

The Common Agricultural Policy and the Next EU Budget

Reflection Paper No. 2: Preparing for the Multiannual
Financial Framework after 2020

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Reflection Paper No. 2: Re-adjusting the Goals of the CAP.

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Contents

1	The CAP – what it is supposed to pursue, what it pursues, and what it achieves	4
1.1	The goals of the CAP	4
1.2	Are ‘non-treaty’ goals pursued efficiently?	5
1.3	The ‘Consultation’	8
2	What should be the goals of the CAP?.....	9
3	Implications for financing, and resistance to change.....	10
4	Literature	11

1 The CAP – what it is supposed to pursue, what it pursues, and what it achieves

Common Agricultural Policy (CAP) spending primarily takes the form of direct payments to farmers in what is referred to as ‘Pillar I’ of the CAP. In the 2015 budget, direct payments accounted for roughly €40.9 billion, or 71% of total CAP spending (€57.6 billion) and 29% of total European Union (EU) spending (€141.7 billion). Most of the remaining CAP spending (€13.8 billion or 25% of the CAP budget in 2015) falls under ‘Pillar II’ which is used to finance rural development and agri-environmental measures. While some adjustment will take place in the course of the current Multiannual Financial Framework (MFF) through 2020, these magnitudes and shares will remain largely unchanged.

Direct payments thus account for the lion’s share of CAP expenditure, and just under one-third of total EU spending. Two main justifications are provided for direct payments: income support and compensation for the environmental services provided by farmers (so-called ‘greening’). Neither justification stands up to scrutiny.

1.1 The goals of the CAP

First, neither income support nor greening is foreseen in the EU Treaties. The goals of the CAP are listed in Article 39, paragraph 1 of the Treaty on the Functioning of the European Union (TFEU):

“The objectives of the common agricultural policy shall be:

- a) to increase agricultural productivity by promoting technical progress and by ensuring the rational development of agricultural production and the optimum utilisation of the factors of production, in particular labour;*
- b) thus to ensure a fair standard of living for the agricultural community, in particular by increasing the individual earnings of persons engaged in agriculture;*
- c) to stabilise markets;*
- d) to assure the availability of supplies;*
- e) to ensure that supplies reach consumers at reasonable prices.”*

According to Article 39 TFEU, the second goal of the CAP (b) is “to ensure a fair standard of living for the agricultural community”. However, the word “thus” clearly stipulates that this goal is to be reached by means of the first goal (a) “to increase agricultural productivity”. Hence, according to the TFEU the CAP should increase standards of living in agriculture by means of productivity increases. The TFEU does not provide for direct income support to farmers.

Regarding greening, Article 191, paragraph 2 TFEU defines the following principles of EU environmental policy:

“Union policy on the environment shall aim at a high level of protection taking into account the diversity of situations in the various regions of the Union. It shall be based on the precautionary principle and on the principles that preventive action should be taken, that environmental damage should as a priority be rectified at source and that the polluter should pay.”

The CAP greening provisions turn the spirit of these principles, which emphasise “protection”, “precaution”, “prevention” and “polluter pays”, on its head. Since 2015, 30% of the total volume of direct payments has been linked to three greening criteria: crop diversification, ecological focus areas, and the maintenance of permanent grassland. If a farm does not fulfil these criteria, its direct payments can be reduced. As has often been pointed out, this is analogous to providing all car drivers with a payment, and later reclaiming that payment from drivers who

are caught speeding, the implication being that drivers have the right speed (and farmers the right to cause environmental damage) if they are willing to forego the payment. Neither the goals of the CAP nor the principles of EU environmental policy outlined in the TFEU provide for direct payments to farmers in return for adherence to basic environmental standards.

