What's wrong with EU investment aids in agriculture?

The underestimation of the importance of the Green Box in current WTO negotiations

by Marita Wiggerthale

1. Introduction:

The chairman of the Doha Round negotiating group on agriculture, Crawford Falconer, issued a new draft negotiating text July 17 outlining reform proposals for domestic support. The current debate in the WTO is rightfully giving due attention to the issue of overall trade distorting support (OTDS) of developed countries and product-specific caps. But the importance of the Green Box is underestimated in the WTO agriculture negotiations. From a European perspective it is the green box that is strategically used as the "key tool" for increasing international competitiveness of the food sector, given the fact that the strategic interest of the EU is in the export of processed food. With a turnover of approximately 800 bn € and approximately 4 million employees, the food and drinks industry represents the largest processing sector in the EU ahead of the automobile and chemicals industries (Wiggerthale 2005:6).

Decoupled payments and investment aids are the main Green Box measures used by the EU to increase the competitiveness of agriculture. This paper concentrates on the analysis of investment aids, because these payments allow for targeted support of productive farms and food processing companies and because there is so far little analysis existing on these payments. There will be first an overview given about the structure of CAP expenditure and the use of investment aids within the Green Box. It is followed by an analysis of investment aids with a focus on their production effects. This paper will show that investment aids are not in conformity with the fundamental requirement to have no or at most minimal trade distorting effects. A thorough review of the Green Box, the closure of the loopholes and the integration of environmental and social aspects is therefore vital for the promotion of sustainable farming, both in the North and the South.

2. The structure of CAP expenditure

In 2005, the European Union spent 52.69 bn Euros on agriculture and rural development, thereof 8.53 bn € (16%) on interventions in agricultural markets, 33.85 bn € (64%) on direct aids and 9.92 bn € (18,8%) on rural development. Exports refunds being part of the support category 'interventions in agriculture markets' accounted for some 3 bn Euro or roughly 6% of CAP expenditure. 335 Mio. have been spent on the export of processed food ranking third after dairy and sugar (COM 2007a).

In 2005, decoupled payments belonging to the support category of 'direct aids' did not form a large part of CAP expenditure. They amounted only to 1.45 bn €. However, this is changing. The European Union allotted 15.97 bn € of decoupled payments (29,3% of CAP expenditure) for the financial year 2006 and 30.19 bn € (57% of CAP expenditure) for the financial year 2007 (COM 2007a). Former estimations, that were assuming about 25 bn € of decoupled support, would even be exceeded (Action Aid et al. 2005:13). The 30 bn € of decoupled payments in 2007 may be notified under the Green Box in the future.

Direct payments are not equally distributed. In EU-15, 20% of beneficiaries receive around 80% of the direct payments (COM 2007b:5). This unequal distribution puts family farmers in Europe at a disadvantage, as most of the money goes to high performance, rationalised and input intensive farms. Additionally, there is much criticism by environmental NGOs that "cross compliance" – conditions imposed on producers receiving decoupled payments - is widely an ineffective instrument for environmental regulation.

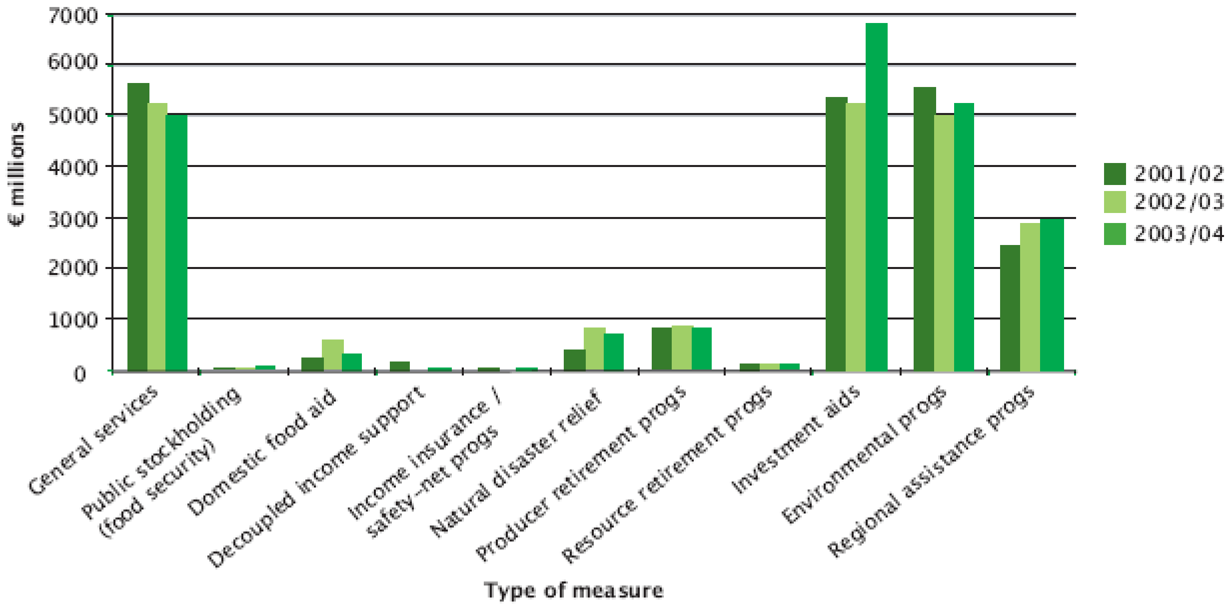
In 2005, 435.67 Mio. € were spent on investment aids. They are split into investments in farms (252.66 Mio. €) and investments in processing and marketing (183.01 Mio. €). For the whole financial period

