EUROPEAN PARLIAMENT

DIRECTORATE-GENERAL FOR INTERNAL POLICIES

POLICY DEPARTMENT B
STRUCTURAL AND COHESION POLICIES

Agriculture and Rural Development

Culture and Education

Fisheries

Regional Development

Transport and Tourism

DIRECT PAYMENTS IN THE CAP POST 2013

NOTE

EN

2011

EUROPEAN PARLIAMENT

DIRECTORATE GENERAL FOR INTERNAL POLICIES

POLICY DEPARTMENT B: STRUCTURAL AND COHESION POLICIES

AGRICULTURE AND RURAL DEVELOPMENT

DIRECT PAYMENTS IN THE CAP POST 2013

NOTE

This document was requested by the European Parliament's Committee on Agriculture and Rural Development.

AUTHOR

Mr. Stefan TANGERMANN
Professor Emeritus, Department of Agricultural Economics and Rural Development, University of Göttingen, Germany

RESPONSIBLE ADMINISTRATOR

Mr. Felice ADINOLFI
Policy Department Structural and Cohesion Policies
European Parliament
B-1047 Brussels
E-mail: poldep-cohesion@europarl.europa.eu

EDITORIAL ASSISTANCE

Mrs Catherine MORVAN

LINGUISTIC VERSIONS

Original: EN.

ABOUT THE EDITOR

To contact the Policy Department or to subscribe to its monthly newsletter please write to: poldep-cohesion@europarl.europa.eu

Manuscript completed in January 2011.

This document is available on the Internet at:
http://www.europarl.europa.eu/studies

DISCLAIMER

DIRECTORATE GENERAL FOR INTERNAL POLICIES

POLICY DEPARTMENT B: STRUCTURAL AND COHESION POLICIES

AGRICULTURE AND RURAL DEVELOPMENT

DIRECT PAYMENTS IN THE CAP POST 2013

NOTE

Abstract

The Communication identifies crucial challenges, above all the need for EU agriculture to provide public goods. However, only limited changes to the CAP are proposed. Rather than making a determined move towards targeted measures, direct payments are supposed to continue forming the backbone of the support regime. The "greening component" cannot really improve the targeting of payments. Redistribution of payments across Member States may or may not enhance equity and will not improve the provision of public goods.

IP/B/AGRI/IC/2011_003 January 2011

PE 438.624 EN

CONTENTS

LIST OF ABBREVIATIONS

CAP	Common Agricultural Policy
DDA	Doha Development Agenda
GAEC	Good Agricultural and Environmental Conditions
SPS	Single Payment Scheme
WTO	World Trade Organization

INTRODUCTION

This briefing note responds to a request by the European Parliament's Committee on Agriculture and Rural Development, to assess the proposals regarding direct payments contained in the Communication of 18 November 2010 from the European Commission, entitled "The CAP towards 2020: Meeting the food, natural resources and territorial challenges of the future" (below referred to as the 'Communication'). The note begins with a few general comments on the reform strategy embodied in the Communication (Chapter I) before discussing the future role of direct payments as foreseen in the Communication (Chapter II). In Chapter II, the note responds to the specific questions raised in the technical specifications that have accompanied the European Parliament's request for this briefing note.

I. THE EC COMMUNICATION: ANOTHER CAP REFORM?

The Communication suggests that another reform of the Common Agricultural Policy (CAP) is needed to prepare EU agriculture for the challenges of the future, in the three dimensions of food security, environment and climate change, and territorial balance. There is no doubt that the challenges mentioned are real and serious. They relate to decisive characteristics of the conditions under which agriculture will have to operate in the future, at both the global level and in Europe. There is also no doubt that the CAP needs further changes in order to create a policy framework that allows Europe's agriculture to meet these challenges successfully.

However, one **additional challenge** is not mentioned explicitly in the Communication, though it transpires from much of its wording. This challenge is specific to the CAP and originates from its evolution in the past. As a result of CAP reforms in the 1990s and 2000s, direct payments have become the most important and visible feature of Europe's agricultural policy framework, making up for about two thirds of EU expenditure on the CAP. When direct payments were first introduced, they served to compensate farmers for cuts in support prices. At the time, no decision was made regarding the future of direct payments. Would they be granted forever? Once farmers had been given sufficient time for adjusting to the reformed policy and compensation was no longer needed, would direct payments continue to be made? If so, how would their purpose be defined? How would the level of payments then be determined, and how would they be distributed across farmers?

Without explicitly discussing this additional policy challenge, the Communication proposes a certain structure of the future direct payments regime and thereby implicitly responds, though in part still vaguely, to these questions: direct payments will remain a firm part of the CAP; their purpose is no longer to compensate farmers for past reforms, but to enable agriculture to meet the various challenges it will face in the future; and they will be redistributed across Member States and farmers so as to achieve more equity. In the absence of decisions on the budget for the CAP post 2013, there is, though, no suggestion regarding the future level of payments.

As far as changes to the current CAP are concerned, the **modifications of policy instruments** proposed in the Communication are rather limited. The more notable concrete changes proposed are introduction of a new "greening" component into the direct payments regime, a redistribution of payments across Member States, a few shifts of measures between Pillars 1 and 2, and inclusion of a "risk management toolkit" in Pillar 2. Thus, as far as concrete proposals regarding instrumentation of the CAP are concerned, the Communication is largely focused on direct payments. Whether such limited modifications amount to a "reform" of the CAP is a matter of definition.

While the challenges mentioned in the Communication are real and important, it can be doubted whether the policy proposals made are consistent responses to them. Under the heading of **food security** the Communication suggests that "the EU should be able to contribute to world food demand". If more production in Europe's agriculture is required to satisfy growing food demand, then rising market prices will signal that to farmers. Indeed, prices on world markets for food are expected to be significantly higher in the future than they were in the past (OECD-FAO, 2010). **There is no need to make direct payments** or provide any other policy support in order **to stimulate extra production in Europe**, nor will decoupled payments be expected to have that effect. To be sure, world food security will remain in a precarious state, in the sense that malnutrition will continue to prevail in many developing countries. However, in order to respond to this global challenge, poverty needs to be overcome in the countries concerned. More food production in Europe cannot make a contribution to that goal. On the contrary, it would make it more difficult for developing country agriculture to create income and employment opportunities.

As a response to uncertainty and volatility on agricultural markets, the risk management toolkit proposed in the Communication, if well constructed, would appear to be a consistent policy approach.

The Communication quite rightly stresses the importance of strengthening the competitiveness of EU agriculture. In this context it is important to keep in mind that enhancing the productivity of resource use in agriculture is key to improving competitiveness. Innovation based on research and development, education and training, effective advisory services and appropriate institutions serving agriculture, as well as continued structural change and well functioning land markets with low land prices are the major means of raising productivity, thus enhancing 'true' competitiveness. Granting aids to Europe's farmers, for example in the form of direct payments, may allow them to withstand international competition. However, such **'artificial' competitiveness keeps agriculture dependent on government payments** and thus perpetuates the need for policy support. There is very little, if anything, in terms of proposals for concrete measures in the Communication that promises to enhance 'true' competitiveness of EU agriculture.