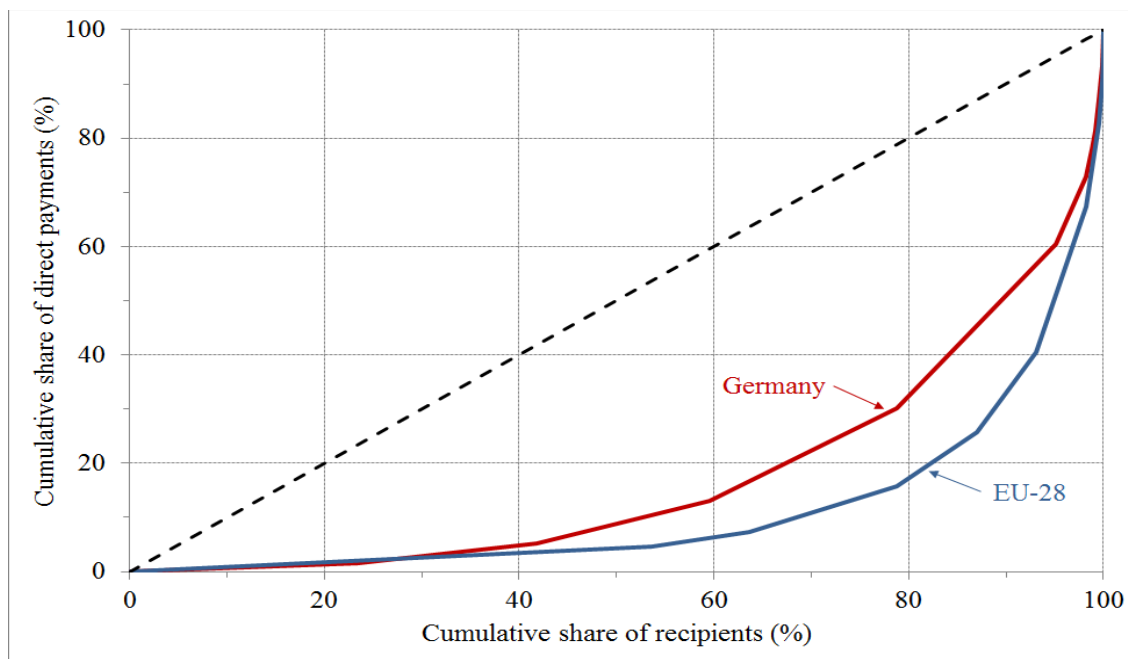
1.2 Are ‘non-treaty’ goals pursued efficiently?

Second, even if income support and greening payments were explicitly provided for by the EU Treaties, the CAP’s record in pursuit of these goals is poor.

1.2.1 Income support

The goals of the CAP in the TFEU refer to “a fair standard of living”. Standards of living are not determined by income alone, but even if we accept the focus on income, the term “fair” suggests progressive redistribution that reduces income inequality by targeting low-income farm households. However, the distribution of CAP direct payments is regressive. Direct payments were introduced as compensation for support price reductions that took place as a result of the MacSharry, Agenda 2000, Fischler and sugar market reforms of the early 1990s to mid-2000s. They were not conceived as income support based on any notion of distributional equity; they were designed to help farmers adjust to a fundamental reorientation of the CAP that was initiated 25 years ago. Those who farmed large areas were granted large compensation payments because they lost the most revenue as a result of support price reductions. While some redistribution has taken place within and between member states in the meantime, the correlation between the number of hectares that a producer farms and the volume of direct payments that he/she receives remains strong. CAP direct payments only contribute to a “fair standard of living for the agricultural community” if one is prepared to believe that a farmer’s need for income support grows in proportion to the amount of land that he/she farms.

Data published by the Commission confirm that the distribution of direct payments is heavily skewed in favour of relatively few, large farms. In 2015, roughly 18% of the recipients of direct payments in the EU-28 received 80% of the volume of these payments (Figure 1). The distribution is less uneven in the case of Germany, which has redistributed direct payments among its farmers more than most other member states. Nevertheless, even in Germany only 10% of the recipients received roughly 50% of the direct payments in 2015 (Figure 1).

Figure 1: The distribution of direct payments in the EU-28 and Germany (2015)

Source: EU Commission (2016).

