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CAP Reform Options: A Challenge for Analysis & Synthesis

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Abstract

The European Union's Common Agricultural Policy is continually evolving. The growing debate about the future of the EU Budget post 2013 raises major questions about the future of the CAP. A formal Communication on the future of the Common Agriculture Policy (CAP) after 2013 is due to be published by the Commission in the summer/early autumn of this year – in order to launch a full public debate on the issues, and as a part of the Budget Review of 2011. Formal legislative proposals on the post-2013 CAP will then follow in mid-2011 – together with Commission proposals for the post-2013 Financial Perspectives.

It is, therefore, appropriate to review the discussions of further reforms, and also to consider our professional capacity to provide robust analysis of potential futures. The debate on the future CAP is of more than an agricultural interest as it affects, *inter alia*, the environment, climate change, food quality and security and rural communities and their development. Numerous views have already been expressed on the future of the CAP. However there is very limited synthesis of the options and principles underlying their evolutionary fitness – that is, the extent to which suggestions correspond to the socio-economic environment and political climate upon which the future persistence of the CAP depends. This paper synthesises present views on the future of CAP, and outlines a possible conceptual framework for future research and analyses in the field.

1. Introduction

With 2020 hindsight, CAP analysis in the 'good old days' seems to have been very straightforward. Beginning with *Josling (1969)* welfare analysis of the major instruments of the Old CAP (import levies, intervention and export refunds) was simple, at least in principle, and it was relatively easy to calculate/estimate the economic costs and benefits of the policy. *Buckwell et al. (1982)*, for instance, were able to develop a coherent model of the economics of the CAP and demonstrate the costs and benefits in traditional economic terms. However, times have changed, and many of the more obvious anomalies of the Old CAP have long since gone.

Now, we are faced with more serious and multi-dimensional challenges. The CAP has evolved (e.g. *Harvey, 1995*), perhaps beyond the dreams of some early researchers, adapting and adjusting to much changed local and world environments. It's apparent scope has been constrained by the fact of the URAA and WTO governance of trade relations, whose introduction coincided with the beginnings of substantial CAP reform under Commissioner MacSharry in 1992. This reform trajectory has continued to embrace 15 new country members with substantially different policy needs from those of the founder and early members. A formal Communication on the future of the Common Agriculture Policy (CAP) after 2013 is due to be published by the Commission in the summer/early autumn of this year – in order to launch a full public debate on the issues, and as a part of the Budget Review of 2011. Formal legislative proposals on the post-2013 CAP will then follow in mid-2011 – together with Commission proposals for the post-2013 Financial Perspectives.[1] The challenge, now, is to further cultivate and civilise the policy so that it is better fitted to the 21st Century, and makes a more positive contribution to further developing and sustaining the EU.

However, the question of what makes a more sustainable and productive policy is now substantially more difficult. Even at its simplest level – Single Farm Payments - beyond simple distributional arithmetic with the raw data, it is not clear what the 'proper' welfare analysis of these payments should be, since we cannot agree on what effects these payments have in either the factor markets or product/service and public good markets. Nor is it obvious how a socially reflective discourse about possible futures for these payments should be constructed or cultivated. Despite this lack of theoretical consensus about the analytical framework, the scope of the CAP appears to be expanding. The CAP, post 2013, is supposed by many to be required to contribute to meeting the major and diverse challenges of: global food security and climate change; environmental and land conservation and management; rural development; agrarian transition; food quality and safety; bioenergy and biofuels; regional and sectoral competitive (dis)advantages; market volatility and business risk and, no doubt, other issues as well. And, its paymasters believe, it should be able to do so with a smaller share of an already tiny European budget than in the past. Tinbergen, back in 1952, told us that we need at least one policy instrument for each and every specific policy target or objective. If so, then any ambitions to simplify the CAP seem doomed to be completely out of reach.

Although several analyses of the options for CAP reform have already appeared, there has been limited synthesis of the options and principles. The aim of this paper is to synthesise the present views on the future of CAP into a framework to serve as a basis for future research and analyses in the field. The paper is organised as follows. Section 2 deals with the history of the CAP, and hence with the historical baggage which still encumbers the policy. Section 3 outlines the major issues for debate and negotiation, and also highlights the major proposals being advanced for the future of the policy beyond 2013. This serves as a basis for Section 4, which outlines a conceptual framework within which these ideas might be considered, and hence how alternative futures may be pictured. Section 5 concludes.

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[1] AgraFacts, 42-09, 02.06.2009.

2. The CAP's Ancestry

The Early Years.

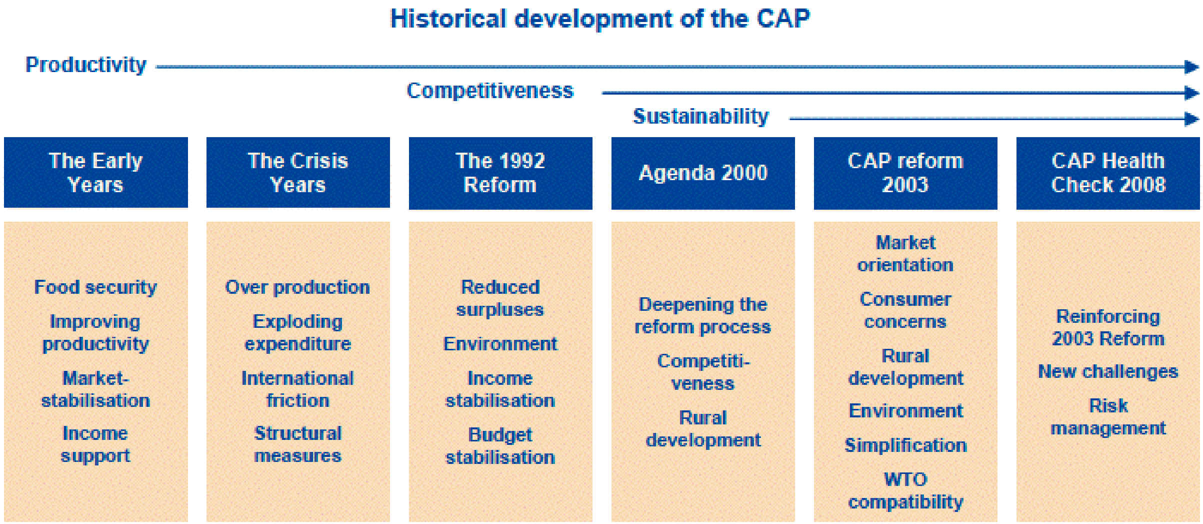
Food policy – the price, availability and security of food – figures highly in the political calculus of all economies, especially those which are in the transition stages of development from predominantly agrarian to modern industrial/consumer societies. Especially for these economies, farming is a critical sector for policy, since very substantial proportions of the population are engaged in agriculture. Especially in Europe in the aftermath of WWII, starvation was a real threat, concerns about food security were heightened by the war experience, agriculture was still a major employer, especially with demobilization. Agricultural policies were seen as essential, with support and protection of domestic supplies an obvious and fitting response to the socio-political conditions of the time.

All European countries designed and implemented significant support and protection policies. The UK, with a Commonwealth and allied countries to consider, was obliged to provide this support at the expense of the taxpayer (through 'deficiency' payments) rather than the consumer (through increased domestic prices). Furthermore, with a substantially more commercial farm structure, and fewer people in farming than elsewhere, the UK did not need, and could not afford such generous levels of support as other European countries – especially Germany.

