The Common Agricultural Policy Role in Addressing External Shocks - The Case of Russian Import Ban

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Abstract: - The Common Agricultural Policy (CAP) is one of the oldest and most controversial common policies and it is financed directly from the European Union budget. Some critics of CAP argue that especially in the context of the challenges brought by the international crisis, this policy represents a "burden" for the European budget. Our research aims to responds those critics by showing that CAP may represent an important tool for addressing the external shocks impact on agricultural sector of EU. In this view, we will highlight the role of CAP in sustaining the European farmer during the crisis generated by the Russian import ban, adopted as a response to the sanctions imposed by EU to the Russian Federation in the context of Ukrainian crisis. Using a quantitative and qualitative analysis we will assess how the CAP has supported the European agricultural sector and also the future measures that could be adopted to create a more flexible response in the case of other external shocks.

Key-Words: - Common Agricultural Policy, Ukrainian crisis, Russian import ban.

JEL Classification: Q, Q1, Q11, Q13, Q17, H12

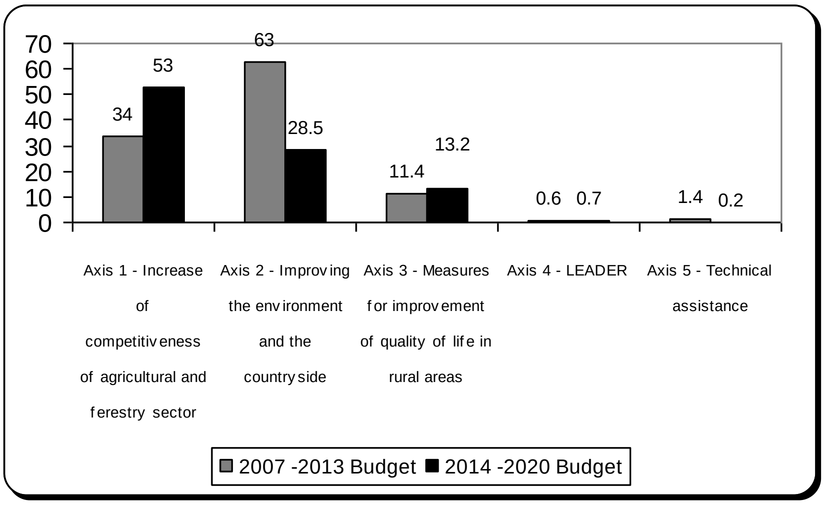
1. Introduction

The Common Agricultural Policy (CAP) is the one of the oldest of the common policies and has been conceived as a partnership between farmers and the European Union, its objective being to increase the productivity and production of the European agricultural sector, but also to support sustainable rural development, a concept that also entailed joining the economic dimension with that of social and human welfare. Initially, the CAP overlapped national agricultural policies and the national agricultural sectors, with the European rural area being only considered an economic sector, without any focus on its social and environmental dimension. Later on, as it has been shown in certain theoretical approaches (Sonnino et al., 2012), the CAP also incorporated the sustainable development objective (after the Reform of 2003), which implies accountability for the use of natural resources and environmental protection. In the specialised literature (Tripathy, 2000), the sustainability dimension is considered intrinsic to the objective of rural development and the sustainable future of the rural area cannot be dissociated from a series of components, such as: the development of human resources, quality of life, the environmental protection component, the issue of development gaps and of population migration in search of employment. The comparative analysis conducted in this research starts from the data provided by the Directorate General for Agriculture and Rural Development of the European Commission regarding the financial allocations broken down according to CAP Axes across EU-28. The analysis of these data focuses on the objective of outlining the way in which the CAP has answered the shock created by the Ukrainian crisis and which affected the farmers in the EU in the context of the Russian import ban. The bibliographic corpus used focuses on the studies and assessment and impact reports published on the website of the European Commission's Directorate General (DG) for Agriculture and Rural Development, but comprises also other references as well (books, studies, articles) published in the specialised literature.

