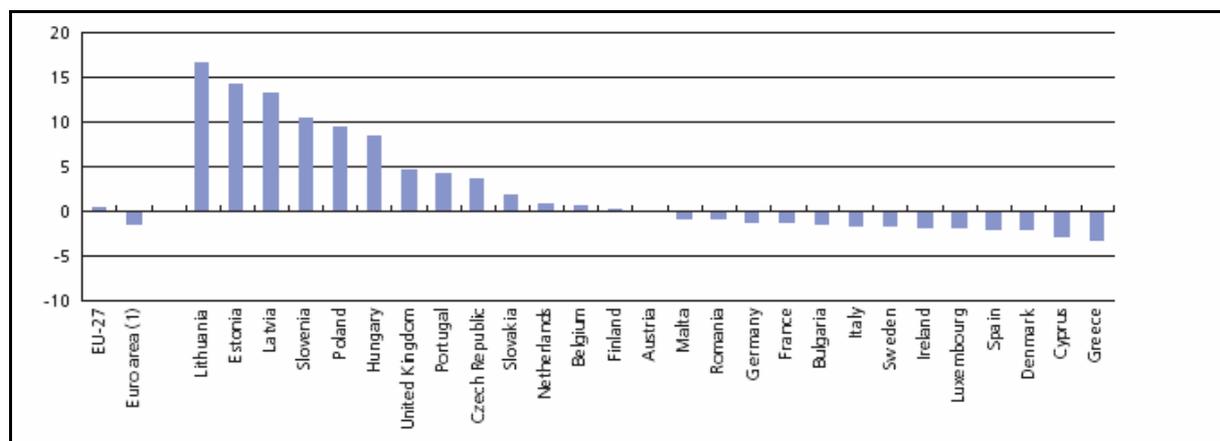
## ii) Development of agricultural income in EU-27, 2008<sup>77</sup>



<sup>76</sup> Figure copied from European Commission (2009a:26)

<sup>77</sup> Figure copied from European Commission (2009a:27)

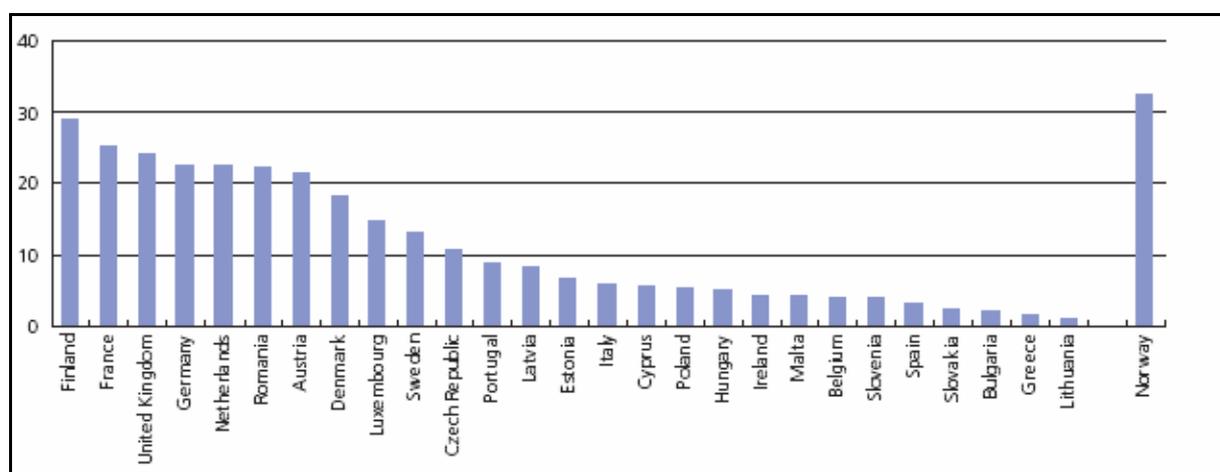
### iii) Income from agricultural activity, 2001-2006<sup>78</sup>



Average annual growth rates, %.

*Not.* Corresponds to indicator A, i.e. the deflated (real) net value added at factor cost of agriculture, per total annual work unit.

### iv) Agricultural holdings with another gainful activity, 2005<sup>79</sup>



*Not.* Other gainful activity refers to any activity other than relating to farm work, including activities carried out on the holding itself (e.g. camping sites, accommodations), or that use its resources or products, and which have an economic impact on the holding. The other gainful activity is carried out by the holder, the holder's family or one or more partners on a group holding.

<sup>78</sup> Figure copied from Eurostat (2008:327).

<sup>79</sup> Figure copied Eurostat (2008:319).