For the founder members of the EU, especially France and Germany, a common agricultural policy (implying a common food price policy) was also critical for the development of a single market within a customs union. The fears of France that Germany would dominate industrial trade were mirrored by fears in Germany that her fragmented agriculture would be dominated by France. The compromise, with the benefit of hindsight, was obvious – set a relatively high external tariff on food, thus raising money for the European budget from the consumers, and let France enjoy the common preferential prices for food exports to Germany. The principles of the CAP evolved from the negotiations on the formation of the Union: common market, free internal trade and common food prices; community preference (defended through a common external tariff); common financing (tariff revenues considered as the EU's own resource, not a revenue for member states).

The *European Commission (2009b)* pictures the development of the CAP as shown in Figure 1. The "Early Years" reflect the socio-economic and political pressures of the founding of the Union. Farm income support – the focus of the policy – was to be generated by improved productivity encouraged and assisted by the market stabilisation and protection provided by the CAP

Figure 1:



Source: EC 2009b

The Crisis Years

As any economist could easily predict, setting and supporting prices above the market clearing level will generate surpluses – the 'Crisis Years'. While the net import position of the founder members disguised this outcome through trade diversion from the rest of the world to the internal market, it also promoted a longer run supply response which substantially exceeded the growth of internal demand. By the late 1960s, the CAP began to generate surpluses within the original 6 member states. The European budget lost its 'own resource' revenue, and (by the common financing principle) became liable for surplus disposal. Mansholt (the European Commissioner for agriculture) delivered a plan for the substantial reduction in the number of farmers, which would allow farms to become more commercial and capable of surviving under lower prices, and which might also reduce the surplus production. It was roundly dismissed as impractical, that is, politically infeasible – though his proposed reductions in farm numbers were actually proved rather modest by the subsequent evolution of European farm structure.

The first solution to excess production, given that price reductions are politically unacceptable, was simple – expand the size of the Community by including a major food importer: the UK. President de Gaulle's objections to UK membership were over-ruled, and (against some scepticism in the UK), the UK, Ireland and Denmark were admitted to the club in January 1973. As luck would have it, this event practically coincided with the world events of floating exchange rates (1971) and the 'first' oil and commodity price spike (73/75), which conspired to raise world prices dramatically. Although the UK had been granted a 7 year accession period, during which UK farm prices were to gradually adjust to the internal EU prices, the world price spike dominated market prices in the UK. Coupled with world-wide heightened anxiety that the Malthusian proposition of the species expanding until the food ran out, the price signals to UK farming were misinterpreted as the consequence of a major policy change, rather than as a temporary market fluctuation. As a result, farm costs rapidly increased (especially through investment in plant and equipment, and through escalating land prices – exacerbated by the strong inflation in the UK) to meet and exhaust the substantially improved revenues, exactly as would be expected in a competitive market.

By the end of the 70s, the chronic surplus position of European agriculture had re-emerged, prompting a variety of policy responses, including Maximum Guaranteed Quantities, producer co-responsibility levies and 'prudent' support price increases. Despite these palliatives, surpluses continued to grow, and with them the cost to the embryonic European budget. By 1983, dairy surpluses seemed out of control, with butter and skim milk powder mountains threatening to overwhelm the CAP. Substantial support price reductions, however, remained politically unacceptable. The only acceptable alternative – quotas on milk deliveries – was introduced in April, 1984.

Meanwhile, cereal surpluses continued to grow, and public anxiety about the despoliation of the countryside and wildlife, as a consequence of industrialized cereal production, increased the political pressure for radical change. In 1986, the Uruguay Round of GATT negotiations began with a commitment by the negotiators to address agricultural trade and trade policy for the first time. This commitment was a clear reflection of the condition of both the EU and the US agricultural policies. Both were afflicted with rising budgetary costs, and each was critically conditioned by the state of world prices. Each major player had a major interest in reaching an agreement which would 'clean up' world markets, and so reduce the costs of their own farm policies.

The 1992 & Subsequent Reforms

The unification of Germany in 1989 altered the context and circumstance of the CAP. Whereas agriculture in West Germany presented a political face dominated by the small farms of the agriculturally disadvantaged areas of Bavaria, the 'liberalisation' of the large state and collective farms of the former East Germany substantially altered the political context, if not the calculus.[2] In any event, MacSharry managed to convince the Council of Ministers of the need to 'de-couple' support from production in advance of the GATT Uruguay Round Agreement on Agriculture (URAA). In 1992, CAP cereal support shifted from product price support to fixed acreage payments, and set-aside was introduced to control excess production, mimicking US policy. This reform paved the way for European acceptance of the URAA in 1994.

In 1997, the European Commission commissioned an expert group to consider the future for the CAP. Arguably, the report of this expert group (the "Buckwell Report" - *EC, 1997*) spelt out the strategy subsequently followed, at least in part, by the development of the CAP. Professor Buckwell and his colleagues argued that there should be three major arms or strands to a 'Common Agricultural and Rural Policy for Europe (CARPE)' – *market stabilization*; *environmental and cultural landscape payments*; *rural development incentives*. In addition, this report also recognized that there would need to be *transitional adjustment assistance* (TAA) to enable and facilitate the adjustment of the farm sector to the proposed new conditions of market liberalization and re-directed public objectives.

In preparation for the Central European expansion of the Union, *Agenda 2000* extended decoupling to livestock products, except the dairy sector, by reducing internal price support in favour of headage payments. Moreover, Agenda 2000 created the CAP's 'Second Pillar' to be responsible for rural development and the 'multifunctionality' of the farming activities. This second pillar provided a home for, amongst others, agri-environmental schemes, support to

2 Although this shift seems obvious from the outside, there is no documented or reliable evidence of its actual impact or consequences in the debates and design of the 1992 reform.

the least favoured areas and early retirement programmes. 'Modulation' was also introduced[3] to allow funds to be transferred from the First Pillar (market support and direct payments) to the newly established second, signalling (at least to some) an intention to eliminate Pillar 1 over time. In fact, the size of the cut in direct payments has been progressively increased since its introduction in 2003, and will be at least 10% by 2013 (*EC, 2009b*), which might be interpreted as following the Buckwell report insistence that these 'transitional adjustment assistance' payments (TAA) be "finite and time limited" (section 7.4).

The *2003 Reform* (following the Mid-Term Review of Agenda 2000) consolidated the area and headage payments into the Single Farm Payment, apparently re-enforcing decoupling. Farmers receiving the SFP have the flexibility to produce any commodity, while they are obliged to keep their land in good agricultural and environmental condition (GAEC) and also respect the Statutory Management Requirements (SMR), in so-called cross-compliance. Again, the design and specification of the SFP (otherwise known as the Single Payment System (SPS)) follows the Buckwell report recommendations for transition assistance: "should be *decoupled* from production, should be *non-distorting* as regards competition, and recipients should respect *environmental conditions*" (Section 7.4). Environmental and other non-commodity based supports for agriculture, forestry and rural development were also completely restructured at this time into the Rural Development Regulation (RDR) for the period 2007 to 2013. As *Buckwell (2007, p13)* notes, the "intense and bad-tempered discussion (about the budgetary agreement for 2007-13) finally agreed, more or less, to maintain the budget for Pillar 1 (the market supports and SPS) until 2012, but only with the proviso that all EU spending policies as well as the structure and size of the budget would be reviewed in 2008/09."