2. The CAP in the perspective of 2020 – from competitiveness to sustainability

In February 2014, DG Agriculture and Rural Development published a report (DG Agriculture & Rural Development, 2014) that synthesizes the main directions of development of this common policy in the period 2014-2020, as well as the implications on national policies in the field of agricultural development in the Member States. According to the analysis published in the abovementioned report, the CAP is a bridge between the EU citizens' expectations regarding agriculture and the expectations of EU farmers who face economic and environmental challenges, requiring at the same time an investment from the EU budget in a sector that is strategic in terms of food safety, environment and economic growth in the rural areas. The comparative analysis of the distribution according to axes of the funds dedicated to rural development (see graphic 1) in the new financing framework 2014-2020 indicates an increase of funds allocated to Axis 1 (increase of competitiveness of the agriculture and forestry sector) and a decrease of funds allocated to Axis 2 (EUR 28.5 billion, compared to EUR 63 billion in the period 2007-2013).

Graphic 1: The comparative analysis of the distribution according to axes of the funds for rural development, comparisons between the current financing context and the period 2007-2013 (EUR billion)



Source: the authors' synthesis based on the DG Agriculture & Rural Development data

In this context, it has to be mentioned that in June 2013, the EU institutions adopted a regulatory framework that outlines new development and reform directions for the Common Agricultural Policy. The new CAP reform was shaped by a comprehensive public debate with the EU citizens and national institutions (EC, 2013) that aimed at enabling the adaptation of the CAP to the new challenges in terms of medium and long-term development of the EU rural sector. According to the new development directions of the CAP, in the period 2014-2020, it will focus on three core pillars: ecology and efficiency in agriculture, ensuring healthy food at affordable prices and revitalising the rural areas and communities.

Figure 1: CAP development directions in the period 2014-2020

FOOD SAFETY	**REVITALISING RURAL AREAS**	**ECOLOGY AND EFFICIENCY IN AGRICULTURE**
Transforming the diversity of agriculture into a strong point of European rural sector **Consolidating the farmers' position in the supply chain**	**Increasing the number of farmers in the European Union** **Stimulating employment and entrepreneurship** **The distribution of financial support with a view to stimulating growth and employment**	**Encouraging a more efficient use of natural resources** **Doubling funds for research, innovation and knowledge exchange**

Source: the authors' synthesis based on the specialised literature

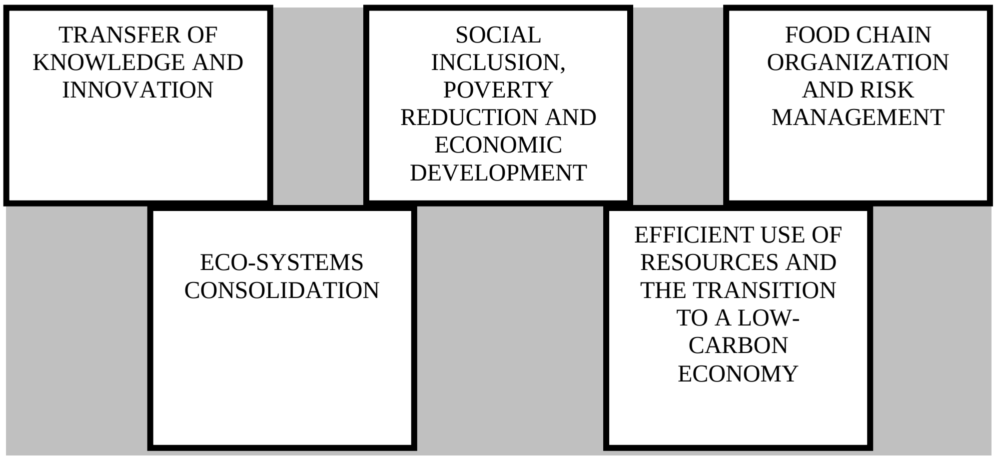
2.1. How the CAP sustains a true partnership between European Union and farmers

