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policy brief

A chance for further CAP reform

By Christopher Haskins

> ★ The Common Agricultural Policy (CAP) accounts for around 40 per cent of the EU budget. There should be a reduction in overall CAP spending, with less going to farmers in western Europe and more to farmers in eastern Europe, as payments are equalised.
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> ★ If global food prices remain strong – which seems likely – the case for subsidising agricultural production will become increasingly irrelevant.
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> ★ Financial assistance should continue to be given to declining rural communities, especially in the east.
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> ★ There should be an increase in research into the impact of agriculture on climate change, and vice versa.

The CAP in its current shape expires in 2013, and negotiations to put its successor in place are underway. As the CAP accounts for around 40 per cent of current EU budget spending, the debate about future agricultural policy is a central part of the debate about the future EU budget, the Multiannual Financial Framework 2014-20, which the EU aims to agree in 2012. British critics argue that the CAP is a costly historic relic whilst the French claim that it remains a cornerstone of the EU's single market.

Initially the CAP, which was established by the Treaty of Rome in 1958, reflected France's position. Driven by the experience of chronic wartime and post-war food shortages, European governments, including Britain, were happy to provide generous subsidies to their farmers in order to raise domestic food production. It was no surprise that the founding fathers of the EEC would adopt such an approach. Furthermore, relatively free trade between the six original states in agricultural products was the first, symbolic step towards creating a much wider common market.

The original CAP was largely funded by Germany and was a sop to France, the main beneficiary. French farmers were concerned about their ability to compete against German farmers. In fact they coped pretty well. And the original case for the CAP has been overtaken by events. During the first 25 years of its existence the system got increasingly out of control as farmers, thanks to the subsidies, produced far more food than the market could absorb. The cost of storing, and worse still, dumping these surpluses on the world's market soared.

Eventually the situation was stabilised by the introduction of production caps on farmers. But the subsidies continued, as did tariffs on food imports. As a result, European consumers paid high prices for their food. Furthermore, the majority of the states who were members of GATT (later to become the World Trade Organisation) were keen to reduce barriers to trade, but the EU's protectionist agricultural policies became a serious obstacle to wider trade liberalisation.

Fischler's reforms

The reforms of the CAP introduced by Agriculture Commissioner Franz Fischler in 1999 and 2003, and due to be reviewed in 2013, have changed all this. They effectively ended a system based around high farm-gate prices achieved through import tariffs and direct market intervention by the Commission.

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Subsidies were decoupled from production and farmers were instead given income support in the form of a 'single farm payment' according to the size of their farms, just for being a farmer. Farmers in some member-states get considerably higher payments per hectare than farmers in other member-states. The EU average is €200 per hectare, but a Greek farmer gets €500 per hectare and a Latvian farmer only €100.[1] (Some direct interventions still apply when there is a crisis, but on a much reduced scale than was the case before.)

[1] *Reform the CAP, 'Fair competition on the internal market'. See http://www.reformthecap.eu/issues/policy-objectives/fair-competition.*

The EU is committed to the phasing out of market subsidies and to a substantial reduction in tariffs on food imports. Fischler's budget reforms also diverted funds away from farmers' incomes and towards the promotion of good environmental practices and rural development. By 2013 about 20 per cent of the agricultural budget will be allocated to these schemes.

So the CAP is much better than it was. It is less protectionist. It aspires to promote environmental sustainability. And it takes up a smaller share of the EU's budget (40 per cent of the total, down from over 60 per cent in 1990). The CAP continues to attract criticism from taxpayers, notably in Britain, because of its cost; from farmers because they do not believe it gives them sufficient protection from global competitors; and from environmentalists who do not think it does enough to protect wildlife and landscapes or to reduce greenhouse gas emissions. The days when the CAP underpinned the development of the single market have long since gone.

An unfinished agenda

So what is the state of EU agriculture today? What difference does the CAP make? What are the future prospects for farmers, and how should the CAP be reformed to satisfy the needs of consumers, farmers and environmentalists, where conflicting influences differ substantially from country to country? In Britain the consumers and the taxpayers make the most noise. In France (and Ireland) the farmers still rule the roost. The Germans remain rather quiescent.