The implementation of these reforms coincided, by design, with the entry of Central and Eastern European Countries (CEEC) into the EU in 2004 and 2007. However, on the dubious grounds that the CEEC farmers did not need compensation – at least not for support reductions - the rates at which SFPs were made in the NMS were set at 25% of the western rates, only to increase by 5% points per annum (hence remaining at 70% or less for these countries by 2013)[4]. As some sort of compromise to reflect the considerable disappointment of expectations of the CAP in the CEEC, the new member states (NMS) were allowed to supplement these European payments with nationally financed payments to the limit of 30% of the (western) European level – i.e. to a total of 55% of the 'European' level in the first year. All the NMS have opted to pay top-ups to their farmers (*Gorton et. al., 2009*). However, and in spite of the original 'agenda' for the 2000 & 2003 reforms, the specific and very different conditions in the NMS were, as *Gorton et al. (2009)* explain, completely ignored in these reforms (a critical point which will be returned to below).

The *Health Check in 2008* continued the trend towards decoupling, agreed the elimination of milk quotas by progressively reducing price protection and increasing total quotas to reduce quota rents to zero by 2015, and also eliminated compulsory set-aside. In 2008, an assistance program to sectors with special problems was also introduced together with several corrective measures strengthening the 'reform directions' agreed in 2003.

Figure 2: Budgetary history of the CAP, 1980 - 2007

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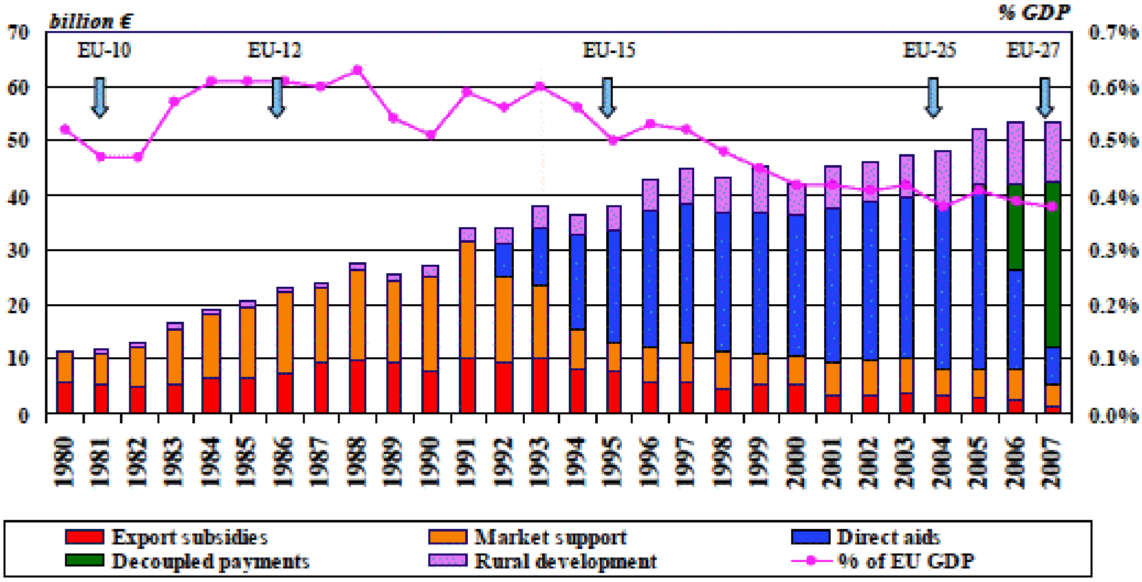
3 The term reflects the fact that reductions in Single Farm Payments are limited to those receiving more than €5000.

4 Without the nationally financed top-up supplement by the Member States.



Source: Haniotis, 2009.

The overall result of this history of reform in terms of budgetary allocation is shown in Figure 2, which clearly shows the extent to which direct payments (aids and decoupled payments) and (to a lesser extent) rural development assistance (Pillar 2) have taken over from coupled market support, at least as far as budget spending is concerned. In addition to a major shift in the direction of budget payments, the CAP spending has also been reduced over the past 20 years from 75% of the total EU spend to about 45%, declining as a share of EU GDP as a consequence to less than 0.4% (less than most parish councils). At the same time, the EU has expanded by 12 member states, and the number of farmers and farm workers has more than doubled. As a consequence, the popular perception that the CAP is both a dominant EU policy in budgetary terms, and also continues to be both generous and highly protective of European farmers is now both substantially misinformed and potentially highly misleading for EU politics. In fact, the extent of support per head and per hectare has declined substantially, especially with the accession of the NMS.

A similar picture, with one important difference, emerges from a comparison of the OECD estimates of Producer and Consumer Support Estimates (PSE & CSE), Figure 3. Although over a slightly shorter period, the story is one of substantial decline in the total PSE from 2003, and an even steeper decline in production related (coupled) support, being replaced by a rise in decoupled support, as the SFP system takes over. Figure 3 also shows the OECD's CSE (the Consumer 'Support' Estimate, here pictured as a Consumer 'Tax' estimate - i.e. as a positive % rather than a negative 'support'). In effect, the CSE is an estimate of the gross user tax at the farm gate (which is the basis of all these estimates) consequent on the market support or protection measures still in place – mostly the effects of the EU import tariffs measured against actual world prices.

Figure 3: EU 27 PSE% and CSE% (1986 – 2008)[5]

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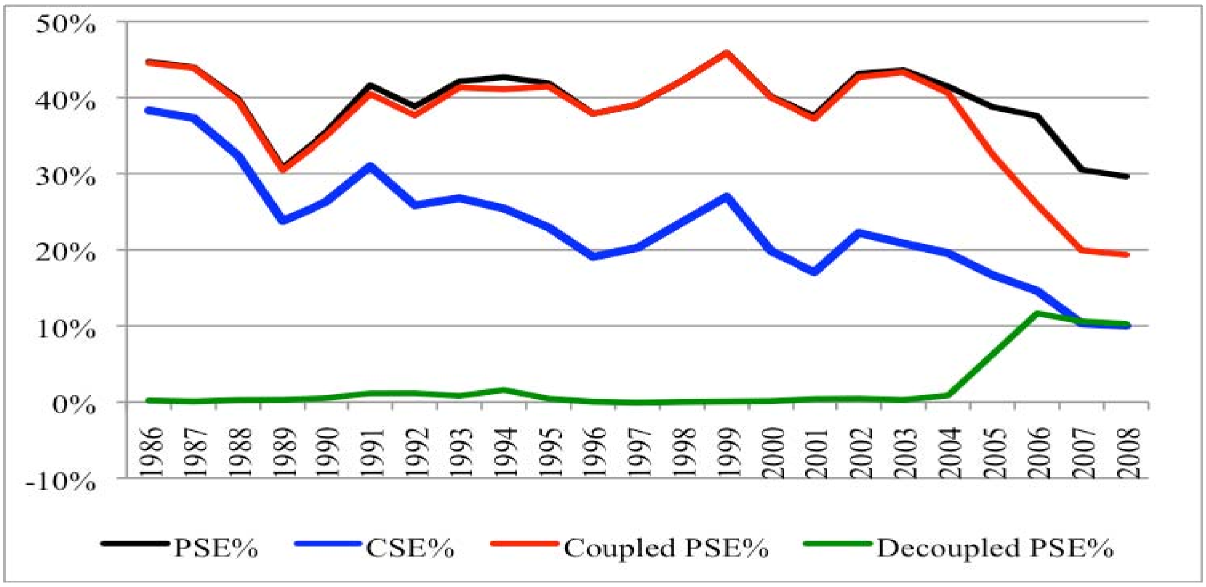
[5] It is, of course, well known that the PSE is generally a considerable over-estimate of the actual levels of support reaching the farmer as a consequence of the support policy. In particular, the estimate ignores any account of the likely input, factor and product market adjustments which would occur in the absence of the policy. For instance, *Harvey (1997)*, p 165, estimates that the conventional economic measure of the producers' surplus gain resulting from the CAP in 1990 amounted to 14% of total farm revenues, compared with the PSE for that year of 35%. However, as the support becomes more decoupled from production, and



Source: OECD, Producer and Consumer Support Estimates, 1986-2008 database. Note: coupled PSE includes only product or production related support (OECD categories A, B, C and D), decoupled includes those support programmes which do no relate to products or production (categories E, F and G).