At present, CAP aims at maintaining the vitality of the rural environment by supporting investment, modernisation of agricultural and non-agricultural activities in the rural areas. The most important CAP reforms started in 1992 and intensified in 2003, once the relation between subsidies and production was eliminated. In order to obtain grants, European farmers no longer have to produce food for which there is no market demand. From now on, they have to meet the market and consumer demand, searching for new profitable markets and exploring new opportunities. Farmers now receive income support on condition of preserving agricultural land and complying with food safety, environmental protection and animal welfare standards, failing which the payments are reduced. The new CAP pays more heed to the reality of an open world. Some analysts (Potter&Tilzey, 2005) consider that the recent history of CAP reform shows that policy-makers apparently have embarked on an attempt to combine elements of the neoliberal vision with continued commitment to state assistance for European farmers in various forms. Consequently, the European Commission, through DG Agriculture & Rural Development is permanently involved in the modernisation, reorganisation and simplification of this common policy. Given the fact that, at present, direct payments are no longer related to production, farmers may continue to benefit from a certain financial security, being loose at the same more free to answer market signals. Market instruments (such as public interventions) have been adapted in order to be able to operate as safety mechanisms, without blocking the normal signals of the free market. Hence, new CAP financing mechanisms help farmers to restructure their holdings and protect the environment, which favours the dynamism of rural areas. Moreover, some analysts (Lowe et al., 1993) have highlighted that the new forms of CAP regulations are linked to the new patterns of development in EU rural areas which have arisen as economic actors seek to exploit the opportunity presented by the new global markets. According to the 2013 Reform[1], although this priority concerning the revitalisation of rural areas and the reduction of interregional development gaps is pursued at EU-28 level, Member States are empowered to select measures adapted to their own needs and manage their rural development programmes according to their needs, in the context in which the EU partly finances the costs (through the co-financing process). In this context, it has to be stated that beginning with 2014, the European Agricultural Fund for Rural Development (EAFRD) is included in the new Common Strategic Framework, just as the European Regional Development Fund (ERDF), the European Social Fund (ESF), the Cohesion Fund (CF) and the European Maritime and Fisheries Fund (EMFF), in order to attain the objectives of the Europe 2020 Strategy (sustainable, intelligent and inclusive growth). The budget allocated to sustainable rural development may be used in order to finance agricultural and non-agricultural activities related to six major priorities (see Figure 2.). The CAP Reform of 2013 entered into force on 1st of January 2014. The full set of reform elements is

[1] The 2013 Reform is considered among the most important in CAP history, and in order to prepare it, the European Commission started a dialogue with the entire civil society and all the economic operator stakeholders. As a result of these ample consultations, the major CAP reform lines adopted in June 2013 were defined following a public debate organised from April to July 2010 (which led to the correction of approximately 6 000 individual and collective contributions) and an intense public debate with the Council and the European Parliament.

applicable from 1st of January 2014, with the exception of the new structure of direct payments, which requires that the annual direct payment cycle be taken into account: the farmers' annual statements under the CAP will be submitted during the spring. Based on these statements, the payments corresponding to the new structure of direct payments will be made in 2015, together with the green payments and the additional support for young farmers.

Figure 2: Priorities of CAP during 2014 -2020



Source: the authors' synthesis based on the specialised literature

EU regulations (EC (g), 2013) lay down the basic rules on the financing, management and monitoring of CAP and allow Member States to grant financial support through direct payments for aid to private storage, aid in fruit and vegetables sector, support measures in the wine sector. As we will highlight next in our analysis, this CAP regulation has allowed granting support measures in exceptional situations, as the one generated by the Ukrainian crisis which eventually led to Russian import ban.