Since the farms that receive the largest payments are those with the most land, they also tend to be those with the highest incomes. Using Farm Accountancy Data Network (FADN) data, Matthews (2016a) calculates that the 80% of the farms in the EU with the lowest incomes receive only roughly 25% of the direct payments. At the other end of the scale, the 750,000 farms in the highest income decile receive 55% of all direct payments. According to these calculations, roughly 15% of the total EU budget is going to the 10% of the EU's farmers with the highest incomes.

Despite the evidence presented above, policy makers and farm lobbyists often claim that direct payments account for a large share of farm incomes, and that any reduction in direct payments would cause severe hardship for many farm households. They argue that even if small farms receive only a small proportion of the direct payments, these payments nevertheless account for a crucial share of their incomes. Even if these claims were true, they would only justify a fraction of the current spending on direct payments (i.e. the roughly 25% of the direct payments that are received by the 80% of the farms with the lowest incomes). Moreover, these claims are based on an incomplete and biased depiction of reality. They are based on the FADN data mentioned above, which provide information on farm income but ignore the fact that farm households often also earn substantial farm-related income (e.g. from generation of wind and bio-energy) and off-farm income (e.g. when a farmer's spouse works as a school teacher). In the rare cases in which more comprehensive data are available, they show that farm-related and off-farm income can be substantial. For example, the Kammer für Arbeiter und Angestellte für Wien (2011) shows that in 2009 Austrian farm households earned on average only roughly one-half of their total incomes from farming. Hence, the numbers that politicians and farm lobbyists are fond of citing systematically over-estimate the share of farm household income that is due to direct payments.

The distributional effects of direct payments are further complicated by the fact that they are to some extent passed on from farmers who rent land to the owners of that land, who may not be active farmers.¹ Therefore, if direct payments were reduced, farm incomes would not fall by the same amount because the costs of renting

¹ The degree to which direct payments are passed on to land owners varies with land market structures and institutions.

land would fall as well. Income support that leaks into the pockets of landowners who are not farmers is presumably an unintended by-product of the direct payment system; there is certainly no basis for such spending in the EU Treaties. Whether this spending leads to a more equitable distribution of income depends on patterns of land ownership and rental, which vary greatly across the EU. In one scenario, a large absentee landowner benefits from direct payments passed on by many small farmers who rent his/her land. At the other extreme, many small landowners in a rural area benefit from direct payments passed on to them from a single large lessor of their land. As an example of the latter scenario, some holdings that receive large direct payments in eastern Germany are the successors of former collective farms that rent much of their land from the former members of those collectives, and/or their descendants.

In summary, most of the money spent on direct payments goes to farm households that are not in need of income support. Income support via direct payments is not a goal of the CAP according to the TFEU, but even if it were, the current system of direct payments is poorly targeted and thus wasteful. It is true that some farmers in the EU require income support, and it is also true that some of these farmers receive direct payments. But this is by accident, not design. Precise evaluation of the effects of direct payments on standards of living, and thus the scope for improving the targeting of direct payments in the future, is limited by a lack of comprehensive information on total farm household incomes in the EU. The European Court of Auditors has repeatedly and most recently in 2016 admonished the Commission for failing to generate this information:

“The Commission has not clearly established the statistical data needed to effectively assess the performance of CAP measures in support of farmers’ incomes. No representative data are available on the disposable income of farm households, which would facilitate assessing the achievement of the treaty objective of ensuring a fair standard of living for farmers. Furthermore, there is no reliable system to allow comparisons to be made between agricultural incomes and those in other sectors of the economy, which could justify EU income support for farmers.” (European Court of Auditors, 2016).²