The EU is broadly self-sufficient in food, with imports of non-indigenous food such as tropical fruit and out-of-season vegetables being offset by surpluses in some indigenous food sectors, notably cereals. (Tariff barriers continue to restrict imports of some foods, such as beef, from the Americas.)

Farmers' fortunes vary considerably, depending on soil and climate conditions, farm size, markets, labour availability, proximity and access to markets, and management skills. Large, well invested European cereal farms with fertile soil and favourable weather can prosper globally, especially when prices are high. Wheat prices per tonne rose from €75 to €240 between 2006 and 2010. But small livestock farmers cannot compete with New Zealand, Brazil and the United States. Farmers within the eurozone have been damaged by the strength of the currency whereas farmers in Britain have benefited from the weakness of the pound against the euro.

The accession of central and eastern European countries to the EU has had a major impact on discussions about the future of the CAP. Farmers in new member-states will not receive full CAP payments until 2013, and the Commission is now suggesting that there could be further transitional arrangements even after 2013.[2] Cereal farmers in the newer member-states in Central and Eastern Europe should do relatively well as they modernise their structures and apply existing science and technology. But it is difficult to see a viable future, with or without subsidies, for small, full-time farmers who have been unable or unwilling to diversify and modify their methods.

[2] *European Commission communication to the European Parliament and Council, 'The CAP towards 2020: Meeting the food, natural resources and territorial challenges of the future', November 2010.*

The value of farmland varies enormously across the European Union. If it is fertile and close to rich conurbations, it can be worth €10,000 to €15,000 euros per hectare. But if it is poor and in a remote region, it can be virtually worthless. Many farmers rent their land. This means that the asset-rich large farmers have the collateral to borrow and invest in modern technology, whilst smaller tenant farmers do not.

The present CAP is less reliant on distorting market interventions than before, and for that reason more acceptable to the WTO. When the last round of negotiations fell apart in 2008, the EU, for the first time, was not to blame. The Fischler reforms resulted in the taxpayer rather than the consumer paying the subsidies. This change benefits the low-paid non-taxpayer, and has brought some reduction in consumer food prices.

Nevertheless, many of the criticisms made of the CAP are valid:

★ It seeks vainly to maintain a status quo both in farm structures and rural society, holding back much needed reform rather than stimulating change.

★ The system designed to administer the single farm payment is complicated, costly and open to fraud.

★ The single farm payment encourages farmers to keep inappropriate land in production.

★ The system enables inefficient farmers to survive – though not to prosper. The difference in performance between the best and the worst farmers, comparing like with like, is extraordinary.

★ The policy seeks in vain to meet the multitudinous and varied needs of millions of farmers across the EU.

★ Much of the subsidy ends up with middlemen rather than bona fide farmers.

★ The system puts too much money into the hands of very large farmers.

★ The system is designed around full-time farmers, whereas an increasing and substantial proportion of farmers are now part-time, supplementing their incomes from other work.

★ The system inflates land values and makes it difficult for new farmers to enter the market.

★ The present arrangements offer farmers in the newer eastern members only half the benefits received in the established western countries.

Britain and France have been the main protagonists in this debate, because of their deep and long established ideological differences about trade and the role of the state in the economy. Ever since the repeal of the Corn Laws in 1846, Britain has been the world's champion of free trade.[3] France, on the other hand, has always had protectionist instincts. British Conservatives argue that state involvement in markets is wrong, whereas their French equivalents are quite relaxed about the issue. The CAP encapsulates these deep differences of approach. In addition, Britain receives relatively little benefit from the CAP while France, because of its substantial farming interests, is a significant beneficiary.

[3] *Import tariffs imposed to protect UK farmers from cheaper imports of grain. The Corn Laws were in force from 1815 to 1846.*

The fact that the UK was not a major beneficiary of the CAP was central to Margaret Thatcher's successful argument that there should be an annual UK rebate. This was introduced in 1984, and in 2010 was worth around £3 billion. Those arguing against the rebate, including the Commission, say that the CAP has fallen substantially as a proportion of total EU spending. Those arguing in favour of retaining the rebate say that this is because other spending streams, notably Cohesion Funds, have increased, not because agricultural spending has been cut.