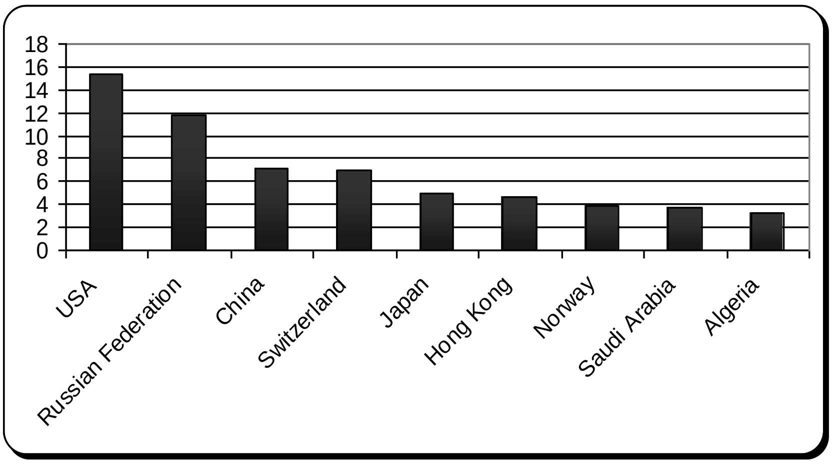
2.2. The Ukrainian crisis case and its impact on EU-Russia trade in agricultural products

As a result of the tensions generated by the Ukrainian crisis[2] in the economic relations between the European Union and the Russian Federation, a series of mutual sanctions have been imposed, whose economic impact cannot be neglected. Subsequent to the economic sanctions imposed by the EU[3], the Russian Federation decided to prohibit imports of food and agricultural products from the EU and the U.S. Below, we propose an analysis of the economic impact of Russian import ban on the European agricultural sector, but also of the exceptional support measures (European Commission (a), 2014) granted in response by the European authorities. Prior to the onset of the Ukrainian crisis, a very close commercial partnership had been in place between the European Union and the Russian Federation in the field of agricultural products, with the Russian Federation representing the second export market for EU producers (see graphic 2).

[2] Started with the annexation of Crimea to the Russian Federation, in June 2014.

[3] In July 2014, the European Union adopted economic sanctions against the Russian Federation, mainly consisting of blocking the country's access to the Union's financial market and prohibiting the sale to the Russian Federation of technologies related to energy, weapons and assets that can be used for both civilian and military purposes.

Graphic 2: The main export destinations of agricultural products of EU-28 in 2013 (EUR billion)



Source: Eurostat, 2014

As referred to above mentioned matters, after the increase of tensions between the EU and the Russian Federation, a series of mutual economic sanctions were imposed, among which the Russian ban on imports of EU agricultural and food products is estimated to have a significant impact on EU producers in the field, with the most affected sectors being fruits and vegetables, followed by dairy products and meat.

The estimates made so far by the European Commission show that the trade embargo put in place by the Russian Federation may cause on an annual basis losses evaluated at EUR 5.1 billion. Other estimates indicate a figure of only EUR 2 billion for the exports and default losses of European agricultural producers. As a result, the European Commission has decided to grant a series of exceptional support measures (see Figure 3) for the agricultural sector, through the additional flexibility mechanism adopted within the Common Agricultural Policy (European Commission (c), 2014).

Figure 3: Main regulations adopted to support European farmers in the context of Russian import ban

AGRICULTURAL SECTOR	DATE OF ADOPTION	LEGAL BASIS FOR FINANCIAL SUPPORT
Milk products	25 February 2015	Commission Implementing Regulation (EU) 2015/303 for submission of applications for private storage aid for butter and skimmed milk powder
	19 December 2014	Commission Delegated Regulation (EU) No 1370/2014 for temporary exceptional aid for milk producers in Finland
	16 December 2014	Commission Delegated Regulation (EU) No 1336/2014 temporary exceptional measures for the milk and milk product sector
	26 November 2014	Commission Delegated Regulation (EU) No 1263/2014 for temporary exceptional aid to milk producers in Estonia, Latvia and Lithuania
Fruit and vegetables	19 December 2014	Regulation (EU) No 1371/2014 for temporary support measures for producers of certain fruit and vegetables