1.2.2 Greening

The consensus among experts is that greening is unlikely to produce substantial increases in the provision of environmental services by farmers. Schmidt et al. (2014) find that crop diversification “will have only a very minimal positive effect on biodiversity and climate protection in the current form of planning”. With respect to ecological focus areas, Pe’er et al (2014) predict that this set of measures is “unlikely to contribute to improving the status of farmland biodiversity given that the majority of farmers would not be required to perform any changes of current farming practices to comply with it.” Pe’er et al. (2016) confirm that the ecological focus area measures that have been most adopted by farmers so far are those that provide the least benefits to biodiversity. These assessments have focussed on biodiversity, which is only one potential environmental benefit of greening. Other potential benefits include reductions in groundwater pollution and reductions in emissions of greenhouse gases. However, there is little reason to expect that greening will either entice or coerce farmers to produce substantially more environmental benefits (or cause less environmental damage) than they have in the past. And there is certainly no evidence that greening will produce more environmental benefits per Euro of spending than other environmental measures that could be adopted.

This lack of environmental effect and efficiency is not surprising, because greening was not designed and implemented by policy makers who are primarily concerned with achieving environmental goals. It was designed to shore up the justification for direct payments to farmers without substantially disturbing the distribution of direct payments between and within member states. The Commission had originally proposed more ambitious greening measures than those later adopted (e.g. 7% ecological focus area rather than 5%). In the early phases of the 2014-2020 MFF debate, agricultural and environmental interests cut a deal on using the concept of greening as a

² The European Court of Auditors (2003) came to similar conclusions.

means of preserving and increasing control over EU spending respectively. But after agreement on the MFF and the overall CAP budget had been reached, the detailed specification of greening was left up to agricultural policy makers. Negotiations between the Council and the European Parliament diluted the Commission's proposals and gave the member states much leeway to interpret and implement greening. Agricultural interests in the member states naturally sought to minimize effects on farmers, resulting in further dilution.

In summary, roughly 70% of the CAP budget and almost 30% of the total EU budget are spent on direct payments in the pursuit of goals that are not entrenched in the TFEU. Moreover, this money is spent in a manner that does not lead to the efficient provision of even these goals, let alone those that are entrenched in the TFEU.

1.3 The 'Consultation'

In recent years the Commission has used 'Consultations', in which citizens, organisations and other stakeholders are invited to provide assessments of the CAP's priorities and performance. In its most recent manifestation, the 'Consultation on modernising and simplifying the Common Agricultural Policy', the EU Commission (2017a) poses, among others, the following questions:

- “1. Which are the most important challenges for EU agriculture and rural areas?
at most 3 choice(s)
 - Fair standard of living for farmers
 - Adaptation to trends in consumer/societal demands
 - Pressures on the environment and on natural resources
 - Climate change (mitigation and adaptation)
 - Lack of jobs and growth in rural areas
 - Uneven territorial development throughout the EU
2. Which of the current CAP policy tools are best suited to meet the challenges identified above?
at most 5 choice(s)
 - Decoupled payments to farmers
 - Coupled support
 - Support for Rural Development environment and climate actions in agriculture and rural areas
 - Support for Rural Development investments in physical and human capital in agriculture and rural areas
 - Trade measures
 - Market safety nets (e.g. market intervention)
 - Risk management schemes
 - Support for integration into producers' organisations
 - Regulatory approaches (such as standards and rules)...
15. Which of the following should be the most important objectives of the CAP?
at most 5 choice(s)
 - Ensuring a fair standard of living for farmers
 - Addressing market uncertainties
 - Foster competitiveness and innovation of agriculture
 - Securing food supply at reasonable prices for consumers
 - Encouraging the supply of healthy and quality products
 - Contributing to a high level of environmental protection across the EU
 - Mitigating and adapting to the impact of climate change
 - Developing rural areas while taking care of the countryside
 - Achieving a balanced territorial development”

This 'Consultation' is a classic example of what social scientists refer to as 'framing', whereby responses to questions are influenced by how they are posed. The Commission does not, for example, pose questions such as:

In Germany in 2015, fewer than 5% of the farms that received direct payments received almost 40% of these payments. On average, these 15,346 farms each received a payment of roughly €132,500. No effort was made to measure the farmers' incomes or wealth and thus determine whether they actually require income support. In your opinion, such payments are:

- Unjustified
- Justified
- Do not know.