2000-2006 investments in farms totalled 6.5 bn € or 10% of total public expenditure for rural development, investments in processing and marketing 3.7 bn € or 5.7 % (COM 2005:29). The total EU financial plan for all rural development financial instruments in the period 2000-2006 amounted to around 64.4 (COM 2006:11)[1]. The expenditures for the period 2000-2005 represented 67% of the budget foreseen for the whole period for EU-27 (COM 2006.12). Payments on rural development will increase up to 77.66 bn € in the period 2007-2013.[2]

3. Investment aids in the green box

Investment aids rank second in the EU-15's Green Box Declarations from 1995/96 to 2003/04. The annual average amounts to 5.27 bn € (Swinbank 2007:7). In 2003/2004 investment aids increased by 1.56 bn € to 6.8 bn € featuring first in that year (ICTSD 2007:39).

Figure 1: EU notified Green Box spending, marketing year 2001/02, 2002/03 and 2003/04



Source: ICTSD (2007:18)

Investment aids in the Green Box have to comply with the basic and policy specific criteria of Annex II. All measures exempted from the reduction obligation should have no or at most minimal effects on production and should not provide market support/price support for the producers, i.e. not imply an improved competition position – such as maintenance or expansion of production - when non-participation in a programme would have led to reduction or stagnation (Wiggerthale 2004:23).

Article 7 of the AoA obliges member states to handle Green Box measures in accordance with the agreement. If no "green" evidence of these domestic support measures is provided, they will be subject to the AMS.

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[1] The European Agricultural Guidance and Guarantee Fund (EAGGF) provides for 95% of the budget. The EAGGF is a fund within the overall European Union budget for the financing of the Common Agricultural Policy (CAP). The Special Accession Programme for Agriculture and Rural Development (SAPARD) reaches about 5%. SAPARD is a programme created by the European Union (EU) to support the efforts of the Central and Eastern European candidate countries to prepare for participation in the common agricultural policy and the single market in the pre-accession period. In 2005, a single fund and a single financial management system for rural development, the European Agricultural Fund for Rural Development (EAFRD), was adopted by the Council replacing EAGGF Guidance & Guarantee and RDFI-EU-10.

[2] In December 2005, the European Council agreed on the allocation of 69.75 bn € for rural development in the financial period 2007– 2013. In September 2006 the Commission approved a total budget of 77.66 bn € as it includes compulsory modulation to first pillar payments (4 % in 2007 and 5 % onwards) and cotton and tobacco transfers (see http://ec.europa.eu/agriculture/publi/fact/rurdev2007/en_2007.pdf).

3.1. Production effects from investments in agricultural holdings

According to the objectives laid down in regulation 1257/99, s*upport for investment in agricultural holdings* shall contribute to the reduction of production costs and to the improvement and re-deployment of production. Support can only be granted to economically viable agricultural holdings. According to the Mid-Term-Evaluation, there is strong evidence that supported investments contribute positively in terms of reducing production costs through the more efficient use of labour resulting in positive impacts on income. Also, a range of reports including **France, Wales (UK), Flanders (Belgium), Sweden and Germany** show that investments are used to increase the production of surplus products (COM 2005:41-55).

In **Germany**, the government has given in total 1,021 Mio. € of investment aids in 33,883 cases triggering 4.27 bn € of investments (2000-2004). 80% were spent on buildings, of which the half for cowsheds followed by piggeries (FAL 2006:1). As the main reform of the dairy market organisation is still outstanding, investment support is used as a key tool for spurring the rationalisation of dairy farms and the structural change in the dairy sector. Productivity in supported farms increased by 40-73%, the milking performance per cow by 6-10%, the number of cows by 7-47% and milk production by 30-59% (FAL 2005a). Growth in production in Western Germany derived mainly from an expansion of production capacity. In Eastern Germany, the situation is different. Increased production derived mainly from a higher milking performance and increased productivity mainly from the saving of labour force. 30-42% of the interviewed farms had not realised the investments without the aid given by the state.