AGRICULTURAL SECTOR	DATE OF ADOPTION	LEGAL BASIS FOR FINANCIAL SUPPORT
	29 September 2014	Regulation (EU) No. 1031/2014 for further temporary exceptional support measures for producers of certain fruit and vegetables
	21 August 2014	Regulation (EU) No. 913/2014 for temporary exceptional support measures for producers of peaches and nectarines

Source: the author's synthesis based on the specialised literature

3. CAP response in the context of Russian import ban

Presently, while ensuring that farmers produce what the markets are demanding, the CAP also provides mechanisms - safety nets - to prevent an economic, health or weather-related crisis from destroying whole swathes of production. These mechanisms include public intervention (national intervention agencies withdrawing the production surplus from the market) and private storage aid (to stabilize markets).

These tools have been modernized as part of the Reform process finished in 2013. Since lately crises are becoming more frequent and more serious than in the past, a specific reserve has therefore been set up to cope with their effects which go beyond the normal functioning of markets. An enhanced Emergency Mechanism has also been introduced. Support is also being given for the creation of mutual funds and insurance mechanisms to help farmers better anticipate and cope with crises. The importance of a safety net offered by the CAP to EU farmers was never more clearly highlighted as in the case of the crisis generated by the Russian import ban on agri-food products from EU. For EU agricultural producers, Russian Federation is the second biggest export market (see table 1).

Table 1: EU export to Russian Federation as share of production

	EU production used domestically	**Ban affected exports to Russian Federation in EU production**	**% of banned exports to Russian Federation in total EU exports**
Fruit and vegetable	90%	**3%**	29%
Cheese	92%	**2.7%**	33%
Butter	95%	**1.7%**	28%
Pork meat	90%	**2%**	20%
Beef	96%	**0.5%**	25%
Poultry meat	90%	**0.7%**	6%

Source: DG Agriculture and Rural Development (2014), Information Note on the Russian Ban on Agri-Food Products from the EU, Brussels

The Russian import ban was stipulated, as a response to EU sanctions against Russian Federation, by the President's Putin Edict No. 560 of August 2014. The Decree specifies types of banned products, which include: meat and poultry, fish and seafood, milk and milk products (including cheese), vegetables, fruits, nuts as well as some other foods and ready-made meals. The restrictive measures do not include wine and spirits, cereals, pasta, olive oil, baby food and beverages. The ban was imposed in 2014 for one year, but can be revisited earlier, if appropriate. Russian Customs commenced implementation immediately in August 2014 with no grace period for existing contracts. Some analysis (Panov et al., 2014) have shown that EU has been the most affected trading partner among all those targeted by the Russian import ban on agricultural products, as 73% of imports that are banned come from the EU. This comes as no surprise, given the fact that the EU alone represents 43% of entire Russian imports from the world.

Although, some analyses (DG Agriculture and Rural Development, 2014) remain optimistic that alternative sales outlets can be found for much of the produce affected by Russian import ban, however, it is also clear that certain products and certain regions will face serious difficulties as a result of the Russian measures, especially in the short term. The most immediate concern of the European authorities was that products previously exported could be cheaply sold on the EU market, leading to a more global price collapse – hence the swift action of the Commission to introduce emergency market measures. The Russian trade restrictions have generated serious pressure on EU agriculture and food sector because of the temporary loss of a significant commercial market share in main agricultural sectors (almost all meat products, milk and dairy products, fruits and vegetables). Given the volume involved and the quantity of perishable products banned in full harvest season, the most serious negative effect was the "cascade effect" of oversupply on the internal market. In order to mitigate the negative effect of Russian import ban, the European Commission has implemented through CAP founding mechanisms a series of support schemes providing exceptional support for European farmers.