Responding to the challenges in the area of the **environment and climate change** requires enabling agriculture to provide the respective public goods. Market forces will not achieve this, and hence this is an important responsibility of public policy. In order to be effective and efficient, policies responding to this challenge need to be highly targeted (OECD, 2007a). The extent and nature of contributions that agriculture can make to providing public goods such as landscapes, farmland biodiversity, climate stability and resilience to natural hazards, and the need to avoid negative impacts of agricultural practices, are highly variable from place to place. Moreover, the extra costs of providing these public goods depend crucially on the natural and economic conditions on the spot. In terms of the CAP's architecture, the **home for such targeted and location-specific policies is Pillar 2**. In order to provide a consistent response to the challenges regarding the environment and climate change, one would, therefore, have expected the Communication to propose a major shift of policies and resources towards Pillar 2. However, unfortunately that is not what the Communication does.

The same comment must be made regarding the response to the challenges in the area of **territorial balance**. By definition, policies thought to improve the territorial balance need to be location-specific. The contribution agriculture can potentially make to the vitality of rural areas very much depends on the economic and social conditions in the respective territory. In some areas, support to farmers can achieve very little, either because the economic performance of agriculture under market conditions is sufficiently strong or because agriculture has only minor significance. In other places, agriculture may make important contributions in terms of providing employment and generating incomes. Policies addressing the challenge of territorial balance, therefore, need to be specifically targeted and location-specific. From this perspective, too, a **shift of attention and resources towards Pillar 2 would appear to be imperative**. However, the Communication does not propose a reorientation in that direction.

In summary, the Communication identifies important challenges. However, the **limited policy adjustments proposed are not consistent with these challenges**. In spite of the emphasis the Communication quite rightly places on the need for better targeting, there is little in the way of concrete policy changes proposed that would result in an effectively more targeted policy. Instead, the primary focus on direct payments, and emphasis on the need to make them more understandable to taxpayers and citizens, conveys the impression that the major aim of the Communication is to develop a justification for making direct payments on a per hectare basis a permanent and politically sustainable feature of the CAP.

II. THE FUTURE ROLE OF DIRECT PAYMENTS

1. GENERAL APPROACH

1.1. Consistency with Objectives

Under the current structure of the CAP, direct aids play a central role. The Communication does not provide any information on which share in overall CAP expenditure the Commission would foresee for the future direct payments regime. However, it is probably safe to assume that direct payments are expected to continue playing a central role, and hence that they would also continue to account for the lion's share of expenditure on the CAP. Thus, to a large extent the objectives of the future CAP overall, as specified in Section 5 of the Communication, will also have to form the basis for the regime of direct payments.

When direct payments were first introduced in the CAP, their purpose was clearly defined. They served to **compensate farmers for a cut in support prices**. There is no doubt that this original role of direct payments was not only fully justified, but absolutely necessary. When a policy regime, be it in agriculture or in any other sector, is fundamentally reformed, then compensation of major negative impacts on individuals and businesses directly affected by the policy has to be a firm element of the reform strategy (OECD, 2006).

The flip side of that consideration, though, is that **compensation is not justified forever** (OECD, 2006). Farmers can be expected to adjust to the new policy framework, and the more time passes, the more of that adjustment will have taken place, and the less there is need for continued compensation. Thus, compensation for a policy reform is justified for some time, but can then be gradually reduced.

The Communication does not argue in any explicit way why direct payments (as opposed to other elements of the CAP) are needed in the future and **which specific purpose they are expected to serve**. It does, though, suggest that "decoupled direct payments provide today basic income support and support for basic public goods desired by European society". It also makes the point that "agricultural income [is] significantly lower (by an estimated 40% per working unit) than that in the rest of the economy". In a recent Agricultural Policy Perspectives Brief, the Commission (2011) has explained that logic more explicitly by suggesting that in a situation where **farm income is below that in other sectors**, providing income support to farmers, through direct payments, is a precondition for enabling them to **provide basic public goods** "by helping to ensure the longer term economic viability, and a smooth structural adjustment, of the farming sector". In other words, direct income payments are seen as serving two closely related purposes, to respond to low farm incomes and to support the provision of basic public goods.

Whether farm incomes are actually low is a matter of both conceptual definition and empirical measurement. The statistics typically cited in this context, and also referred to by the Commission, relate to income from agricultural activity per annual work unit, as compared to labour income in the rest of the economy. Agricultural income per work unit is not an appropriate indicator of standard of living as that depends on total household income of the family concerned (OECD, 2003a). If farm income support were to respond to equity concerns like other social policies, in particular if its purpose were to overcome unacceptably low standards of living in the farming community, then it would have to be based not on agricultural income per work unit but on overall incomes of farm households where income from other sources often complements agricultural income. From that perspective there is not much reason to provide general income support to agriculture in the EU as empirical research has shown that farm household income is not generally below incomes in other parts of society (OECD, 2003a).

However, the argument made by the Commission in support of direct payments is not focused on social equity but on functional concerns. It is argued that support is needed "to ensure the longer term economic viability, and a smooth structural adjustment, of the farming sector". Thus it would have to be shown that **viability of Europe's farming sector** would be threatened if direct payments were greatly reduced or even eliminated. In this regard it is not sufficient to look at the current share of direct payments in agricultural factor income, but it has to be considered that adjustments would take place if direct payments were reduced. Yet, even in studies that have considered some forms of adjustments, it is found that farm incomes would decline significantly if direct payments were removed altogether.

For example, the Scenar 2020-II study (Nowicki et al, 2009) finds that under the liberalisation scenario farm income in the EU-27 would decline by 15% more until 2020 than under the reference scenario.[1] While some part of that decline is due to liberalisation of border protection, the major part is due to the elimination of direct payments. However, in that study, farm income is defined as gross value added (revenue plus premiums minus variable costs). The impact on farm income shown in that study does, therefore, not reflect the impact that declining land prices, as resulting from the elimination of direct payments, have on income of tenant farmers. Thus, the net reduction of actual farm incomes would be less than what is shown in that study. What is important regarding the "basic public goods" provided by agriculture is what would happen to land use. In the Scenar 2020-II study it is found that elimination of the direct payments would make land use in the EU-27 decline by 5.5%.

Whether a decline in land use by that order of magnitude would fundamentally threaten the provision of "basic public goods" is debatable. More specifically, **it must be asked whether it is economically efficient and actually necessary to make direct payments to all farmers** in the EU in order to secure the provision of public goods. A good share of agriculture in the EU is economically viable without direct payments, as shown, for example, in Vrolijk et al (2010). A targeted policy would, therefore, not make generalised payments to all farmers in all parts of the EU, but focus on those cases where the public goods desired can be provided only when specific payments are made.

In that context, it would also be advisable to discuss the **concept of "basic public goods"** to be provided by agriculture. The Commission (2011) makes a distinction between "basic public goods", to be supported through general direct payments to all farmers, and "more specific public goods" to be supported through rural development measures. The Commission (2011) identifies "basic public goods" with "agricultural land management throughout Europe", and argues that it is the precondition for the ability of agriculture to provide the "more specific public goods". However, from that perspective it should be sufficient to make sure that the targeted payments made to support the provision of specific public goods are adequate to generate the economic incentives to supply them, in the places where these public goods are actually needed.