The case for a smaller CAP budget

The main economic justification for an EU common agricultural policy is that, consistent with the rules of the single market, it offers all EU citizens secure and adequate supplies of affordable food. So, putting the case the other way round, would supplies of food be at risk if farmers did not receive financial support from the taxpayer?

If such action was taken precipitously and unilaterally (i.e. without comparable action by other large food producing countries especially in North America) some areas of European agriculture would contract in the short term, especially dairy and beef farming. But imports would fill any gap in the market without much difficulty. If there were a problem of supply, prices would rise and it would entice European farmers back into production. Interestingly, pig farmers receive no support from the CAP but they survive.

There is no food security problem in the EU, and nor would there be if subsidies were phased out. Furthermore, if support for farmers was run down in an orderly way and in conjunction with the United States, it is arguable that the industry's income would not be seriously damaged. Indeed, European agriculture might even benefit. Without the cushion of subsidies and protectionist barriers, farmers would have an incentive to tackle the extensive inefficiencies of their industry – too many small unproductive farms, inadequate investment because of a lack of collateral, and insufficient co-operation in reducing costs and strengthening market clout. The most inefficient farmers would probably go out of business (and should receive one-off compensation if need be). But the better farmers could further expand with all the benefits of scale – more capacity to invest, increased efficiency, more resilience when times are tough. Good small farmers would also survive by continuing to diversify and develop alternative sources of income.

Farming will always be a volatile business, and even though the CAP is designed to minimise such volatility, it has failed to do so. Small changes in supply can have a huge impact on prices, because of the idiosyncrasies of weather and movements in exchange rates across the globe. Most farmers understand this and build up their reserves in the good times in order to cope with the downturns.

It is politically unrealistic to propose that the CAP should be scrapped altogether, because of the strong vested interests in France and elsewhere. As with the banking system, the possibility of market failure in the food chain, however remote, would be catastrophic. But most EU members accept that agricultural policies need to be adjusted to today's changing circumstances.

Further reductions in market support

In order to complete the Fischler reforms, there should be further reductions to market support:

★ All tariffs on food imports into the EU should be phased out by 2023. This is a logical extension of the Fischler reforms.

★ The Commission should still, in exceptional circumstances, have the power to buy and store certain products such as butter, milk powder and beef – when market prices collapse because of freakish events, such as a food scare. However, the intention would be to dispose of stocks as soon as markets recover, not to dump them on markets as happened in the past.

★ No farm should be entitled to subsidy for more than 1,000 hectares of land. This would cap the subsidies claimed by very large landowners such as the UK Royal Family.

★ All restrictions on production (the main one being milk quotas) should be phased out.

★ Subsidies should only be paid directly to farmers. At present payments are frequently made to manufacturers – sugar, butter and milk powder processors. This results in a large amount of subsidy remaining in the hands of such middlemen, some of it fraudulently, rather than passing through to the intended beneficiaries. If product subsidies were eliminated, no taxpayers' money would get into the hands of middlemen.

Phasing out single farm payments

The aim should be to phase out the single farm payment by 2023. This is by far the largest component of the CAP – somewhere around three-quarters of the €43 billion total. However, the elimination of the single farm payment could only be achieved if, at the WTO, leading agricultural economies – particularly the United States and Canada – also agreed to phase out their direct payments to farmers. If global food prices remain high, as many forecasters believe, then the single farm payment becomes an irrelevant extravagance.

Farmers, being heavily reliant on the single farm payment, will ask how such a loss of income can be recouped. In part it cannot be, because the existing system condones and sustains inefficient farming practice. It is up to farmers themselves to address these problems, and other reforms should help them to do so, especially the abandonment of quota restraints. Subsidised dumping of products on world markets depress prices, so if these practices were stopped, prices would rise.

The spectacular difference in performance between the best and the worst farmers should be eroded as the less efficient realise that they either adopt the best practices of their more successful neighbours – or get out.