As can be seen, the effective consumer or user tax resulting from the CAP has been more or less steadily declining since 1986, from 40% to the current 10% of farm gate revenues, as world prices have tended to strengthen and as EU import tariffs have been reduced. Consequently, the responsibility for the continued support of farmers now falls much more heavily on the EU budget and taxpayer (approximately the gap between the PSE and CSE in Figure 3). In this light, the decline in the proportion of EU GDP actually spent on agricultural support is even more remarkable – and reflects the fact that the treatment of farmers in the NMS is substantially less generous, and less common, than is the case in the EU15. Had the NMS been treated equally with the 15 as far as the SFP is concerned, the tax bill for the EU would have been substantially greater. EU Budget constraints effectively ruled equal treatment impossible.

Nevertheless, Figure 3 does show that the CAP continues to be an important component of EU farm incomes. Delivering a PSE of 30% of total farm revenues is bound to generate considerable dependency (*Harvey, 2004*) amongst farmers (and their political supporters and civil servants) on continued support, especially since this estimate is now much closer to the actual increase in producer receipts as a consequence of decoupling. Aspirations to substantially alter this flow of support, reducing it and re-directing it to other uses and targets, can be expected to generate very substantial resistance.

3. The Future of the CAP?

Based on the history above, numerous views have already been expressed on the future of the CAP. Some authors deal with direct payments and their possible effects *(e.g. Swinnen, 2009)*, others write about food safety and security *(e.g. Schmidhuber, 2009)*, while again others analyse the possibility of 'greening' the CAP *(e.g. Garrod, 2009)*. Some analysts, especially

hence less distorting of markets, so the gap between the PSE and the associated producers' surplus gain will become smaller, and should be zero under completely decoupled and non distorting payments (aside from the considerable administrative costs of the policy).

Bureau & Mahé, 2008, have presented a complete re-appraisal of the whole policy and its possible objectives, and have outlined a new policy framework. Nevertheless, a comprehensive review of these contributions (*Jambor & Harvey, 2010*) reveals that the critical ideas for reform still largely echo the Buckwell Report (*EC, 1997*), and reflect the accepted economic logic. The issues can be grouped under three major policy headings: *food markets; rural development; the environment.*

Reviewing the ideas and reform proposals related to each of these three policy areas is well beyond the scope of this text and is done elsewhere *(Jambor & Harvey, 2010)*. Here we focus on the future of direct payments, which is a critical, if not the most important, part of the debate. Direct payments, created under the MacSharry reform in 1992 and further reformed in 2003, are now mostly decoupled from production and also supposed to meet the WTO "green box" criteria as non-distorting. Currently, the EU is spending around €37 billion per year on direct payments, accounting for 75-80% of total agricultural payments *(Gorton et al., 2009)*. The Commission *(2009b)* asserts that decoupled direct payments not only ensure that farmers respond to market signals but also contribute to maintaining sustainable farming.

Despite the obvious importance of the direct payments to European farmer accounts, the vast majority of the professional literature analysing the CAP *(Jambor & Harvey, 2010)* considers that direct payments are well past their sell-by date. Intellectually and academically, the case for continued direct payments, without very considerable re-design and much more careful targeting to specific objectives, is virtually non-existent (see, especially, *Swinnen, (2009), Bureau and Mahé (2008)*). As *Swinnen (2009, p. 16)* says: "the most daunting challenges ahead appear to be reducing/mitigating climate change and producing sufficient, safe and high quality food. The analysis in this report suggests that direct payments generally are *not* an effective way of dealing with these challenges."

Swinnen (2009) well summarises the arguments that improvements in farm incomes due to support are temporary, which both history and economic logic demonstrate. Competition in the industry soon results in the revenue increase being capitalised in the value of farm assets, or being spent on increased costs of production. In either case, market competition ensures that total production costs will increase to match the supported increase in revenue. In effect, the benefits of support are frozen into higher costs for the sector and its businesses. Entrants to the supported industry have to purchase or rent their farm assets and pay the additional costs generated by the support, and are, consequently, no better off with the policy than they would have been without it.

What else might justify the continuation of direct payments? A range of possibilities is considered in the reform literature. The most obvious are already identified in the axes of Pillar 2: *competitiveness*; the *environment & land management*; *rural development & diversification*. However, as is recognized in the design and implementation of Pillar 2, all of these justifications demand well-aimed targeting of payments towards specific objectives and conditions, and not to general, sector-wide payments to 'all' farms[6]. There is, perhaps, one argument for continued sector-wide support that at least some analysts find persuasive – the inherent volatility of agricultural markets and the need for some safety net or

[6] 'All' is in quotes here simply to indicate that there are minimum size conditions which apply to the SFP in all member states, such that in some cases, especially in the New Member States, operations which are both farms and providing more or less full time (if very low) livings for their operators are disqualified from the SFP prgrammes.

insurance/security provision. While there is some support for the provision of a safety net – to cope with ‘exceptional circumstances’ *(Bureau & Mahé, 2008)*, there are also strong arguments *(Swinnen, 2009, Antón, 2009)* that private sector/market provision of insurance is likely to be both more efficient and effective, though perhaps requiring some public facilitation through information and extension. It should also be noted that the EU’s import tariffs (as reflected in the CSE element of support, Figure 3 above) continue to provide a substantial ‘safety net’ as far as world market prices are concerned, albeit that this protection can be expected to be reduced in the future as and when agreement is reached under the WTO Doha round. Nevertheless, at a gross value of some 10% of total farm revenues, this continued market protection and associated stabilisation cannot be ignored.

4. Four major institutional factors

The reform debate is also heavily conditioned by four major institutional factors which shape the CAP reform process *(Jambor & Harvey, 2010)*: (1) EU Budget; (2) WTO negotiations; (3) EU competition law and (4) the consequences of the Lisbon Treaty.

The substantial pressures on the EU budget indicate that traditional agricultural support, as presently enshrined in the SFP, is not likely to be preserved at anything like its present level in the future. At present, Pillar 1 of the CAP continues to be wholly financed by the EU budget, in contrast to all other European policies. This ‘financial solidarity’ provision is a relic of the old market intervention CAP, and is not strictly necessary for a CAP dominated by decoupled single payments. Associated with this provision is the UK’s budgetary rebate, and the idea of at least partial re-nationalisation of the CAP. Based on the assessment of the current budget, and taking account of prospects for the future, *Ecorys (2008)*, for instance, argue that three policy areas demand much more attention from the EU budget than agriculture : (1) Climate change and energy resources; (2) Knowledge and innovation; (3) Common security and foreign affairs.