[1] In the reference scenario, farm income in the EU 27 is found to decline by 7% until 2020, while under the liberalisation scenario it would decline by 22%.

However, the concept of "basic public goods" could potentially also be defined so as to include not only the ability to provide "more specific public goods" under Pillar 2 measures, but also certain general contributions agriculture is expected to make towards the objectives of the CAP. For example, food security could be seen as a basic public good. The mention, in the Communication, of low farm incomes in Section 3.1 on food security might suggest that direct payments are supposed to make a contribution to attaining food security. However, it has to be pointed out that the payments are decoupled and that the EU argues, vis-à-vis trading partners in the WTO, that they have essentially no impact on production.

Similar points could be made regarding other objectives that could possibly be pursued through direct payments, and in particular regarding the provision of public goods. Direct payments to all farmers in the EU, granted on a per hectare basis, are a blunt instrument that is not capable of making efficient contributions to attaining specific objectives and to providing the public goods Europe's society expects from agriculture. Policy instruments need to be much more targeted in order to be both consistent with objectives and economically efficient (OECD, 2007a). If the EU aims at a more targeted policy for agriculture, direct payments should not form the backbone of the CAP.

1.2. Flexibility for Member States

Within the overall structure of the CAP, certain measures should deal with EU-wide objectives and concerns, while other measures need to be specifically targeted to the widely variable conditions in individual Member States and their territories. The implementation of these two categories of measures should also be clearly aligned with their different character. Measures focusing on EU-wide matters are best implemented in a fairly uniform manner across the EU, while much flexibility in responding to differentiated needs and conditions is required when it comes to instruments dealing with specific issues in the individual Member States. For example, market policy is an EU matter because producers and consumers should, in the interest of economic efficiency, be allowed to compete freely across the whole of the EU territory. In consequence, market policy must be pursued at the EU level, in a uniform manner for the whole of the EU. In contrast, dealing with specific local habitats is best performed in a highly disaggregate matter, and much flexibility for the Member States is needed in this area.

As argued in the preceding Section, **generalised per hectare payments** granted to all EU farmers, in amounts decided at the European level, **cannot do a good job in targeting specific objectives** of the CAP, nor in providing public goods that are typically tied to local conditions. Thus direct payments per hectare should be considered an EU-wide policy, even though they may be paid at differing rates in different Member States. It is also worth considering the general advice that there should be a close relationship between the levels of decision making, financing and implementation of policies (OECD, 2005). Thus, the fact that direct payments are financed from the common EU budget also speaks in favour of implementing them in fairly uniform manner across the whole of the EU.

Flexibility for Member States in implementing direct support would, though, appear to make sense where given components of the overall regime of direct payments are focused on more specific territorial conditions, such as additional support to farmers operating in areas with specific natural constraints. These components of direct payments will be discussed below.

1.3. Definition of "Active Farmers"

The proposal of targeting support to "active farmers" may appear to deal with a marginal problem. However, it touches upon a number of issues that are central to the question of whether direct payments are consistent with their objectives.

In the public debate, different dividing lines are drawn between "active farmers" and other potential recipients of support. One criterion is the nature of land use, for either agricultural or other activities (e.g. golf courses). Another distinction is that between farmers working the land and absent landowners. Still other criteria relate to the size of holding ('super large' versus 'normal' farms), the nature of business ('industrial' or agricultural) or the level of income (the 'Queen of England' issue). According to the legal provisions currently governing the implementation of direct payments, Member States may establish criteria "to ensure that no direct payments are granted to a natural or legal person: (a) whose agricultural activities form only an insignificant part of its overall economic activities; or (b) whose principal business or company objects do not consist of exercising an agricultural activity" (Article 28(2) of Council Regulation (EC) N° 73/2009). An 'agricultural activity' is defined as "the production, rearing or growing of agricultural products including harvesting, milking, breeding animals and keeping animals for farming purposes, or maintaining the land in good agricultural and environmental condition" (Article 2(c) of Council Regulation (EC) N° 73/2009).

If **agricultural activity** (versus golf courses and other non-agricultural activities) were to be made the basis of payments, then it is not clear whether that is consistent with objective 2 suggested in the Communication ("sustainable management of natural resources and climate action"). Not only agriculture, but also other forms of land use (for example growing trees on former agricultural land) can provide environmental public goods and contribute to mitigating climate change.

The **distinction between working farmers and absent landowners** is largely futile when it comes to agricultural support. Support is always more or less capitalised in land values, and that is particularly true for direct payments (OECD, 2007b; Ciaian et al, 2010). As payments are made on a per hectare basis, recipients can and will pay more per hectare acquired, be it through purchase or renting. Thus price formation on the land market means that a significant share of the payments ends up with landowners. Tenant farmers derive little or no benefit from direct payments. The share of agricultural area farmed by tenants varies across Member States, between about 20% and 80%, and averages about 40% in the EU-27 (EUROSTAT, 2009).

Thus, there are limits to what direct payments can achieve in terms of contributing to farm incomes, at least if 'farm incomes' are meant to be the incomes of farm operators. No definition of "active farmers" will overcome that. This casts doubts on the consistency of direct payments with the farm incomes element of objective 1 mentioned in the Communication ("viable food production"). It also raises questions regarding the ability of direct payments to contribute to a "balanced territorial development". In many cases, landowners not actively farming don't live in rural communities, but in cities. Some part of the direct payments will therefore always unavoidably flow out of rural areas.

If "active farmers" were to be defined such that **'super large' farms were excluded** from receiving support, then it must be asked whether that is consistent with the supposed function of direct payments as stimulating the provision of environmental and other public goods: there is no reason to assume that very large farms cannot provide public goods (at least) as well as smaller ones. The same must be said regarding the justification of using the nature of business ('industrial' versus agricultural) or the income of the recipient ('Queen of England' issue) as criteria for defining "active farmers".

1.4. Definition and Treatment of Small Farmers

The Communication is silent on the definition of "small farmers" supposed to benefit from a "simple and specific support scheme". That definition, and the overall assessment of this proposed feature of the direct payment regime, must depend on the justification of special treatment for small farmers.

The Communication provides two justifications. First, the small farmer scheme is expected to "enhance the competitiveness and the contribution to the vitality of rural areas". This must probably be interpreted as meaning that the scheme would aim at **providing small farmers with more support** than would be the case if they were to receive the same per hectare payment as larger farms. More public support to a farm does not improve its true competitiveness in the sense defined above. Also, providing extra benefits to small farmers slows down structural change and impedes progress towards better competitiveness of the agricultural sector overall. In the longer term, such specific support to small farmers is therefore inconsistent with the competitiveness objective for the future CAP and with the objective of maintaining a strong contribution of agriculture to the economic well-being of rural areas. Even in the shorter term perspective, it must be questioned whether providing specific support to small farmers will really contribute to the vitality of rural areas. Many individuals working on a 'small' farm do so on a part time basis and derive the majority of their income from non-agricultural activities. Their contribution to the vitality of rural areas does not depend on receiving more support per hectare than larger farms. Thus, this justification is neither convincing, nor does it lend itself as a basis for defining a "small" farmer.