Structural reform of EU agriculture

Structural reform of European agriculture should be encouraged rather than opposed. Many pressure groups strongly resist any policy which advocates reform. But the trend towards fewer and larger farms has been continuous ever since the CAP was set up half a century ago, and the Canute-like refusal to recognise this reality has disadvantaged small farmers, whom the policy was intended to benefit. Some of these small farmers rely on subsidies for as much as 80 per cent of their income, and still find it hard to make ends meet. The children of farmers who in the past would have taken over from their parents now find more attractive sources of work elsewhere. The average age of Europe's small farmers is over 60, so if the present system remains there will be a shortage of farmers.

The CAP should address this problem head on by encouraging small farmers to expand and diversify, whilst providing support for those existing farmers who want to retire but cannot afford to. Part-time farming is widespread in western Europe, and should not be treated as if it were full time. But the CAP should provide incentives such as one-off grants to encourage small farmers to diversify. There are remarkable examples of success in this regard. Just outside Munich BMW has created a motor-cycle factory which enables many of its employees to continue as part-time farmers.

A growing proportion of the CAP budget is committed to encouraging farmers to enhance biodiversity in the way they manage their land. The aspiration is laudable, but reviews, such as the one published by the European Environment Agency in 2010, indicate that these subsidies may not be effective in meeting their environmental objectives.[4] The payments should therefore be reviewed.

4 European Environment Agency, 'Ten messages for 2010 – agricultural ecosystems', June 2010.

Farmers have been encouraged to grow crops which can be converted into biofuel. But there are two concerns about this. First, they may not be contributing to the reduction of greenhouse gas emissions, and secondly it seems inappropriate to convert land from food production to energy crops when world food prices are soaring and supplies are tight. Support for renewable energy crops should be reviewed.

The Fischler reforms also directed a significant portion of the agricultural budget towards encouraging the rural economy to diversify and become less dependent on farming. This strategy also needs to be reviewed, because of the very different circumstances which exist in rural communities across the EU. If they are within easy reach of thriving conurbations they should be able to benefit from such proximity. But if they are remote from alternative economic activity, there is a good case for taxpayer support. However, most of this should be provided by national governments rather than the EU. The CAP budget should concentrate on rural development in the newer member-states, where agrarian reform has been especially limited. This would effectively be a fiscal transfer from the richer to the poorer countries.

Farmers in the newer member-states have yet to qualify for the full level of subsidy provided to farmers in the longer established members. Under current plans, they will not do so until 2013. The differential should now be eliminated. This would be possible even while the overall CAP budget was being reduced, so long as it was coupled with the phasing out of single farm payments.

The Malthusian conundrum

These proposed reforms primarily relate to the existing circumstances affecting European agriculture. But during the next 15 years, two new factors – growing demand and climate change – will begin to have a profound impact on global food production and may even render the CAP redundant.

It is possible that for the first time since the second world war farmers will struggle to meet the rising demand for food from a growing and more affluent global population. In 2007 and again in 2010 a number of harvest failures across the world reduced food production, causing shortages and soaring prices for most agricultural commodities. Some countries banned exports in order to keep domestic prices down. This may well be a sign of things to come.

Over the next 40 years the world's population is set to grow by about 40 per cent, to 9 billion. More affluent people eat more food – in particular more meat – which puts even more pressure on resources because animals are very inefficient at converting cereals into meat. It may be necessary to double global food production to meet this demand.

Yet yield increases per hectare, which rose dramatically in the years following the second world war as a result of the 'green' scientific revolution, and which produced global food surpluses, appear to have peaked in the last 20 years. Yield per hectare has stopped increasing partly because regulations have been introduced (especially within the EU) to stop the environmental and health damage arising from the irresponsible misapplication of some of this science. The use of dangerous chemicals has been suppressed and the excessive use of oil-based fertiliser has been restricted. Another reason why yield per hectare has stopped increasing is that support for agricultural research has been reduced. Pressure groups have successfully persuaded governments to discourage critical research work, notably on the development of genetically modified foods.