Table 1: Production and productivity effects of investment promotion in the dairy sector (average values)

	unit	Lower Saxony	Bavaria/Baden W.	Mecklenburg W.P./Saxony A.
Nb of interviewed farms	----	22	24	16
Productivity increase	%	73	59	40 (Top quartile:90)
Number of cows	number	72 (+ 47%)	63 (+ 35%)	445 (+ 7%)
Milking performance	kg/cow	8,098 (+ 6%)	7,513 (+ 8%)	8,569 (+ 10%)
Dairy production increase	t/year	214 (+ 59%)	154 (+ 52%)	497 (+ 30%)
Investment volume	€	177,583	177,583	441,250
Realisation of big investments without aid?	%	35 No	42 No	30 No

Source: Compilation according to FAL (2005a)

In **France**, the government introduced a new instrument for the modernisation of cattle, goat and sheep farms ("plan de modernisation des batiments d'elevage", PMBE) giving at most 60-70,000 € or 90-100,000 € for the construction of buildings (depending on the geographical area). In 2005, the distribution of the 129 Mio. € PMBE was foreseen as follows: 46% for dairy farms, 45% for cattle farms, 9% for sheep and goat farms (no support for pork and poultry farms). In 8 regions the total sum for the modernisation of farms exceeded the total sum for extensive livestock farming. In general, the strategies pursued by farmers are oriented towards the expansion of production capacity. Diversification is the exception from the rule (MAAPAR 2003a:9).

3.2. Increased competitiveness through investments in processing and marketing of agricultural products

Support for investments in the processing and marketing of agricultural products must contribute among other objectives to encourage the development of new outlets for agricultural products, to rationalise marketing channels and processing procedures, to apply new technologies and favour innovative investments. Enterprises for which support is given must be able to demonstrate economic viability and must contribute to improving the situation of the basic agricultural production sector in question. According to the Mid-Term-Evaluation, the question of competitiveness was considered relevant. In two thirds of cases the measures have helped to increase the competitiveness of agricultural products through improved and rationalised procedures.

In **Spain**, 70% of the beneficiaries in the Basque Country state felt that there has been an increase of production capacity as a result of support. In Aragon, 86% of beneficiaries stated that production processes have improved following support, 70% have incorporated new technologies and 63% claim that production costs were reduced. In **Sweden**, more than 70% of supported investments were used to rationalise the production process. In the **UK**, 91% of beneficiaries in Wales reported enhanced capacity use, 73% as a result of new buildings and/or new equipment and 36% due to the better use of existing facilities. Almost three-quarters of beneficiaries (73%) indicated that costs had reduced as a result of their participation and the average reduction made was 10% (COM 2005:154-158). In **France**, 28% of the beneficiaries in the wine, fruits and vegetable sector stated an improvement of export competitiveness (MAAPAR 2003b:16). **In Germany**, a survey in North Rhine-Westphalia showed that the increase in competitiveness plays a very prominent role. 85% of the beneficiaries stated "outlet orientation" as a top-ranking objective (FAL 2005b:31).

The Müller Group is milking tax payers

The Müller Group is the third-largest and financially strongest dairy company in Germany in the year 2005. The EU Commission approved in 2004 the investment plan presented by the dairy company Sachsenmilch, a member of the internationally operating Müller Group, for the modernisation of the factory in Leppersdorf (Saxony). The financial support amounted to 31.3 Mio. €. Additionally, there was an investment aid of 40 Mio. € given by the Federal State of Saxony that was also approved by EU Commission. In sum, over 70 Mio. € were spent to increase the production of surplus dairy products. Also, there was no net creation of jobs, as the Müller Group closed down at that time one factory in Lower Saxony (150 job losses) and one in North Rhine-Westphalia (15 job losses). Taking into account the newly created 158 jobs in Leppersdorf this means in the end a net loss of jobs and an industry relocation made possible with the help of the EU and local investment aids.

Source: BUND (2005)

When it comes to the question of added value, 9 of 10 Member States considered the investment aids relevant. In just more than half of the Mid-Term-Evaluation reports (56%), the supported investments were considered to have helped to increase the added value and competitiveness of agricultural products by improving quality. In **Italy,** the total additional added value through supports amounts to 47 bn € split between the wine, fruit, vegetable and dairy sectors. In **Spain**, 58% of the beneficiaries in the Basque Country stated that improved quality had resulted in higher added value. In La Rioja, the main impact of the support has been an increase in production of higher quality wines (crianza and reserve wines). In the **UK**, the majority of beneficiaries in Wales reported that throughput of higher quality produce had increased by an average of 122%, mainly through better processing facilities (64% of cases).