The second justification suggested, i.e. "to cut the red tape", is more persuasive. From an efficiency perspective, the **transaction cost per farm** of implementing direct payments, born by both the farmer and the public administration, should not exceed a reasonable share of the actual payment. Where that share is exceeded for payments below a given threshold, either of two approaches could be followed. One approach is to make the same total payment per farm to all farms below that threshold, irrespective of their actual size. Under this approach, the 'reasonable share' of transaction costs in the payment is achieved through making payments that are larger than they would otherwise be. This approach lacks logic as in order to maintain a reasonable cost/payment relation, public expenditure is raised rather than administrative cost reduced.[2] The second approach, then, is to simplify administrative and other requirements for small farms so as to reduce costs. The simplification would have to come in the form of less, or no, requirements regarding cross compliance and any "greening" component of the payments. This would in effect mean that small farms are not required to contribute to the provision of public goods covered by cross compliance and the "greening" component – a somewhat questionable implication which may, though, be justified on the grounds of saving transaction costs. Simplification could, in addition, come in the form of allowing small farms to submit a new payment application only once in five years.

[2] The only administrative cost saved under this approach is the identification of the number of hectares for the individual farm – a small share of the overall costs. Moreover, it would still be necessary to monitor farm size so as to verify whether the farm actually qualifies as "small".

With this in mind it would appear logical to **define "small farms" on the basis of the amount of payment** below which the fixed transaction costs per farm appear no longer 'reasonable' relative to the payment made. What 'reasonable' means in this context is a matter of judgement, but a range of ten to twenty percent of the share of transaction costs in the payment per farm might appear plausible. Once that threshold share is decided, it is an empirical matter to determine the amount of payment below which a farm is to be considered "small". It should, though, be noted that under this approach "small" farms would still receive the same payment per hectare as larger farms, but they would be relieved of some or all requirements to be met by larger farms. Another issue is whether payments below a given minimum threshold (lower than the "small farm" threshold) should be made at all because the remaining administrative costs for such very small payments may simply not be justified.[3]

If payments to small farms come with less conditions attached and with applications for a five year period it would make sense to pay the full five year amount already in the first year. Not only would this save administrative cost. It would also facilitate structural adjustment as recipients could use the larger sum to make investments, be they on the farm or in alternative employment. If this approach should cause budgetary problems, then an alternative form of implementation would be to hand certificates out to farmers that guarantee annual payments for the five year period. Recipients interested in a capital sum could then sell these certificates on the capital market, very much like government bonds.[4]

1.5. Impact on Supply

As none of the policy changes proposed in the Communication is quantified, it is impossible to provide a quantified estimate of the impacts such changes might have on any variable, including agricultural supply. However, the majority of the direct payments under the Communication's proposals would remain decoupled from production, and would therefore be expected to continue to have an only minor impact on supply. This implies that any changes to the nature and amount of these payments would have only very small effects on supply (as long as payments remain decoupled). For example, the Scenar 2020-II study (Nowicki et al, 2009) finds that complete removal of all direct payments would reduce overall agri-food production in the EU-27 in the year 2010 by no more than 0.25% relative to the reference scenario.[5]

The only somewhat more pronounced impacts on supply could conceivably result if the voluntary coupled support proposed in the Communication were to become a larger element of the overall direct payments regime than the coupled payments that are currently granted. However, the Annex to the Communication suggests that the voluntary coupled support component "would be equivalent to today's coupled support paid through Article 68 and other coupled aid measures". Thus even this element of the Communication would not have any noticeable impact on overall agricultural supply in the EU.

---

3 Under current rules, Member States shall not make payments where the amount to be paid is less than EUR 100 or the farm's eligible area is less than one hectare (Article 28(1) of Council Regulation (EC) N° 73/2009).

4 This form of implementation would have some similarity to the bond scheme earlier proposed by the present author (Tangermann, 1991). For empirical research on the implications of a bond scheme, see Swinbank and Tranter (2004).

5 Under the reference scenario in the Scenar 2020-II study, direct payments would decrease by 30% in nominal terms until the year 2020. As far as the impact of direct payments is concerned, there is nearly no difference in overall agri-food production between that reference scenario and the "conservative CAP" scenario, under which direct payments would decrease by only 15% in nominal terms until the year 2020.

1.6. Compatibility with WTO Green Box Criteria

The decoupled payments of the current Single Payment Scheme (SPS) are notified to the WTO as falling under the Green Box, and it is generally assumed in the EU that this can continue in the future. However, some authors have pointed out that doubts could potentially be raised regarding the compatibility of SPS payments with all criteria currently governing the Green Box. In particular, Swinbank and Tranter (2005) and Swinbank (2008) point out that payments are made to farmers, based on their agricultural area and on the cross-compliance requirement that the land be kept in good agricultural and environmental conditions (GAEC), and argue that this raises the question of whether the SPS fully meets all criteria of paragraph 6 of the Green Box, in particular the stipulation in paragraph 6(b) that "The amount of such payments in any given year shall not be related to, or based on, the factors of production employed in any year after the base period" (WTO, 1995).

With a view to changes proposed in the Communication, such **doubts may become even more relevant** if payment recipients are required to qualify as "active farmers" engaging in agricultural activities. More generally, the Communication's emphasis on food security, food production potential and food supply, in combination with the central role that direct payments play in the CAP, might be read as suggesting that direct payments are considered by the Commission to be necessary in order to maintain the EU's agricultural production potential – which could raise questions regarding their compatibility with the general Green Box requirement that support has "no, or at most minimal, … effects on production" (WTO, 1995).

The "greening" component of direct payments would at first glance appear to be unproblematic in Green Box terms, given that this payment component would remain decoupled and, moreover, become subject to environmental criteria. However, regarding actions that might qualify for the "greening" component, the Communication provides two examples that would appear to have a clear relation to production, i.e. permanent pasture and crop rotation. Pasture is used to feed livestock, and crop rotation is relevant only where crops are produced. If requirements like these two examples are attached to the "greening" component, then it could potentially be argued that they **undermine the decoupled nature**, not only of the "greening" component, but also of the basic income support component of the direct payments (after all, both components are related to the same hectare).

The additional support to farmers "in areas with specific natural constraints" would most likely be compatible with current Green Box criteria if it were to be implemented like the current SPS payments, including complete decoupling from production. The same can be said regarding the support scheme for small farmers.

The ongoing WTO negotiations under the DDA may result in changes of some Green Box criteria. The nature of these changes may go in the direction of what is contained in the draft modalities tabled by the Chair of the agricultural negotiations in December 2008 (WTO, 2008). Regarding decoupled income support, the modifications envisaged relate to updating of the basis for payments. This could potentially be relevant for any changes made to the nature and level of current payments, including the redistribution of payments among Member States. However, without going into any detail, it would appear that the new provisions envisaged in the draft modalities would not get in the way of making the changes to direct payments proposed in the Communication.[6]

[6] Moreover, a footnote in the draft modalities provides scope for the switch from the Single Area Payment Scheme to the SPS in the EU-12.

2. BASIC COMPONENT OF DIRECT PAYMENTS

Though the Communication does not indicate any quantitative weights, it can probably be assumed that the “basic income support” component of direct payments would form the largest part and cornerstone of the new direct payments regime. Regarding the specific implementation of this component, it appears that it would essentially be equivalent to the current SPS payments, except for being redistributed among Member States and regions, and being capped for large farms.