The results of the Commission's Consultation are predictable. Most respondents will no doubt indicate under questions 1 and 15 that ensuring a fair standard of living is an important challenge and should be an important objective of the CAP. Most will also respond to question 2 that "decoupled payments to farmers" are one of the "best suited" tools. And the Commission will claim that this provides a mandate for the continued use of direct payments to provide income support to farmers. No matter that those who participated in the Consultation are not representative of society as a whole.³ No matter that the Commission has not managed in 60 years to establish an accurate yardstick for measuring farm incomes, let alone standards of living. And no matter that the TFEU clearly stipulates that fair standards of living are to be ensured by means other than payments to farmers.

The EU Treaties have been amended several times since 1957, but the goals of the CAP have remained untouched and appear today in the TFEU word for word as they were formulated six decades ago. Agriculture has changed over these six decades, as have society's priorities and expectations. Nevertheless, if policy makers wish to pursue new goals that reflect these changes, they should first secure a formal mandate by revising the goals that are stated in the TFEU. 'Challenges' identified in a survey are no substitute for goals entrenched in a treaty, and framed 'Consultation' is no substitute for constitutional legitimacy.

2 What should be the goals of the CAP?

In accordance with Article 39 of the TFEU, goals (a) and (b), the CAP should foster agricultural productivity, also as a means of improving standards of living in agriculture. Research, education and technology transfer are important policy tools in this regard, as are measures to encourage early retirement and consolidation of land holdings in member states characterised by large numbers of small holdings and older farmers.

Social policy is a national and not an EU responsibility. Hence direct payments should be gradually but completely eliminated over the next 10 years up to the end of the 2021-2027 MFF. The schedule for eliminating direct payments should be clearly communicated and strictly adhered to, so that farmers can negotiate land leases and plan other aspects of their farm operations accordingly. Combatting poverty in the farming community should be left to national social policy systems with their established procedures for means-testing and delivery.

Assessing an agricultural system's productivity means comparing its inputs with a comprehensive measure of its outputs, including non-market outputs such as environmental goods and cultural amenities. The productivity goal (a) in Article 39 TFEU therefore provides a justification for policy measures aimed at increasing farmers' production of such non-market outputs. However, these measures should be targeted and efficient, with individual

³ According to preliminary results published by the EU Commission (2017b), 322,912 online responses to the 'Consultation' were received by the May 2, 2017 deadline. This amounts to roughly 0.064% of the EU population. 47% of the responses came from Germany, which is therefore heavily over-represented (Germany accounts for 16% of the EU population). Apparently, many of the responses received were coordinated by NGOs and lobby groups that supplied their members with sample or specimen responses. The Commission will release detailed results of the 'Consultation' at a conference on July 7, 2017.

farmers or groups of farmers being paid appropriate amounts for the production of measurable outputs that have been prioritised by experts. A clear distinction should be maintained between the ‘provider gets’ principle for additional benefits, and the ‘polluter pays’ principle for environmental damage. Furthermore, EU policy should focus on environmental goods of European dimension such as climate change, transnational watersheds, and cross-border measures such as corridors that link protected areas. The current greening payments do not fulfil any of these criteria. The agri-environmental measures currently financed in Pillar II of the CAP should be subjected to a thorough review that draws on environmental as well as agricultural expertise to identify effective tools. Note should be taken of past assessments of these measures, for example by the European Court of Auditors⁴, which have often been critical of targeting and implementation.

The market stability goal (c) is difficult to pursue at the EU level for two reasons. First, market conditions and farm structures vary greatly across products and regions of the EU. Second, direct intervention in market prices and quantities is restricted by the EU’s WTO commitments and its dependence, as a leading exporter of agricultural products, on open markets and trade. The potential for EU co-financing of national, product-specific revenue and income insurance schemes can be explored. However, these schemes should be limited to stabilisation and not misused to provide income support or undermine agricultural competition within the Single Market.