As a second factor, international trade negotiations have always been and will continue to be a major external pressure on the shape and form of the CAP. Present calls from some quarters for a return to market intervention are inconsistent with present WTO rules, to say nothing of the revised rules likely to be agreed sometime under Doha. Recent studies (*(DG IPOL (2009), Adler et al. 2009)*) stress that the CAP is presently ‘WTO-compliant’ – in that the SFPs, particularly, can be included in the ‘green’ (non-distorting) box, exempting them from either control or dispute through the WTO. So long as this is the case, further negotiated reductions in import tariffs, and elimination of export subsidies may well generate strong pressure within the EU for extension, even increases, in SFPs in compensation for the reduced market support, as has happened to date (Figures 2 and 3 above). The *European Commission (2009b)* also claims that the SFPs are in the WTO’s Green Box.

However, there is a critical paradox at the heart of the claim that SFPs are WTO green: if, indeed, SFPs do not distort farm production decisions, what, exactly, do they do? If these payments help farmers at all, they must result in farms staying in business when they otherwise would not, and therefore cannot help but affect the structure of production. Whether or not this structural effect also and necessarily affects the total European volume of production, and if so, in what direction, remains an empirical question. It may be possible to defend claims for green box status for the SFP system, though this is not guaranteed. In any event, world trading partners can be expected to continue to seek ways of challenging the green status of SFPs so long as the inherent paradox remains.

The third critical institutional factor is the *EU competition law and practice for regulating competition* between member states, which will continue to prevent individual member states from seeking to advantage its own nationals at the expense of the other member states. The European Parliament has argued (see, e.g. *Buckwell, 2007*) that re-nationalisation of the CAP (i.e. obliging national contributions to Pillar 1, and thus providing member states with discretion over the level of these payments) will encourage the richer and/or more agriculturally conscious member states to unfairly advantage their own farmers and agricultural sectors at the expense of the rest of the Union. However, as Buckwell points out, such an argument effectively undermines the EU claim that these payments are non-distorting and WTO green. How can SFPs be non-distorting at the European level, yet distort trade between EU member states? In addition, EU competition law (as it applies to state aid, and control of direct and indirect aid, *EC, 2009b*) provides, at least in principle, the means to counter such member state manipulation of direct payments to their own nationals' advantage. In any event, the current disparity in the application of direct payments between the western member states and the NMS has very clearly already breached the notion of a 'common' policy, and has, in effect, already 'nationalised' the policy as far as the NMS are concerned.

The fourth critical element is the *Lisbon Treaty*, which, *inter alia*, gives the European Parliament (as well as national parliaments) both stronger and more direct control over European policy than in the past. The European Parliament's new Agricultural Committee now has co-decision powers with the Council of Ministers, which means that no EU Policy will be passed without the full agreement of the EP. The clear intention is that this co-decision will make the EU policy process more democratic. A common presumption is that this extension of the decision-making process will delay and even frustrate further policy development. National and European Parliament elections (together with the farming lobby) may also have a more important role in the common agricultural decision making process in the future as political parties with different views can shape the future of European agriculture more directly. However, it is not clear that the direct engagement of the Parliament will necessarily strengthen the hand of the farm lobby (and the farm ministers) in resisting radical change. It is possible that the Parliament, constituted on the basis of total population distribution, may find that conflicting and competing demands for very limited European budget resources generates pressure for more, rather than less radical reform of the CAP.

5. A Conceptual framework

As outlined above, the future of the CAP is complex. *Harvey (1998)* suggests that policies need to be judged on the extent to which they are well fitted or suited to the perceived socio-economic conditions and political aspirations (p112). If a policy is well suited, one can expect little change. If not, then it is the character and the extent of the mal-adjustments which can be expected to shape the reforms. He also argues that compatibility of the policy with socio-economic and political conditions can be further described in terms of *coherence*, *legitimacy*, and *sustainability.*[7]

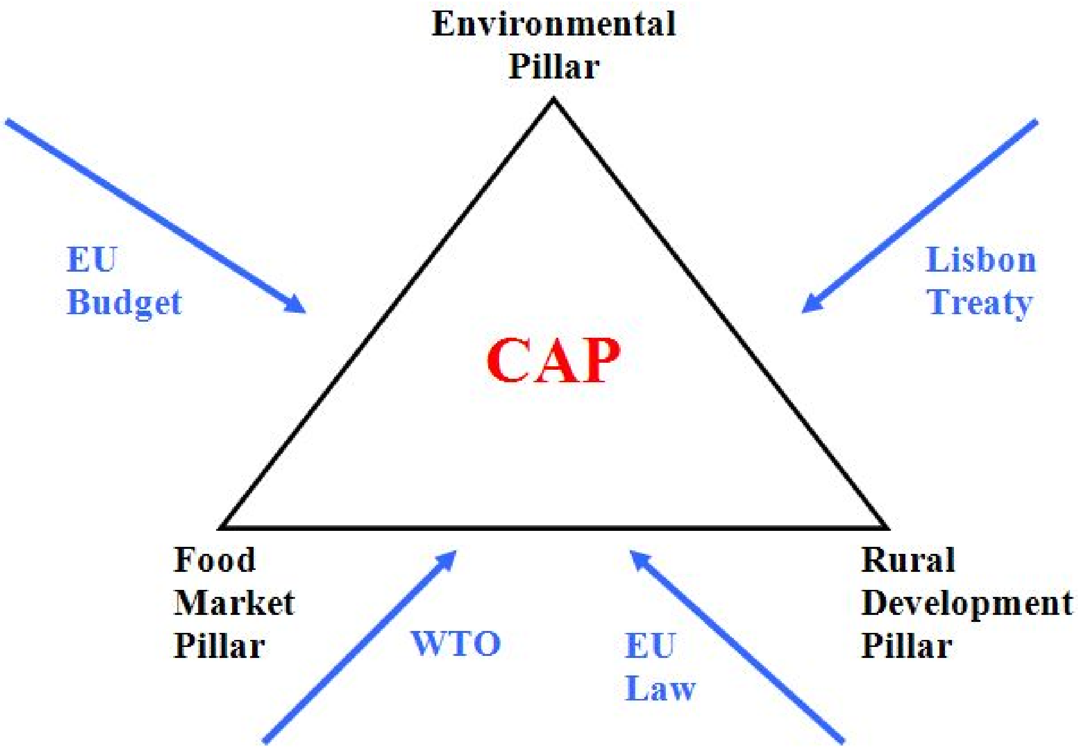
It is clear from a review of the thinking about CAP reform is that two pillars are not enough for a sustainable future for the CAP. Furthermore, the arguments strongly suggest that the

7 These terms are as defined in the Oxford English Dictionary: *coherent*: sticking, hanging together; being consistent; fitting together in a consistent and orderly whole; *legitimacy*: following by natural sequence; genuine; conforming to an accepted standard; *sustainable*: to keep going; capable of indefinite replication and regeneration.