Only these two changes will be discussed here, given that general comments on the consistency, or lack of it, of general per hectare payments to all EU farmers with the objectives of the CAP have already been made above.

The **redistribution of direct payments among Member States** should, according to the Communication, follow two criteria, i.e. to fulfil the basic income function of direct payments, and to support the provision of public goods. If payments are redistributed in this way, they are expected to be more understandable to the taxpayer. There is also mention of the desirability of reaching an equitable distribution.

Whether a given distribution of public aids is considered equitable depends not on whether each recipient receives the same amount from the public purse, but on whether it is in line with relative needs. The need for income support depends on the actual income situation of the recipient. If a farmer with a high income receives the same payment as a farmer with a low income, equity is not achieved. Thus, in order to become really equitable, the basic component of direct payments (and possibly also the “greening component”, though it is supposed to address different goals) would have to be distributed on the basis of a means test of all potential recipients. This is obviously not intended as the payments will continue to be made, it must be assumed, on a per hectare basis. As that is the case, and in the absence of a distribution key related in some way to actual farm income, there is no reason to assume that any given distribution across Member States is fundamentally more equitable than any other distribution.

The public goods objective, unfortunately, also does not lend itself as a basis for determining the most appropriate distribution across Member States. The extent to which agricultural activities can contribute to the provision of public goods, be they of environmental or any other character, depends on the natural, economic and social conditions on the spot. It therefore differs from place to place, within individual Member States and across Member States. Making the same payment to all hectares across the whole of the EU is as good or as bad as any other schematic distribution that is not based on an empirical analysis of the potential of contributing to the provision of public goods.

Thus it must be clearly said that the **distribution of payments across Member States**, as long as it is no longer based on the historical origin of the payments (as compensation for past CAP reforms), is **a purely political matter**. In the absence of willingness to target payments to empirically established criteria, **no economic advice can be given** regarding the ‘right’ distribution of direct payments across Member States. From a purely political perspective, if direct payments continue to play a central role in the CAP, then a more equal payment per hectare across all Member States than is currently the case may appear plausible.

The issue of establishing an **upper ceiling for payments to large individual farms** ("capping") is, in some regard, similar to the distribution issue. There is no reason to assume that owners or operators of large farms have systematically higher incomes than those of small farms. There are many small farms that are managed on a part-time basis, and some of the farmers concerned may earn high incomes outside agriculture. On the other hand, there are large farms operating under difficult natural or economic conditions (or being badly managed), and the respective farmers may have rather low incomes. Thus, the capping of direct payments may, in a purely political sense, solve the 'Queen of England' problem, but whether it results in an actually more equitable distribution of payments across recipients is impossible to say. **Only means testing could improve inter-personal equity** with certainty.

At the same time, the public goods argument for direct payments also does not speak in favour of capping. There is no reason to assume that small farms, by virtue of being small, have more potential for providing public goods than large farms.

Capping, though, has **negative implications for structural development** of agriculture. In a very immediate sense, there will be a tendency to split large farms up so they can escape the implications of capping. However, more important is the fact that capping distorts competition on the land market. This is a consequence of the relationship between direct payments and land prices. Based on the larger payment they will receive for extra hectares, farms below the capping threshold can pay a higher price for land, purchased or rented, than farms above that threshold. The capping threshold (upper ceiling for payments) will, therefore, act as a break on structural change in agriculture. It is for that reason that capping is not consistent with the objective of improving competitiveness of Europe's agriculture.

3. "GREENING" COMPONENT OF DIRECT PAYMENTS

3.1. Significance of the "Greening" Component

The "greening" component of direct payments is the **most novel element** of the whole Communication. In the absence of any quantitative indication it is not clear which weight this component is supposed to have in the future overall regime of direct payments. However, one probably has to assume that the "greening" component is expected to play a much more than marginal role. The Communication strongly emphasises the objective of sustainable management of natural resources and climate action, and the proposal overall is seen, and publicly promoted, as a major step towards a greener CAP. The new "greening" component of direct payments is the only concrete change to the CAP proposed in the Communication that points in this direction. The "greening" component is also obviously seen as an important means of improving the credibility of the CAP vis-à-vis citizens and taxpayers.

All of these considerations would lead one to assume that the "greening component" is expected to account for a significant share of the totality of future direct payments. As one can probably also assume that the overall budget for direct payments post 2013 will not be larger than it is currently, it follows that the **"greening" component would substitute** for some part, possibly a significant part, of the **current direct payments**, and hence that the basic component of direct payments would be significantly smaller than the current level of payments (in addition to the payments being redistributed across Member States).

This means, among others, that the impact of the future overall regime of direct payments in terms of providing income support would be smaller than what is currently the case, because **the "greening" component will generate less farm income**, per Euro spent, than the current SPS payments. This has to be expected in any case as the "greening" component will oblige farmers to engage in activities they have not been required to undertake under current SPS rules. Moreover, the Annex to the Communication suggests that the "greening" component would be "based on the supplementary costs for carrying out these [agri-environmental] actions". If one takes that literally, than the "greening" component would not add to farm incomes at all, because it is no higher than necessary to cover the cost of undertaking the respective agri-environmental actions.

3.2. Differentiation

Objectives relating to the environment, sustainable use of natural resources, biodiversity, management of the countryside, climate change etc., in short environmental objectives, can be pursued through various categories of instruments. The measures used under the current policy structure include mandatory standards in the regulatory baseline, requiring all farmers to respect certain norms, typically without financial compensation; cross-compliance requirements linked to direct payments, either reinforcing the regulatory baseline or establishing additional norms; agri-environmental measures under Pillar 2, providing payments to farmers who enter into contracts with the administration to deliver given environmental services; and purely national, regional or local measures of various kinds. Given such variety of instruments already available, the question is what a new additional instrument, in the form of the "greening" component, could potentially deliver that cannot yet be delivered by the existing instruments.

The answer to that question cannot be derived from new or specific objectives, because they could potentially be achieved through one, or a combination, of the measures already existing. The answer must rather be based on the effectiveness and/or efficiency of the specific instrumentation foreseen for the "greening" component, relative to the instrumentation of the measures already available. In that regard, though, the Communication does not provide much detailed information. It is, therefore, not really clear how this new component of direct payments would be implemented and to what extent, and in which way, it would be different from existing measures.

One possible interpretation is that the "greening" component might become relatively similar to the cross-compliance feature of the current SPS. In particular, the proposition that it should support "environmental measures applicable across the whole of the EU territory", that the actions required would be non-contractual and annual, and reference to the possibility of "enhancing certain elements of GAEC standards" might be read as suggesting that **the "greening" component could become some sort of a 'super cross compliance'**. If that is what the "greening" component is supposed to be, then at least two comments are in place.

First, it is not clear why a wholly new component of direct payments needs to be introduced, rather than revising, and possibly adding to, the requirements under current cross compliance rules. Second, it would be important to understand why the environmental issues to be covered by the "greening" component were not already included in the cross compliance requirements currently in force. Are they issues that are completely neglected under today's policy regime and therefore currently causing environmental problems that can no longer be accepted in the future?