The second factor which is likely to have a significant impact on global food production over the next 15 years is climate change. Global warming is already beginning to turn fertile regions such as southern Spain into desert, but will also enable farmers in more northern colder areas such as Britain to grow a wider range of crops as temperatures rise. Low level fertile deltas in Bangladesh, Egypt and China are in danger of being overwhelmed by the sea.

All of this could put a severe strain on the capacity of the world to produce enough food unless governments respond appropriately. The European Union should therefore substantially raise its investment in agricultural research, to improve yields, to develop plants which can cope with the extremes of flood and drought, and to enable its farmers to grow more food. If this happens, Europe could well become a major source of food for other parts of the world struggling to cope with a combination of population growth and climate change. The Commission should organise collaborative agricultural research across the EU rather than leaving each country to go its own way.

A reformed CAP also needs to provide incentives and regulations to reduce the impact of agriculture on climate change. Farming is a significant contributor to greenhouse gas emissions. In 2009 a Commission report estimated that about 9 per cent of total EU greenhouse gas emissions came from agriculture.[5]

[5] *European Commission staff working document, 'The role of European agriculture in climate change mitigation', July 2009.*

The cultivation of land absorbs substantial quantities of energy. Crops become more productive through the application of oil based fertilisers and are protected from disease and predators by the extensive application of chemicals. Organic farmers campaign for the abandonment of these practices, but the crop yield from even the best organic farms is about a third lower than from chemically-treated fields, so if the use of agricultural chemicals was made illegal there would be chronic food shortages. Responsible scientific and technological research, including research and development of genetically modified pest-resistant, drought-resistant and salt-resistant crops, is key to addressing these problems. However, farmers must expect further regulation to curb excessive use of pesticides and fertilisers.

Current politics of the CAP reform debate

The Commission's 2010 communication on the post-2013 CAP essentially argued for only minor reform, thus reflecting the view of DG Agriculture rather than DGs Climate Action, Environment, Regional Development or Budget.[6] In the European Parliament, the European Peoples Party's position is similarly traditional and anti-reform. The Socialists and Liberals in the Parliament are calling for more substantial reform in order to promote public goods, including climate protection, biodiversity, employment creation and a reduction in regional disparities.

[6] *European Commission communication to the European Parliament and Council, 'The CAP towards 2020: Meeting the food, natural resources and territorial challenges of the future', November 2010.*

The French government is arguing for the preservation of a large CAP budget on the pretext of ensuring European food security, and wants some new subsidies for 'risk management'. France opposes the redistribution of subsidies, which would see western member-states getting less and eastern ones getting more. Germany's official position is also against significant change, but parts of the German government are tacitly hoping for reform, partly because of Germany's reliance on an open world trading system, which the current CAP undermines, and partly because of Germany's position as the largest net contributor to the EU budget.

Sweden, Denmark and the Netherlands favour significant CAP reform. So does the UK, which remains strongly opposed to any increase in CAP spending, and equally strongly in favour of the UK's annual rebate.

Fluctuating exchange rates contribute as much to the volatility of food prices as do the vagaries of the weather. Perversely farmers prosper when their national currency is weak. The dollar/euro rate has gyrated up and down in recent years. And within the EU the euro has been similarly volatile against the non-euro currencies, notably sterling. British farmers will have to live with this additional uncertainty because there is no possibility of Britain joining the eurozone in the foreseeable future.

The way to a better farm policy

Further reform of the CAP should be built around the radical changes introduced by Fischler, with a continued, gradual phasing out of direct subsidies. The objective must not be to eliminate the CAP altogether, as many politicians in Britain demand, but to make it more effective, more relevant to today's dramatically changing circumstances, fairer and better value for European taxpayers.

Will this happen? It seems unlikely, even though Obama is proposing severe cutbacks in support for farmers which, if successful, strengthens the case for reducing the EU farm budget. But the UK and France – the two main protagonists in the EU – continue to take intransigent positions. A presidential election in France in 2012 will ensure no change in that country's position ahead of that event. And the eurosceptics will insist that the British government continues to hold on to the rebate, even though a phasing out of the single farm payment and reduced overall CAP spending would undermine whatever justification there might have been for the deal negotiated by UK Prime Minister Margaret Thatcher 25 years ago.

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