current Pillar 1 (dominated, at least in budgetary terms, by the direct (SFP) payments) is intellectually and logically *incoherent* – there is no economic case for the continued, indefinite support of farmers simply because they are farmers. Payments can only be justified by associated contributions to society not otherwise compensated by the market. Furthermore, as already accepted by the Farm Council (see below), Pillar 1 as presently constituted is not *legitimate* either. The wide variations in rates of payment, both between farms and between countries, bear no obvious relationship to any justifiable criterion for support. Nevertheless, it is clear that there are public interest and concerns about food safety and security and about the 'proper' place, role and performance of agriculture and the food chain in society. It is also clear that climate change and questions about the sustainability of global economic and population growth have raised the food, and thus agricultural issues to the top of the political agenda, while the recent food price spike has also increased concerns about the inherent volatility of agricultural markets. There is, therefore, still a *legitimate* role for a European Food Market Policy (or Pillar), aimed at facilitating competitive, secure, safe and valued food supplies. Failing an explicit recognition of this legitimacy, the existing policy instruments will be bent and re-shaped to meet these concerns. There is a challenge, according to this logic, to develop a *coherent* framework for such a *Food Market Pillar*. What should government (specifically the European Government) be doing that it is not doing already to secure a healthy and safe food market for its constituents? This is not at all obvious from the proposals and analyses we have reviewed for this paper *(Jambor and Harvey, 2010).*

It is also clear that there are legitimate concerns about both *rural development* and the *management of the environment and rural land use*, both of which ostensibly deserve European policies, since both issues are trans-boundary, and also since any government intervention necessarily involves both budget assistance and considerations of inter-regional competition. Furthermore, it also seems apparent that the issues involved under each heading are sufficiently different and differentiated that each deserves its own 'pillar', rather than being conflated into one heading and only separated into axes. There are, therefore, legitimate cases for both a *Rural Development Pillar*, and an *Environment Pillar* (Figure 4).

Figure 4: A conceptual framework for CAP2014-2020



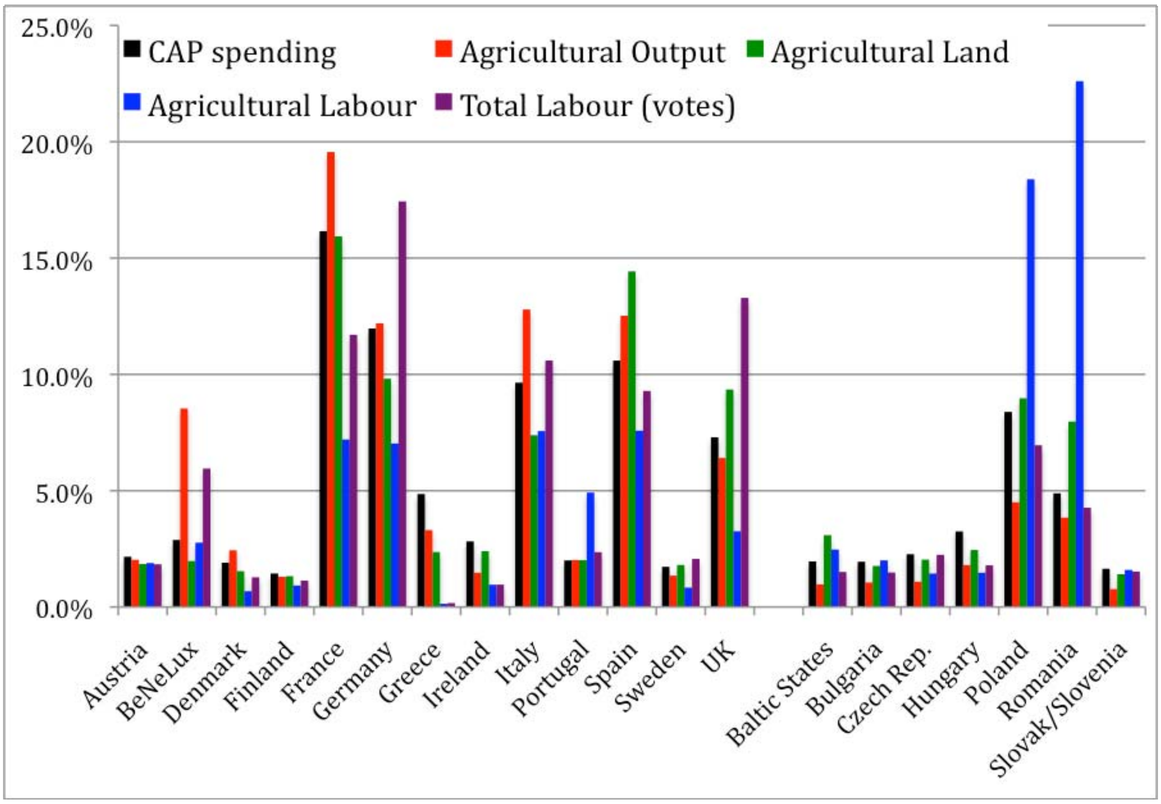
Source: Own composition

We note that this conception has actually been around for more than ten years. It closely echoes the conclusion of the European Commission's Expert Group, chaired by Buckwell, in 1997, which outlined in some detail a Common Agricultural and Rural Policy for Europe (CARPE). Our concept, however, stresses – on the grounds of both history and the ongoing debate issues – that one pillar (Environmental Pillar) should be added to the CAP as well as the existing first pillar should be renamed (Food Market Pillar) in order to represent its clear (and changed) meaning. Figure 4 corresponds with the conventional notion of the critical aspects of sustainability: economic, social and environmental. Our Food Market pillar is largely concerned with economic sustainability, Rural Development concentrates on social sustainability and the Environment Pillar is, of course, about environmental sustainability.

Figure 4 also illustrates the influence of the four major institutional factors (EU Budget, WTO, EU Law, Lisbon Treaty) on the shape of the future CAP. These factors will have different effects on the size and shape of the triangle. They can be treated as external and internal pressures responsible for creating the size of the field upon which the future CAP can be built, while the three Pillars identify the issues a future European Common Policy should deal with. Although not explored here, it might be possible to operationalise this concept if an appropriate index of the importance of policy action under each of these three headings could be defined and measured. Thus, the relative balance of policy action might be determined. Or, given relative balances of importance between regions and/or member states compared with the EU average, the concept might illustrate the intra-EU differences. In other words, this outline might provide a framework for the analysis necessary to identify the gaps between legitimate reasons for policy action, and the capacity of the present policy to meet these objectives.

As an illustration, Figure 5 shows the present (2012) distribution of total CAP spending (Pillars 1 and 2) between the EU Member States, in comparison with three measures which might roughly correspond to the three major 'points' of the policy. The three (crude) indicators are: agricultural output (representing the food market pillar); agricultural land, representing the (farmed) environment; agricultural labour, representing rural development issues. The figure also includes the EU distribution of total labour, as a proxy for the democratic votes which are supposed to determine the policy.

Figure 5: EU distribution of CAP spending and possible indicators:



Greece and Ireland, of the EU15, stand out as currently receiving disproportionate shares of CAP spending relative to any of the three major indicators (agricultural production, agricultural land, agricultural labour) shown here. Perhaps surprisingly, most of the NMS seem to fare reasonably well, with the obvious and major exceptions of the Poland and Romania, according to these crude indicators, though the CAP spending used here is the final distribution once the SFPs achieve the EU15 rates. Clearly, a switch of emphasis from the traditional market related supports towards either or both environmental and rural development objectives will involve a substantial re-distribution of funding between member states. However, it seems likely that such major re-distribution between member states will severely test the capacities of the democratic and political processes of the EU.