4. Exceptional support measures adopted for European farmers through Flexibility Mechanism of CAP

The revised CAP provides for the possibility to adopt exceptional and emergency measures to address some severe market disturbances (e.g. steep price falls or other significant market disturbing events) and to resolve specific problems where a duly justified imperative ground of urgency is present. The Russian import ban was considered such an event requiring an imperative response. Hence, in order to further mitigate the consequences of the import ban on the most vulnerable EU sectors and holdings, European Commission has implemented a series of exceptional measures, as detailed in the following sections of our analysis.

4.1. Measures to support producers of peaches and nectarines

On 11 August 2014, the European Commission announced the entry into force of an aid scheme for European producers of peaches and nectarines (European Commission (a), 2014), affected by the impossibility of exporting their products to the Russian Federation. Those support measures were based on the Flexibility Mechanism[4] of the Common Agricultural Policy which can be used for promotion or free distribution of products on the European market. Support measures have increased by 5 to 10% the financial support for producer organizations in the field of free distribution and withdrawal from the market. Also, an exceptional secondary support (up to 50% of the cost of withdrawal from the market) may be granted to producers who are not members of associations along with additional measures to promote the two products (peaches and nectarines).

4.2. The support scheme for vegetables and fruits

Adopted on 14 August 2014 The Support Scheme for Producers of Perishable Fruits and Vegetables, affected by the impossibility to export their products to the Russian Federation was financed from the Emergency Fund of the Common Agricultural Policy.

The budget allocated – EUR 125 million – was considered sufficient until November 2014. Beneficiaries eligible for support under this scheme were producers of tomatoes, carrots, cabbage, cauliflower, cucumbers, peppers, mushrooms, apple, pear, red fruits (strawberries, raspberries), grapes and kiwi.

Financial assistance also covered all fruit and vegetable producers, whether or not they were organized into producer associations and support measures have been established with retroactive application from 18 August 2014. The support scheme provided assistance also through the Flexibility Mechanism of the CAP, for fruit and vegetables producers from all Member States.

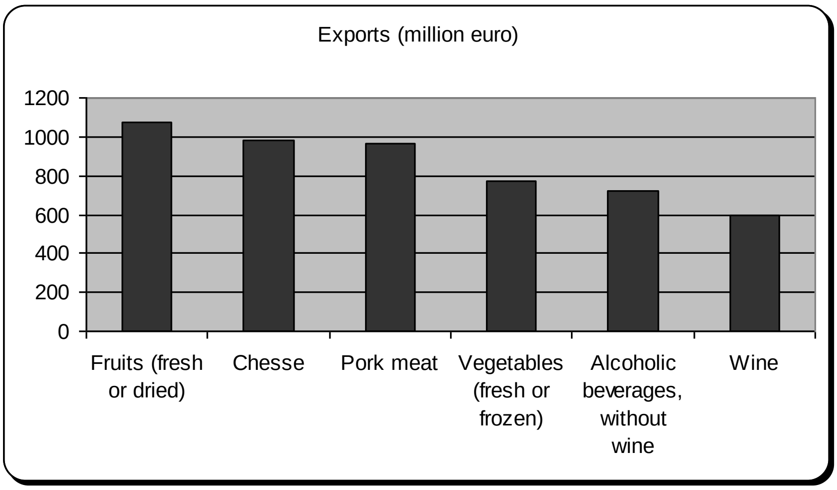
Those support measures were considered very important by some analysts (European Commission (b), 2014) especially given the fact that the Russian import ban occurred during full harvest season, and by their nature, these products could not be stored for a long time.

In the aid scheme implemented ceilings were established up to EUR 82 million for apples and pears producers (whose applications were the most numerous) and EUR 43 million for other fruits and vegetables producers. Consequently, it should be noted that, according to the Eurostat data, in 2013 the fruit and vegetable

[4] Allowing the financial transfer inter Pillar 1 (Market Payment) and Pillar 2 (Rural Development).

sector was holding an important place in total agricultural exports of the EU-28 to the Russian Federation (see graph 3).