However, the "greening" component may not have been conceived as a 'super cross compliance'. Indeed, another interpretation of the "greening" component is that it would have the function of **moving measures currently included in Pillar 2 into the realm of Pillar 1**. In particular, the agri-environmental actions mentioned in relation to the "greening" component are now covered by Axis 2 of Rural Development. From this perspective it looks like the purpose of proposing the introduction of the "greening" component is to shift the dividing line between the two pillars of the CAP. If that is the more appropriate interpretation of the "greening" component, again a few comments must be made.

First, it is not clear why the respective set of agri-environmental actions should be moved from Pillar 2 to Pillar 1 with its much different implications for decision making and financing. This move would be likely to create all sorts of 'technical' difficulties. For example, the intention to base payments under the "greening" component on the costs of carrying out the respective agri-environmental actions will be very difficult to implement. These costs will differ from place to place, depending on the natural and economic conditions in the respective territory. It is difficult to see how a general approach, covering the whole of the EU, can possibly be designed such that it is in line with this intention.

Second, it would be important to know whether a move of the respective measures from Pillar 2 to Pillar 1 would go along with an equivalent move of budgetary expenditure, and what that would mean for the overall budget available for the agri-environmental actions affected. Pillar 2 measures are co-financed while that is not the case under Pillar 1, which implies that the Member State contributions to the financing of the respective actions would no longer be available if the measures concerned were to be moved to Pillar 1. Under this interpretation it is also difficult to understand why actions that are currently undertaken on a contractual basis for several years should in future be of non-contractual and annual nature.

Third, given the Communication's emphasis on targeting direct payments to "active farmers", it would be interesting to know whether the current possibility of supporting agri-environmental actions undertaken by "other land managers" who are not farmers[7] would be excluded in the future. Fourth, it appears questionable whether the move of given agri-environmental actions from Pillar 2 to Pillar 1 can be expected to enhance the efficiency of delivering the respective public goods (see following Section).

Since **the "greening" component is neither convincing as some kind of a 'super cross compliance' nor as a means of shifting the dividing line between Pillars 1 and 2**, it may have been proposed in order to play some other functional role. However, the Communication does not explain how that role would be differentiated from the current policies under cross compliance and Pillar 2 (or from the regulatory baseline or purely national measures). Given the wide spectrum of different categories of agri-environmental policies already existing, it is not at all clear why another category should still be needed, and which role that category of measures is expected to play that cannot be played by any of the existing categories of measures. The purely political interest in **making direct payments "more understandable to the taxpayer" is not a sufficient reason** for introducing a new instrument that does not provide any functional advantages.

3.3. Efficiency of Delivering Public Goods

Environmental public goods can have widely differing geographical dimensions, ranging all the way from global to local. For example, mitigation of climate change is a global public good, while avoiding smell emissions is of local significance. In the literature on policy making in multi-level jurisdictions it has long been shown that alignment of the level of decision-making with the geographical dimension of the public good concerned is an important factor in achieving efficiency in the delivery of public goods, and this has also been shown for the case of agricultural policy pursuit in general (e.g. OECD, 2005) and the CAP in particular (e.g. Grethe, 2008; Tangermann, 2010).[8]

From this perspective it must be questioned whether inclusion of agri-environmental measures in the direct payments regime under the CAP is promising an efficient outcome. Many environmental public goods in agriculture are of a primarily national, regional or local nature, with an only limited significance at the level of the European Union. If measures designed to enhance the provision of such environmental goods with a more limited geographical dimension are made part of a policy that is pursued at the level of the European Union, this **cannot be seen as a policy structure that promises the best conceivable efficiency in delivering the respective public goods**. The "greening" component would, thus, not be an appropriate instrument to be used for supporting such agri-environmental measures.

It might, though, appear that agri-environmental actions pursuing the provision of environmental public goods of a European (if not global) dimension should indeed be covered by an EU-wide policy such as the proposed "greening" component. Actions to mitigate climate change, to preserve biodiversity or to maintain a landscape of European significance, and by implication NATURA 2000 measures, might thus appear to be

[7] Art. 39(2) of Council Regulation (EC) no. 1698/2005.

[8] Other considerations of relevance for the most efficient level of decision making are the homogeneity of preferences and scale economies, see the literature cited in OECD (2005) and Grethe (2008).

appropriately pursued through an instrument such as the "greening" component. However, even for such measures the "greening" component may not really be the most appropriate policy.

As an integral part of the future direct payments regime under the CAP, the "greening" component is proposed as a "mandatory" measure "supporting environmental measures applicable across the whole of the EU territory". Yet, the contributions that farms in the different parts of the EU can efficiently make to providing environmental public goods of an EU-wide significance differ from place to place, depending on the natural, social and economic conditions under which they operate. For example some farms in given regions may be particularly efficient in carbon sequestration, thus making a contribution to mitigating climate change. Other farms in different regions may be much better able to contribute to the preservation of biodiversity, given the particular habitat in which they operate. Thus, even though the provision of environmental public goods of EU-wide importance should be pursued at the EU level, the concrete measures adopted in the framework of that policy, and the budgetary expenditure related to them, should be targeted to those places where these public goods can be most efficiently delivered.[9] A mandatory direct payment made in all parts of the EU such as **the "greening" component will not be able to achieve this**.

Form a **political economy perspective**, an attempt at pursuing environmental policy through a measure that is financed at the EU level is likely to run into an additional problem. Given some degree of territorial differentiation that will be needed for any environmental policy, the "greening" component would probably be implemented such that a 'menu' of actions qualifying for this form of support will be established at the EU level. Member States can then choose those actions from the menu which they consider most appropriate for their territory. As the payments under the "greening" component will be financed out of the EU budget, without any national co-financing, Member State governments will feel under strong political pressure from their farm groups to make sure the 'money from Brussels' actually flows to them and provides the highest conceivable benefits. This may mean that the choice of actions chosen from the 'menu' for implementation of the "greening" component in the individual Member States is not primarily based on considerations regarding the most needed and effective agri-environmental policy, but on what promises the largest benefits to domestic farmers. An agri-environmental policy that is pursued as part of Pillar 2, where financing is shared between the EU and the respective Member State, is less prone to suffer from that problem.

Thus it must be said that **the "greening" component is not a compelling way of achieving a better targeting of support** through direct payments, contrary to what the Communication suggests. Pillar 2 of the CAP, allowing for a much higher degree of policy differentiation across Member States and regions is a more convincing home for targeted policies, promising better efficiency in the delivery of public goods.

[9] One (though not the only) approach to implementing a policy along such lines is to use an auctioning mechanism to identify the farms that can deliver the public good concerned most efficiently, see OECD (2007a).