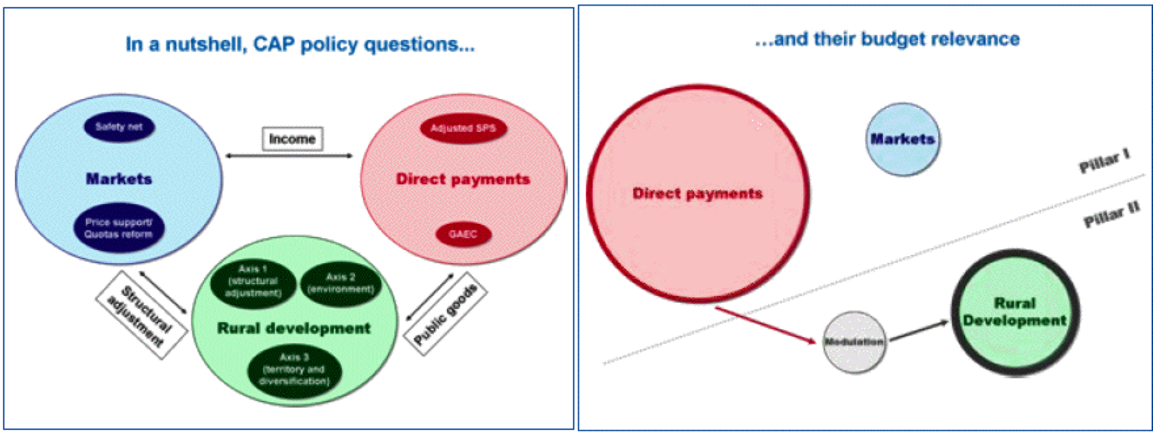
6. The Policy Response

Until now, the evolution of the CAP has followed the recommendations of the Buckwell Report (*EC, 1997*) rather closely, with one critically important *caveat*. The Expert Group were very explicit about their Transitional Adjustment Assistance (TAA), which is (effectively) the current SFP (section 7.4). "*… the message to the recipients of TAA is that society recognises that they have been encouraged, maybe even trapped, in certain forms of agriculture which are fundamentally non-viable. Therefore they are offered some cash to help them rearrange their resources and life, but are warned that it is finite and time limited, so they should make the best use of it as they see fit.*"

However, the *European Commission (2009b)* makes it pretty clear that it is not willing to acknowledge the temporary nature of the SFP system, at least publically. "*Put simply, the CAP can be described as having three policy dimensions. This structure ensures sustainability. The three dimensions supported through the CAP are: producer prices, producers' income, and rural development. The three policies are interconnected, and overall sustainability depends on the ability of the three policies to act collectively.*" (p1). This brief goes on (p. 11) "*Direct payments provide a basic level of income to all farmers throughout Europe, and market measures ensure a guaranteed price for some agricultural products. Changing one of these, without counterbalancing the other, thus affects the overall income level of producers. At the same time, the provision of a basic income payment to all farmers ensures the basic provision of public goods throughout Europe, by encouraging them to stay in farming.*"

The brief pictures the current status of the policy (Figure 6) as a combination of these three 'arms' of policy assistance or intervention.

Figure 6: The CAP structure and Future



Source: EC, 2009b.

It identifies three major questions as being central to the discussions of the future (p. 12), which frame the present agenda for further reform:

- "*How do we adjust the Single Payment Scheme for it to be generally perceived as fairer, while still maintaining the payment as a basic income support and as a warrant for the provision of public goods?*
- *How do we deal with market crises in the future? How do we ensure that intervention is used as a safety net, and is there a need for a new tool in order to contribute to the stability of farmers' income?*

And in rural development, how do we increase the effectiveness of the policy while ensuring balance between supporting increased competitiveness, environmental concerns, and wider rural economy challenges? And how do we best tackle the concerns related to climate change?"

Given that the European Commission sets the agenda for the reform discussions, and given, too, that the negotiations over the future of the European budget precede those about the CAP, the future level, pattern and distribution of the Single Farm Payments (and thus the split between the present Pillar 1 and Pillar 2 of the CAP) is central to the practical political debate. Furthermore, a leaked draft of the European Commission's Reform Agenda for the budget review, following an extensive consultation exercise *(European Commission, 2009c)*, is quite explicit about the intended budgetary constraints on the CAP. "*While it is too early to define the detailed contours or the exact intensity of the future reform of the CAP, it is clear that it should be driven by two objectives. First, it should resolutely pursue the modernisation of the CAP, enabling it to respond to new challenges and concentrating spending where it adds most value. Second, it must stimulate a further significant reduction in the overall shape of the EU Budget devoted to agriculture, freeing up spending for new EU Priorities*" (p17). This paper also suggests one possible response to this challenge (p 19): "*A larger responsibility of current CAP spending could be assigned to the member states, or direct aids could be co-financed by national contributions*."

In framing the debate over the CAP future in this way, the outgoing Commission is certainly reflecting the current state of the debate within the Farm Council. "*In broad terms, virtually all Member States appear to agree that the current distribution of 1st Pillar direct payments – varying from 500 €/ha in Greece to barely 100 €/ha in Latvia - is unfair, and therefore not justifiable in the longer term. However, there was also a strong feeling that direct support will continue to play a significant role in the future CAP*" *(AgraFacts, 2009)*. But it is not just the present distribution of direct payments which is unjustifiable, it is the very conception of general direct payments, as repeated disinterested analysis demonstrates. The future of the direct payments is at the heart of the debate about the future – as it has always been, in the sense that farm policy has always been about protecting and supporting farmers.

The simple fact is that farmers will loose substantially from the elimination of the support. Much of this loss will be suffered in the decline in their asset values, which, in most cases, constitute their pension funds or the base for their future business expansion, innovation, adaptation and resilience. Furthermore, the continued uncertainty about the future of the present policy, encapsulated in the current debates about the future of the CAP post 2013, adds to the difficulties faced by producers. They cannot be sure of the value of their assets, or of the appropriate prices to pay for acquisition or lease of additional assets for expansion. Future business conditions depend, critically for many farms, on the level of support. Since this is under continual pressure, both from within the EU and from trading partners, the policy itself generates considerable uncertainty about future conditions. In short, farming has developed so that farmers cannot live without support, yet the support does not deliver the proximate objectives – to improve farm incomes and maintain farm employment. Worse, the continued pressure on the future of support adds to the uncertainty farmers face in making their strategic decisions.

The political economy of SFPs has two important and inter-related aspects: the impact of the present SFPs on farm business performance and perceptions of future farm business viability; the distribution of EU support over regions and member states. Firstly, we can expect (and already observe) strong calls for the continuation of SFPs on the grounds of 'market failures' and more general socio-economic and sustainability objectives, both from farmers themselves and from their political supporters and dependents. The range of possible objectives to 'justify' continued direct payments expands by the day. But, secondly, these interests in continuing the direct payments are also translated into 'national' (member state) interests in seeking to preserve the present intra-EU distribution of these payments. *Olper (2008)* argues that one of the reasons behind the success of the 2003 CAP Reform was the fact that the reform implied very little reallocation of support across member states, or even across farms.

If member states persist in defending what they see as their 'national interest' in the present distribution of these payments, it is difficult to foresee anything other than modest reform towards more standardised EU rates per hectare, likely differentiated by agro-ecological region, and perhaps limited to some maximum per account holder. Attempts to 'target' this continued assistance by extending and enforcing the cross-compliance provisions under the heading good agricultural and environmental condition (GAEC) are likely to confound the Commission's clear intention to 'simplify' the CAP. In addition, tighter cross-compliance and targeting necessarily imply substantial redistribution of the support between farms and regions, since there is no reason to suppose that historic levels of commodity coupled support (the basis for the present distribution of SFP) reflect the 'new' reasons and associated targets for this support.