Graph 3: The main types of agri-food products exported by EU-28 in the Russian Federation in 2013 (EUR million)



Source: Eurostat, 2013

Regulations of the support scheme stipulated the obligation of the Member States to notify the European Commission concerning all support requests received from national producers. Financial support was granted to the European producers for withdrawing products from the market, free distribution of those products, compensation for products not harvested or early harvesting. On 8th of September 2014, the European Commission found that the support requests notified reached the ceiling fixed in both apple and pear producers and other fruits and vegetables producers. Consequently, on 9th of September 2014, Support Scheme was suspended because of the extremely high demand for compensation, but in order to continue to support European farmers, the European Commission has established (European Commission (d), 2014) that it will adopt in the near future a new Support Scheme. In this respect, it should be mentioned that, according to CAP regulations, in the fruit and vegetable sectors Producer Organizations have the possibility to integrate crisis prevention measures within their Operational Programmes, covering actions such as market withdrawal, harvest insurance, the setting up of mutual funds etc. The maximum EU support normally limited to 4.1% of the Producer Organization's turnover is increased to 4.6% if the amount in excess of 4.1% of the turnover is used solely for the financing of the crisis management or prevention measures.

4.3. Support measures for European producers of dairy

According to data provided by Eurostat, in 2013, EU dairy exports to the Russian Federation totaled EUR 2.3 billion, mainly focused on cheese (about EUR 0.98 billion), butter (EUR 0.14 billion), fresh dairy products (EUR 0.10 billion), skimmed milk powder (EUR 0.07 billion) and whey powder (EUR 0.03 billion). From the 25 Member States which have exported cheese to the Russian Federation in 2013, the largest European exporters are represented by the Netherlands, Lithuania, Finland, Poland, Denmark, Germany, Italy, France and Latvia. On 28 August 2014, the European Commission announced the entry into force of an Aid Scheme for Private Storage of Butter, Skimmed Milk Powder (SMP) and Certain Cheeses in order to mitigate the negative effects of Russian import ban on the domestic market. Support scheme was designed as a tool for providing financial assistance for butter and skimmed milk powder producers. The Scheme's support measures were implemented in accordance with the provisions of the Common Agricultural Policy related to prevention of significant risks on the European market. The support scheme, eligible costs were designed to cover daily costs storage for a period of 3 up to 7 months.

It should be noted that, according with current legal framework, Common Agricultural Policy, through the support for private storage, helps to finance the costs of temporary storage for at least 90 days - and not more than 210 days. Moreover, according with CAP regulations, for the dairy sector, public intervention is open each year from 1st of March until 30th of September and exceptional measures could be envisaged for the free distribution to certain organizations, such as charitable organizations and schools, but also for animal feed, biomass, processing industry, destruction, etc. (depending on the Member State) and for non-harvesting and green harvesting.

Through the Common Agricultural Policy there are funded part of the costs of temporary storage (comprising a fixed rate per tone, plus a fixed daily amount per tone). Those products remain the property of the operators, who are consequently responsible for their sale when storage period expires. Given the importance of cheese in the total value of EU exports to the Russian Federation (EUR 0.98 billion in 2013), the European Commission wants to extend this measure regarding storage cost for the cheese producers. In assessing the impact of Russian import ban, some analysts (European Commission (e), 2014) have shown, that since CAP only provide support for private storage for butter, skimmed milk powder and cheese DOP or PGI type, exceptional new measures will be needed to cover the wide variety of cheeses exported to the Russian Federation.