The picture with regard to the company size of the supported beneficiaries is a mixed one. In Bavaria (Germany), supporting larger enterprises was considered by the implementing authority to be a safer course of action as these are more economically sustainable. Experience from Sweden and Denmark show that a higher degree of deadweight is associated with support of larger companies and the scheme has been adjusted to address this in Denmark.

3.3. Insufficient analysis of social and environmental effects in evaluation reports

From a civil society point of view the main question is how to achieve **a sustainable and equitable farming and food system both in the North and the South** in order to protect livelihoods, ensure food security, create jobs, maintain the viability of rural areas, allow for diversity in production, protect natural resources, preserve bio-diversity and facilitate regional economic cycles and marketing systems. If one looks at EU investment subsidies, these issues are mostly not taken into account.

The Mid-Term-Evaluation indicates that supported investments had environmental improvements as a side-effect. To the authors knowledge, there has not been any thorough **environmental impact**

assessment. The damages are likely to be underestimated as the Mid-Term-Evaluation reports did not look at greenhouse gas emissions, water pollution with nitrates and associated costs of water pollution control, loss of bio-diversity etc. Support for investments in intensive livestock farming is even continuing in areas with high densities of livestock and serious nitrate pollution such as Lower Saxony (Germany) and Brittany (France). Approximately half of the 1,3 Mio. requested and/or approved piggery units in 2003-2005 are concentrated in Lower Saxony (Germany; state contribution unknown). As self-sufficiency with pork is at 107%, every additional piggery unit means therefore increasing pork exports and increasing liquid manure polluting watercourses at home. (BUND 2006:31). The 2006 reforms of German rural development legislation for the period 2007-2013 allow in principle also big investors to apply for investment aids for piggeries with 10.000 and more units. In Brandenburg and Saxony (Eastern Germany), there are piggeries planned with 85.000-95.000 units.

However, in some countries environmental improvements have been the main aim for specific support categories (e.g. in Flanders; a shift in investment policy in Germany in the period 2002-2004 following the BSE crisis). The “best practices” in Germany ranged from extensive livestock farming, and animal welfare to machines for environmental friendly farming, renewable energy and energy saving investments.

With regard to the **social impact assessment**, the Mid-Term-Evaluation concludes that there is evidence “to suggest a positive impact on both job creation and particularly job maintenance”. However, on the other side it is mentioned also that investments leading to efficiency improvements potentially result in job losses. In general, maintaining employment has not been an objective of investments in agricultural holdings (COM 2005:51).

The analysis of the social impact is suffering from several shortcomings. Job losses are perceived as somehow “normal side-effects” of induced efficiency gains, leading eventually to increased competitiveness. Also, there is no analysis of the direct or indirect social effects of investment aids within the current policy framework. For example, the structural change in the dairy sector, supported among other instruments by investment aids, will force approximately 50,000 dairy farms (45%) in Germany to give up their business till 2013 (Schmidt 2006:13), potentially triggering further negative effects in other related economic sectors. The focus of the reports on the maintenance of employment of the supported bigger and most productive dairy farms is hiding these negative effects. And finally, no consideration is given to the quality of employment (COM 2005:51).

4. Concluding remarks

Developing countries have again and again asked for new disciplines for the use of Green Box subsidies to ensure that they are really non trade-distorting by meeting the "fundamental requirement" in §1 of Annex 2 of the Agreement on Agriculture (G-20 proposal from June 2005 and May 2006, ACP proposal from July 2007, African Group proposal from July 2007). They are right in doing so! The presented analysis of EU investment aids do show that there are considerable production effects involved because they are desired by policy makers in the Member States and at the European Commission level. Investments are first and foremost used to increase international competitiveness, all other objectives are at best secondary, if at all. Current spending on investment aids is not in conformity with the fundamental requirement to have no or at most minimal trade distorting effects. The reluctance of the EU and US to touch the Green Box and to support a thorough review is self-explanatory. They do have a strategic interest in maintaining current language in order to preserve the existing loopholes.

The review of the Green Box does not only offer the chance “to green” the Green Box, but also to ensure that its provisions help to promote sustainable agricultural production with the help of decoupled, but targeted payments. In order to achieve a sustainable and equitable farming and food system both in the North and the South, provisions are needed for protecting livelihoods, ensuring food security, creating jobs in rural areas, maintaining the viability of rural areas, allowing for diversity in production, protecting natural resources, preserving bio-diversity and facilitating regional economic cycles and marketing systems.

Berlin, July 2007

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