On these grounds, any radical reform of the SFP system, including its progressive elimination via continually increasing the modulation of the payments to Pillar 2, is unlikely. Analytically, the future involves adjusting the current farm, regional and hence national pattern of payments so as to minimize changes in national distributions of the budget allocation while maximizing a weighted expression in likely political support. Given the Commission's commitment to simplifying the CAP, and its declared intention to make the present system 'fairer', an obvious starting point is a single flat rate per hectare across the whole Union. Achieving agreement might then involve adjusting this simple system towards segmented rates for different regions, farm types and sizes so as to secure sufficient support in both the Farm Council and the European Parliament.

However, as soon as the negotiations move towards differentiated rates, the arguments about why we are making the payments necessarily come to the fore. Virtually all of the academic and professional assessments of the SFP, which consider the possible arguments for these payments, conclude that the system is both ineffective and inefficient – *there is no sound reason for their continuation. So, how might these different perspectives be reconciled?*

The tendency of the political system to preserve the *status quo* reflects the dependencies which the policy history has generated *(Harvey, 2004)*. Reforming the policy depends on 'weaning' the interested parties (farmers, their political representatives and the administrative bureaucracy) from this dependence. The common perception is that many farms would be bankrupted by elimination of the SFP support. As a consequence, it is usually argued that any proposal to do so must involve progressive and gradual change, rather than abrupt reform. One interpretation of the Commission's strategy (presuming there is one) for the reform of the CAP is that it has been progressively shifting the perceptions of European farmers towards a largely unsupported future. Conversion of support to direct payments, and subsequent incorporation into the SFP has focused attention on what the European taxpayer is supposed to be getting for this spending. As a result, it could be argued, many farmers are already aware of the pressures to reduce this spending and are already anticipating the eventual elimination of the SFP, or (at least) substantial conditioning of these payments on the basis of provision of public goods and services. If so, then it may become possible to actually eliminate the payments in due course, without raising irresistible opposition. On the other hand, this increased awareness of the pressures on SFP can also be expected to increase farmers' (and their representatives') actions and efforts to resist the pressure and preserve the payments.

The EU's support of the farm sector has progressively 'simplified' farm support into the present single farm payment – albeit still suffering from considerable disparities across the Union. The next political step is simply to agree a new, simpler and more common set of single farm payments – which is what the negotiations on the CAP post 2013 are likely to produce, rather than any radical change such as progressive elimination. There are, essentially two critical issues which prevent such a 'radical' change: the farmers' legitimate concerns about whether or not they can possibly survive without ongoing support; public concerns about what the countryside and rural economies would look like in a world without support for farmers. Neither or these questions can be answered persuasively without actually seeing what such a world would look like. So both generate more than sufficient room for doubt and debate to a) substantially discourage our political system from risking such a change; b) encourage all sorts of propositions as to what might happen which can then be used to justify continued payments to avoid these market failure outcomes.

There is a potential resolution to this paradox: the CAP Bond *(Swinbank & Tranter, 2004* provide the most detailed explanation and analysis). The next logical step is to roll up whatever future stream of direct payments can be agreed into a single, lump sum, once-and-for-all payment to existing farmers. Providing adjustment assistance as a single lump sum, bond issue to farmers would both compensate them properly for the elimination of support, and give them a basis on which to make the most appropriate adjustments to cope with an unsupported world. At least some would be expected to adjust rather quickly, and in so doing begin to generate effects on rural development and the countryside. As these effects become apparent, so it would become more obvious what, if anything, society (and its policies) need to do to correct the self-revealing market failures. Until and unless we try the market, we cannot be sure where and how the market will fail, and hence cannot sensibly design policies to correct the failures. Farmers would be no worse off with such a bond issue. They would be arguably much better off since their causes of uncertainty would be reduced, and their need for adjustment and adaptation better defined as the markets adjust. Society would be better off, since the support payments would finally be finite and time limited, and also since the emerging needs for new policies would be much better defined.

Who would loose from this policy change? Unfortunately, the big losers would be the politicians who currently depend on the 'agrarian' vote for their election, who would no longer be able to shelter under the socially destructive defence of continued and indefinite farm support. Of course, we might also expect 'countries' (i.e. Farm Ministers) to complain that the undoubtedly necessary re-distribution of present direct payments would be to some countries' disadvantage – in the sense that some countries' share of the agreed distribution of SFPs would decline, perhaps substantially, compared with the present. But we should not accept such simplistic arguments. If the farmers don't lose, and society gains, how can a country lose in any serious and sensible sense of the word? In any event, the finally agreed sums to be paid in the SFP are going to be substantially smaller than at present, and 'tiny' in national interest terms.

Conclusions

This paper reviewed the major options and opinions being advanced on the future of the CAP reform and developed a synthesizing framework able to serve as a basis for future research and analyses in the field. The evolutionary history of the CAP suggests that the popular perception that the CAP is both a dominant EU policy in budgetary terms, and also continues to be both generous and highly protective of European farmers is now both substantially misinformed and potentially *highly misleading* for EU politics. It is clear that past reforms of the CAP have generated *considerable dependency (Harvey, 2004)* amongst farmers and their political supporters on continued support.

This dependency can not be maintained in times when agriculture's economic contribution to society has declined substantially *(Swinnen, 2009)*. The declining role of agriculture over the world together with the *new challenges the CAP* faces has generated very substantial pressure for CAP reform. As a review of the ongoing CAP debate (*Jambor-Harvey*, 2010) makes clear, reform ideas address three major policy areas (policy pillars): *Food Markets; Rural Development; Environment*. However, as the review also reveals, there are no clear indications, other than targeted but otherwise largely undefined support, about what sensible policies for each of these three areas should look like. Much more thinking and research is needed under each of these headings.

We suggest that the present CAP is *not coherent, nor legitimate, nor sustainable*. Our framework suggests – strongly based on the literature review and the "Buckwell" report *EC (1997)* - that the future CAP should be *based on three pillars* (Food Market, Rural Development and Environment) in order to better target policies as well as to create a clearer distribution of different policy issues. This framework (Figure 4) also corresponds with the conventional notion of the critical aspects of sustainability (economic, social and environmental) as well as illustrating the influence of the four major institutional factors suggested by authors.

As to the policy response, our main point is that *direct payments should be totally phased out* as they are neither effective nor evenly distributed by farm sizes and by geographical locations. The very conception of general direct payments is unjustifiable, contrary to the view of the *European Commission (2009b)* about the future of CAP. Therefore, the authors argue that that the Buckwell Report's recommendation for transition adjustment assistance (TAA) should be both taken more seriously as the current grounds for the SFP, and re-enforced by converting the limited and finite stream of agreed payments per farm into a single, lump-sum, payment (*the CAP bond*). Such a single, once-and-for-all payment would provide farmers with a more secure capacity for the substantial adjustment and adaptation, which will be necessary for agriculture to meet future challenges. In addition, until markets begin to adapt and adjust to a less supported future, it will be impossible to determine what, if anything, the EU and Member State governments should be doing to encourage and facilitate rural development or conserve the rural environment. Without a clean break of the CAP bond, it is likely that the policy will continue to generate wasteful argument as well as unproductive instruments and assistance.

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