4.4. Additional measures to boost support for promoting agricultural products of the EU

After the adoption of Support Schemes for Fruit and Vegetable producers, the European Commission has adopted additional measures (European Commission (f), 2014) to better promote the European agricultural products. In this context, it should be noted that the EU provides annually approximately EUR 60 million for co-financing programmes for promoting European agricultural products based on proposals submitted by Member States. Presently, EU provides financial assistance up to 50% of the cost of these measures (up to 60% for programmes promoting fruit and vegetable consumption by children), the remaining costs being covered by professional and inter-professional associations. In the context of Russian import ban, additional support measures totaling EUR 60 million may be provided through the National Programme for the Promotion of Agricultural Products of the CAP. Note that the funds provided under the CAP to promote agricultural products in the EU - 28 amounted to EUR 60 million per year, according to the budget already adopted. To these measures will be added, in 2015, EUR 30 million in the first payment and the other remaining EUR 30 million will be allocated in a second payment. To take advantage of these additional funds, the new regulations adopted by the European Commission stipulate that Member States must submit applications for Support Schemes for promoting national agricultural products until September 2014 for the first payment and until February 2015 for the second payment. It should be noted that CAP assessment will prioritize the schemes for products which, in the absence of Russian import ban could have been exported to the Russian Federation. In 2015, the European Commission intends to adopt new additional emergency market measures for perishable fruit & vegetables in response to the market disturbances resulting from the Russian import ban. These additional measures will run until the end of June 2015. The emergency schemes provide for new eligible volumes of certain fruit and vegetables in specific Member States that may be withdrawn from the market and the quantities will be based on export volumes to Russian Federation in the last 3 years.

5. Conclusions

Given that, prior to the Russian imports ban on agricultural products, the Russian market was an important receptor, it is estimated that the potential impact of economic sanctions imposed by Russian Federation will be an important one for EU. The impact assessment conducted by the European Commission concerning the effects of the Russian import ban shows that this exceptional situation requires a faster and better access to market information for each sector in order to better implement through CAP founding schemes a adequate support for EU farmers and producers. The challenges induced by the Russian import ban have highlighted the importance of creating a Consolidated Market Monitoring Mechanism in order to identify the areas most affected and to create a targeted response at EU level. The European Commission's preliminary analysis of the main sectors affected by the Russian import ban- fruits, vegetables, dairy products and meat- concluded that the most urgent measures concerns certain perishable vegetable products. These perishable products are the most affected since their harvest season has started and a key export market disappeared without any immediate alternative. Under these conditions, new exceptional measures to support EU producers of perishable fruits and vegetables could be further adopted. These types of measures designed to support the European agricultural sector may be granted under the Common Agricultural Policy Flexibility Mechanism in order to protect European farmers from the impact of external shocks such as the one produced by the Russian ban on agri-food products. We may conclude that in such critical situation CAP represents a financing tool that can allow a common, coherent response for maintaining the stability of the internal market via effective and properly calibrated crisis management at EU level.

The 2014-2020 Multiannual Financial Framework fixes the amounts available in the Common Agricultural Policy for the financing of market expenditure and direct payments. From these funds a crisis reserve is established every year by applying a reduction to direct payments through the financial discipline mechanism. The total amount of the crisis reserve for the period 2014-2020 is EUR 2 800 million with equal annual installments of EUR 400 million (at 2011 prices). However, in the case of Ukrainian crisis that led to Russian import ban, the main challenge is to implement the right measures targeting the most critical sectors or operators, at the right time, and in a cost-efficient way, since targeted efficient measures implemented at the very early stage are the most cost effective way to act. Through its Flexibility Mechanism CAP may strengthen the resilience of EU agricultural and food sector and encourage reorientation towards new markets and opportunities, including through enhanced promotion measure. However, in our opinion, although the emergency measures have helped ease the market pressure for fruit and vegetable growers following the Russian import ban, more measures will be need for all the sectors affected (particularly meats, milk products and fruit and vegetables) and agri-food exporters must be supported including by using co-financed assistance for products promotion in order to diversify their options for export markets. Moreover, since in the buyer –supplier relationship the large share of a single buyer is always vulnerability for any vendor, in our opinion the case of Russian import ban shows that EU agriculture producers should diversify their markets and be more open to the global market.

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