4. PAYMENTS FOR 'AREAS WITH SPECIFIC NATURAL CONSTRAINTS'

The Communication's proposal to provide "an additional income support" to farmers in areas with specific natural constraints also raises the issue of the dividing line between Pillars 1 and 2 of the CAP. The Communication says that this element of the future direct payments regime should be "an area-based payment as a complement to the support given under the 2nd pillar". That wording can be read as suggesting that extra payments would be made to the farmers concerned, over and above the payments they anyhow receive under current Pillar 2. If that is the meaning of this proposal, then it is not clear why the current level of payments is considered insufficient. However, within the overall framework of the future CAP, it is also conceivable that the level of Pillar 2 payments to farmers operating in less favoured areas would be reduced when the new Pillar 1 payments to these farmers are introduced, thus shifting measures and resources from Pillar 2 to Pillar 1. If that is the more appropriate interpretation of this element in the Communication, then **it must be asked what that shift between the two pillars is expected to achieve**.

Moreover, in that second case fundamentally the same comments apply that have been made in the preceding section regarding a possible shift of agri-environmental measures from Pillar 2 to the "greening" component of direct payments. These comments don't need to be repeated here. Suffice it to say that political economy concerns should also be considered in relation to the design of policies regarding agriculture in less favoured areas. The more the payments to farmers in these areas are financed out of the EU budget, rather than being co-financed by the Member States, the stronger will be the interest of the individual Member States to have as large areas as possible included in the scheme.

5. LIMITED VOLUNTARY COUPLED SUPPORT

The element of coupled support included in the Communication, voluntary for the Member States and "within clearly defined limits", would appear to be similar to the element of coupled support under the current SPS, i.e. the so-called Article 68 measures. However, the respective wording of the Communication appears to suggest that a more limited set of objectives would be pursued. Also, the Communication proposals regarding a risk management toolkit under the Rural Development heading appear to suggest that the support to insurance premiums and mutual funds currently covered by Article 68 would be moved from Pillar 1 to Pillar 2.

From the perspective of economic efficiency, **not much positive can be said about any form of coupled support**. The coupled support element is, according to the Communication, thought "to take account of specific problems in certain regions where particular types of farming are considered particularly important for economic and/or social reasons". Yet, it is hard to think of any economic or social problem that can be solved exclusively through producing a particular agricultural product. The underlying conceptual issue is that of jointness between specific agricultural outputs and given public goods, much discussed in the context of the debate about multifunctionality of agriculture. The OECD has engaged in a comprehensive analysis of this issue and discussed the findings intensively in its inter-governmental setting.[10] One of the most important results was the finding that there are nearly no cases where production of a specific agricultural output is the most efficient way of providing the public good considered necessary.

To provide a concrete example, abandonment of land may be a threat in a given area with natural constraints. There may be good reasons to guard against that threat, for example to maintain a given valuable feature of the landscape. Avoiding land abandonment, then, is a public good, and in order to provide that public good, government action is required because the market will not achieve that. Thus there is no doubt that public support is needed and justified in that case. However, that does not mean that specific agricultural products must be produced. It is sufficient to make a payment to individuals who provide the service of keeping that land in specified good condition. These individuals may well decide to do so through agricultural production, based on market prices they can receive. But that **decision should indeed be left to those managing the land**, because that is the economically most efficient way of making sure that the land is not abandoned.

Moreover, it should also be considered that a given amount of payment to a farmer provides the more economic benefit the less it is coupled to any requirements. Specifically, a decoupled payment is more efficient in transferring income to the farmer than a payment requiring the farmer to engage in the production of a given agricultural output (OECD, 2008). This means that farmers receive a smaller income benefit from a payment that is provided in coupled form because policy makers believe that production of a specific agricultural output is desirable. In effect, the recipients of the coupled support are thus made to pay for providing the public good through a particular form of agricultural production that is considered, by policy makers, to be needed. In other words, spending some of the money that could be granted as a decoupled payment in the form of coupled support is **against the interests of the farmers concerned**.

[10] For a summary of the most important policy conclusions from the OECD's analysis of multifunctionality, see OECD (2003b).

These considerations suggest that it would be **preferable to eliminate the element of coupled support altogether** from the direct payments regime under the CAP. Where response to specific environmental concerns, preservation of landscapes or the provision of other public goods require public support, measures under Pillar 2 can be used in a targeted way. Article 68 measures must be seen in the light of their historical origin, closely related to the process of decoupling past payments from production. When the overall policy structure is now revised for the post 2013 period, it is time to align the individual policy instruments with the objectives pursued. In that process, response to the concerns for which Article 68 measures catered historically can and should now be transferred to Pillar 2.

CONCLUSIONS

The Communication identifies important challenges for EU agriculture. However, it proposes only limited changes to the CAP, primarily the introduction of a new “greening” component into the direct payments regime, a redistribution of payments across Member States, a few shifts of measures between Pillars 1 and 2, and inclusion of a “risk management toolkit” in Pillar 2. Whether such limited modifications amount to a “reform” of the CAP is a matter of definition. In any case, the changes proposed are not consistent with the challenges identified. In response to the challenge of food security, more needs to be done to raise productivity of EU agriculture, so as to enhance its ‘true’ competitiveness. The challenges regarding the environment, climate change and territorial balance call for more targeted policies and a shift of attention and resources from Pillar 1 to Pillar 2.

Though the Communication does not provide any quantitative indication, it appears that direct payments are supposed to continue forming the backbone of the CAP. The justification offered is that direct payments are needed as basic income support that enables agriculture to provide basic public goods in the form of agricultural land management throughout Europe. This is seen as a precondition for the ability of agriculture to provide the more specific public goods that would be supported through rural development measures. However, there is no reason to assume that public aids are needed in all of EU agriculture in order to keep land in agricultural use. Thus, generalised direct payments to all farmers are an inefficient way of making sure that basic public goods can be provided. Thus the Communication does not provide a convincing reason why direct payments should continue forming the backbone of the CAP.

The changes to the regime of direct payments proposed in the Communication aim at “redistribution, redesign and better targeting of support, to add value and quality in spending”. However, it is questionable whether the changes proposed can achieve these objectives.

The principal innovation proposed, i.e. introduction of a “greening component”, would either amount to some sort of a ‘super cross compliance’ or have the effect of shifting certain measures from Pillar 2 to Pillar 1. In both cases it would not improve the effectiveness and efficiency of the CAP. It is, therefore, not clear why this change in the structure of direct payments should be necessary. Better targeting of support requires a policy that is more directly focused on the provision of the individual public goods considered necessary. Given the wide variation in natural, economic and social conditions of agriculture across the territory of the EU, that policy has to be location-specific. Generalised per hectare payments to all farmers in the EU are far from being a targeted policy of that nature. Pillar 2 is the appropriate home for targeted measures.

If direct payments continue to form a central element of the CAP, then redistribution across Member States may be politically necessary. However, no economic advice can be given regarding the ‘right’ distribution. Equity of income support, in the sense of fair social conditions, can anyhow not be achieved by per hectare payments that are not based on a means test. Appropriate provision of public goods would require an empirical analysis of the potential of individual farms to provide the public goods in question.

“Capping” of payments to large farms is not a guarantee for more equity as farmers’ incomes do not necessarily depend on farm size in hectares. The supposed public goods function of direct payments would not be enhanced by “capping”. However, “capping” distorts competition for land among small and large farms and therefore has negative implications for structural development.

Specific payments to farmers in areas with specific natural constraints are currently well placed in Pillar 2 and it is not clear why they should also be made as part of the direct payments regime in Pillar 1.