## Appendix D – What the EU institutions do<sup>80</sup>

<b><u>European Council</u></b> <sup>81</sup>
- Political leadership but no legislative power <sup>82</sup>

<b><u>Council of Ministers</u></b> <sup>83</sup>	<b><u>European Commission</u></b>	<b><u>European Parliament</u></b> <sup>84</sup>	<b><u>EC Court of Justice</u></b>
- Legislation EC <sup>85</sup> - Concluding treaties EC	- Exclusive right to propose legislation - Guardian of the treaty - Executing common policies - Information, data analysis reporting - External representation EC	- Approval EU budget - Advice on some EC draft laws - Co-decision on some EC draft laws - Assent for EC treaties & accession	- Supreme judiciary for EC laws - Advice via requested opinions

<b><u>Court of Auditors</u></b>	<b><u>Economic &amp; Social C'tee</u></b> <sup>86</sup>	<b><u>European C'tee for the regions</u></b>	<b><u>European Investment Bank</u></b>
-Detailed, technical budget control; scrutiny of waste of resources	- Right of advice on most EC draft laws	- Right of advice on most EC draft laws	- Long-term finance, market-based, EC linked

<sup>80</sup> Reference: Pelkmans (2001:13-15).

<sup>81</sup> Citizens elect the members of their national parliaments, who in turn form the governments that are represented in the Council.

<sup>82</sup> However, it has played an important role in the development of the CAP as decisions are frequently referred to the European Council when the Council of Agricultural Ministers fails to agree (Garzon 2006:18).

<sup>83</sup> Represents the states.

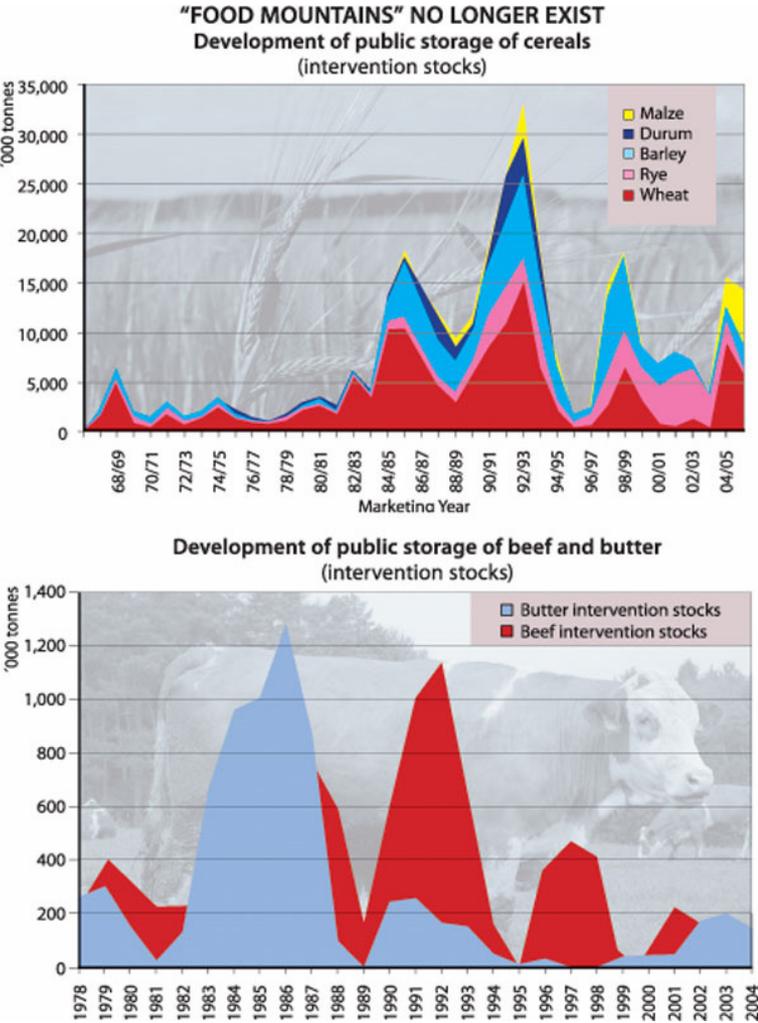
<sup>84</sup> Represents the citizens. Members of the Parliament are elected by the citizens in European elections.

<sup>85</sup> EC stands for the European Community, which is based on the first pillar.

<sup>86</sup> C'tee = Committee.

# Appendix E – Food mountains<sup>87</sup>

The post-war period brought revolutionary advances in technology which boosted the production. Advances were seen in all the farm products supported by the CAP (Baldwin & Wyplosz 2004:220) and as a result supply rose so much faster than consumption that EU became a net exporter of most agricultural goods (ibid:221). Tariffs shut off imports from the RoW, but supply still exceeded demand at the EU market. EU had to act as buyer of last resort, implying that it became a major buyer of food. Since EU did not have use for the food it bought it had to store it, and soon EU had stored ‘mountains’ of wheat, beef and butter (ibid:222). In 1985 EU had 18,5 million tonnes of cereals stored (ibid.).



During the 1980s and 1990s the EU established measures such as fixed quotas and penalties for overshoots, with the aim to limit the surplus. Also the reforms that were implemented in the 1990s served to reduce the gap EU prices and world prices. Today, food mountains are relatively small.

<sup>87</sup> Figure copied from European Commission (2007:7).