The availability (d) and reasonable prices (e) goals in Article 39 TFEU harken back to the EU’s early post-War decades when food was sometimes scarce and accounted for large shares of consumer spending. Today the EU is a major exporter of staple food products and most of its food imports (e.g. tea, coffee, cocoa, tropical fruits, and livestock feed that ends up being re-exported in the form of meat and milk products) are not essential for food security. While some agricultural lobbyists suggest that direct payments are required to ensure continued supplies of sufficient and safe food in the EU, this is disingenuous at best; the direct payments are decoupled and therefore have little effect on agricultural production. Food availability does not call for concerted action at the EU level and is best sustained by fostering agricultural productivity. For many EU citizens, food prices are no longer a crucial issue – many are more concerned about various dimensions of food quality. Where poverty and the food bill is an issue, they are best addressed by means of social policy, not by manipulating food prices.

3 Implications for financing, and resistance to change

The changes outlined above would lead to a substantial reduction in CAP expenditure. This would entail major changes in the member states’ net contributions to the EU budget, thus disturbing the delicate balance of net contributions that has evolved over decades of difficult negotiations. Resistance to such redistribution has protected the CAP in the past, restricting the politically feasible set of CAP reforms to those that largely preserve the balance of net contributions. Greening provides an example of this lock-in. In 2013, policy makers did not develop new spending criteria based on an assessment of agri-environmental policy needs. Instead, they decided that 30% of a farmer’s historical direct payments would henceforth be re-labelled as payments for environmental services. Did agricultural policy makers believe that each farmer in the EU already just happened to be producing environmental benefits in proportion to the volume of direct payments that he/she was receiving? Presumably not: policy makers simply wanted to construct an environmental justification for direct payments while avoiding major changes in the member states’ net contributions to the budget.

The Brexit provides an opportunity to free the CAP from this straightjacket of *juste retour*. The UK’s withdrawal will result in a loss in net contributions to the EU budget of over €10 billion.⁵ This is equivalent to roughly 7.5% of the total EU expenditure of €138 billion in the other 27 member states. The resulting disturbance of the complex

⁴ See European Court of Auditors (2011).

⁵ Based on DG Budget operating balances of member states, Matthews (2016b) calculates an average net contribution by the UK of €10.3 billion over the four years from 2012 to 2015. The UK government publishes higher estimates of net UK contributions to the EU budget, but it only measures flows to and from the public sector and does not take into account EU funds that flow directly to the private sector (for example for research). See <http://capreform.eu/impact-of-brex-it-on-the-eu-budget/>.

current balance of contributions involving the UK rebate, and the 'rebates from the UK rebate' that benefit especially Austria, Germany, the Netherlands and Sweden, makes negotiations about the future distribution of EU revenues and expenditures inevitable. This opportunity should be used to separate the design of a treaty-based and efficient CAP from the issue of juste retour. Agricultural policy options should be debated and adopted on their merits, and any remaining political need for maintaining some pattern of net contributions by member states should be accomplished post-CAP reform by a system of fiscal transfers among member states.

A second related straightjacket that should not be permitted to constrain agricultural policy reform in the EU is the logic of 'communicating Pillars', which dictates that any money saved in Pillar I must automatically be shifted to increase spending in Pillar II, and vice versa. To preserve what they consider to be 'their' budget, agricultural policy makers at the EU, national and regional levels will act, as they have in the past, as if such a one-to-one correspondence were self-evident. However, there is no compelling reason why CAP reform should be restricted to zero-sum reallocations between the Pillars. Scarce EU budget resources should be allocated across policy areas to maximise European value added, and not stuffed into fixed budget envelopes. Reform of the CAP might lead to increased spending on measures in Pillar II, but only after the costs and European benefits of these measures have been rigorously evaluated against alternative priorities in pressing areas such as migration policy, securing European borders, European transportation and energy infrastructure, European defence, and European education and research.

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