Rather than providing scope for voluntary coupled support in the direct payments regime it would be preferable to terminate all coupled support. There are no good economic reasons for providing support only if given agricultural products are produced. Moreover, farm income is supported more effectively through payments that are decoupled from production.

A specific support scheme for small farmers should be focused on avoiding unreasonably high transaction costs relative to the amount of payment made.

Granting direct payments to “active farmers” only is not consistent with the supposed public goods function of the payments. It can also not avoid the leakage of some part of the payment benefits to landowners who do not themselves engage in farming.

Overall this note provides an assessment of the Communication that is less than enthusiastic. The reason is not so much that some of the individual elements proposed in the Communication could have been more convincing. The scepticism expressed here is of more fundamental nature and relates to the longer-term development of the CAP and the role direct payments play in that context. The Communication is focused on maintaining direct payments as the backbone of the CAP and fails to make the next step forward in the process of strategic CAP reform.

That process began in the early 1990s when price support was cut to improve market orientation of Europe’s agriculture. Introduction of direct payments at the time served an important purpose as farmers had to be compensated for the sudden loss in income. Market orientation was further enhanced when payments became decoupled in the early 2000s. The process of reducing support prices and decoupling support from production was a big step forward. It helped greatly to modernize EU agriculture and improve its competitiveness. It also earned the CAP much international recognition.

The next step now called for is to move from decoupling to targeting. EU agriculture is facing new challenges. To meet them it needs support that is not blunt but specific. Compensation for past price cuts is no longer necessary. What is of the essence now is targeted support, specifically tied to the public goods society expects agriculture to provide. Generalised per hectare payments are not targeted, whatever the name is one gives them or the side-conditions attached to them. It is time to enter into the next phase of strategic CAP reform and shift resources from direct payments to specifically targeted policies.

This is not to say that an immediate elimination of direct payments would be good policy. Policy design requires a degree of continuity, and gradual changes are preferable to overnight breaks in strategy. However, in order to be credible, gradual policy changes need to be announced early and with determination. Thus, in preparing the CAP for the future it would be preferable to embark now on a longer-term schedule of gradual decline in direct payments, rather than making attempts at constructing justifications for a policy that is not really consistent with its objectives.

REFERENCES

- Ciaian, P., D. Kancs and J.F.M. Swinnen (2010), *EU Land Markets and the Common Agricultural Policy*. Brussels: Centre for European Policy Studies.
- European Commission (2010), *The CAP towards 2020: Meeting the food, natural resources and territorial challenges of the future.* Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions. Document COM(2010) 672 final. Brussels: European Commission.
- European Commission, Agriculture and Rural Development (2011), *The future of CAP direct payments.* Agricultural Policy Perspectives, Brief no. 2. Brussels: European Commission.
- EUROSTAT (2009), *Tenure of the UAA following the sex of the holder in selected Member States (FSS 2007).* Last update 30/04/2009. Excel file provided at http://epp.eurostat.ec.europa.eu/portal/page/portal/agriculture/data/ad_hoc_tables_farm_structure_survey
- Grethe, H. (2008), *Agriculture Policy: What Roles for the EU and the Member States?* In: G. Gelauff, I. Grillo and A. Lejour (eds.), *Subsidiarity and Economic Reform in Europe.* Berlin, Heidelberg: Springer-Verlag
- Nowicki, P., V. Goba, A. Knierim, H. van Meijl, M. Banse, B. Delbaere, J. Helming, P. Hunke, K. Jansson, T. Jansson, L. Jones-Walters, V. Mikos, C. Sattler, N. Schlaefke, I. Terluin and D. Verhoog (2009), *Scenar 2020-II – Update of Analysis of Prospects in the Scenar 2020 Study.* – Contract No. 30–CE-0200286/00-21. European Commission, Directorate-General Agriculture and Rural Development, Brussels.
- OECD (2003a), *Farm household income: issues and policy responses*. Paris: OECD.
- OECD (2003b), *Multifunctionality: the policy implications.* Paris: OECD.
- OECD (2005), *Financing agricultural policies with particular reference to public goods and multifunctionality: which level of government?* AGR/CA/APM(2005)19/FINAL. Paris: OECD.
- OECD (2006), *The role of compensation in policy reform*. Document AGR/CA/APM/WP(2007)7. Paris: OECD.
- OECD (2007a), *Effective Targeting of Agricultural Policies: Best Practices for Policy Design and Implementation.* Paris: OECD.
- OECD (2007b), *Agricultural support, farm land values and sectoral adjustment; implications for policy reform*. Document AGR/CA/APM(2006)19/FINAL. Paris: OECD.
- OECD (2008), *Agricultural Policy Design and Implementation: A Synthesis.* Paris: OECD.
- OECD-FAO (2010), *OECD-FAO Agricultural Outlook 2010-2019*. Paris: OECD.
- Swinbank, A. (2008), *Potential WTO challenges to the CAP*. Canadian Journal of Agricultural Economics, Vol. 56, pp. 445-456.
- Swinbank, A., and R. Tranter (eds.) (2004), *A Bond Scheme for Common Agricultural Policy Reform.* Wallingford: CABI Publishing.

- Swinbank, A., and R. Tranter (2005), *Decoupling EU Farm Support: Does the New Single Payment Scheme Fit within the Green Box?* The Estey Centre Journal of International Law and Trade Policy, Vol. 6, pp. 47-61.
- Tangermann, S. (1991), *A Bond Scheme for Supporting Farm Incomes*. In: Marsh, J., B. Green, B. Kearney, L. Mahe, S. Tangermann and S. Tarditi, *The Changing Role of the Common Agricultural Policy. The Future of Farming in Europe*. London and New York: Belhaven Press, pp. 95-96.
- Tangermann, S. (2010), *EU-Agrarpolitik und Niedersachsen: Muss Brüssel alles entscheiden?* Vortragsabend der Akademie der Wissenschaften zu Göttingen im Niedersächsichen Landtag in Hannover, 1. Dezember 2009. In: Jahrbuch der Akademie der Wissenschaften zu Göttingen 2009, pp. 251-268.
- Vrolijk, H.C.J., C.J.A.M de Bont, P.W. Blokland and R.A.M.E. Soboh (2010), *Farm viability in the European Union: Assessment of the impact of changes in farm payments.* LEI report 2010-011. The Hague: LEI.
- WTO (1995), *The Results of the Uruguay Round of Multilateral Trade Negotiations. The Legal Texts*. Geneva: WTO.
- WTO (2008), *Revised Draft Modalities for Agriculture.* Committee on Agriculture, Special Session. Document TN/AG/W/4/Rev. 4, 6 December 2008. Geneva: WTO.

DIRECTORATE-GENERAL FOR INTERNAL POLICIES

POLICY DEPARTMENT B
STRUCTURAL AND COHESION POLICIES

Role

The Policy Departments are research units that provide specialised advice to committees, inter-parliamentary delegations and other parliamentary bodies.

Policy Areas

- Agriculture and Rural Development
- Culture and Education
- Fisheries
- Regional Development
- Transport and Tourism

Documents

Visit the European Parliament website: **http://www.europarl.europa.eu/studies**

PHOTO CREDIT: iStock International Inc., Photodisk, Phovoir