

Modelling the Effects  
of the EU Common  
Agricultural Policy

Productivity Commission  
Staff Working Paper

December 2009

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The views expressed in  
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ISBN 978-1-74037-296-1

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**An appropriate citation for this paper is:**

Costa, C., Osborne, M., Zhang, X.G., Boulanger, P. and Jomini, P. 2009, *Modelling the Effects of the EU Common Agricultural Policy*, Staff Working Paper, Melbourne, December.

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## Key points

- The Common Agricultural Policy (CAP) of the European Union has undergone significant reform since the early 1990s, with the aim of improving its market orientation.
  - There is an increasing focus on breaking the link between direct income payments and production decisions — so called ‘decoupling’.
- Expenditure on the CAP accounts for about 46 per cent of total EU budgetary expenditure, or over 50 billion Euros.
  - The majority of expenditure is in the form of direct income payments to farmers. Expenditure also includes market price support and rural development programs.
- The European Union also assists its agricultural sector with various border protection measures including import duties and other non-tariff barriers.
- In this study, economic impacts of the CAP are evaluated using the GTAP model. According to the modelling results, the effects of the CAP include:
  - higher output of the farm and food processing sectors in the European Union, of about 8 and 6 per cent respectively
  - lower output of the EU manufacturing and services sectors
  - lower GDP in the European Union of about 0.3 per cent, or \$US 52 billion.
- The additional farm and food output in the European Union is estimated to depress world prices for these goods by between 1 and 4 per cent. World prices for manufactured goods and services increase. These price movements induce a contraction in agriculture and food processing in non-EU regions, and an expansion in the manufacturing and services sectors.
  - Some of the largest contractions occur in the livestock sectors in Latin America (12.7 per cent) and Australia–New Zealand (4.9 per cent) and in the food processing sectors in most regions.
- The estimated net effect of the CAP is to reduce global welfare by about \$US 45 billion, with a cost to the European Union of \$US 30 billion. The largest contributor to this welfare loss is the border protection component of the CAP.
- Important caveats to these modelling results apply. The estimates are sensitive to parameter choices, specific model features, and the structure of the database. In addition, the modelling does not capture some aspects of the CAP including the effects of cross-compliance measures, any impacts on productivity in the agricultural sector, and positive and negative externalities associated with the policy. Therefore, these results should be interpreted as only indicative of the magnitude of the economic impacts of the CAP.

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# Preface

This report is part of a project that was conducted in collaboration between the Productivity Commission and the Groupe d'Economie Mondiale (GEM), where Patrick Jomini from the Productivity Commission was on secondment, and co-author Pierre Boulanger is a research and teaching fellow.

GEM is an independent and non-partisan European, Paris-based research centre that seeks to promote debate on international economic integration. Its director is Professor Patrick Messerlin.

## Acknowledgments

The authors wish to thank the following people for their help and advice in the production of this paper: Neil Andrews (ABARE), Antoine Bouet (IFPRI), Catherine Moreddu (OECD), Badri G. Narayanan (Purdue University) and John Salerian and Lisa Gropp (Productivity Commission).

The authors would also like to acknowledge the contribution of Jacqueline Crowle (Productivity Commission), who provided valuable supporting research.

The views in this paper remain those of the authors and do not necessarily reflect the views of the Productivity Commission, GEM or of the external organisations and people who provided assistance.