

European Landowners Organisation (ELO)

Full response to Commissioner Ciolos's Consultation on the post-2013 CAP

1. The ELO takes the view that a strong, well-funded CAP must continue to be a core policy of the EU to help Europe contribute to global food and environmental challenges.
2. We have been debating the future role of the CAP for many years. We spelled out our fundamental position in our 2008 paper 'The 21st Century Land Use Challenge', and followed this more recently this year with our joint paper with Bird Life International, 'Proposals for the Future CAP'. We suggest that the CAP, and the EU budget heading which funds it¹, have a critically important role to help the EU achieve and maintain **Food and Environmental Security**.
3. The agricultural and forest land management sectors and their related upstream and downstream activities are a dynamic part of the European economy. As the pressure on our land resources increase these sectors become more knowledge intensive, precision activities. The new paradigm is to see the enduring roles of food, forest and 'fuel or green chemistry' production as part of a broader ecosystem service function embracing biodiversity, cultural heritage, water and carbon management. Europe can provide a global role in discovering the precision land management, rural business structures and integrated rural policy instruments to deal with these complex challenges. This constitutes a very important contribution to the vision of smart, sustainable and inclusive growth which is at the core of the Commission's vision for Europe 2020.
4. ELO responded on-line to the Commission consultation, submitted on 3rd June a short six-page version of this paper, and on 10th June a two page version. All these versions are available on the ELO website www.elo.org However because of the complexity of the CAP and the arguments which surround it we felt it useful to explain our ideas at greater length. The structure follows the four questions posed by the Commissioner. We think that the Commissioner is absolutely right to start with these very broad questions. We urge him to engage fully with the European public to explain the answers. That European agriculture, is vitally important, it delivers food but it also delivers a great deal more, but that there are substantial market failures which justify collective European policy action to achieve Food and Environmental Security. The Commissioner's questions are:
 - i. ***What do citizens expect from agriculture?***
 - ii. ***Why do we need a Common agricultural policy?***
 - iii. ***Why reform the CAP?***
 - iv. ***What tools do we need for the CAP of tomorrow?***

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Which is most appropriately called the Preservation and Management of Natural Resources.

What do citizens expect from EU agriculture?

5. The view of the ELO is that European citizens expect essentially two sets of services from agriculture². First, they want a secure supply of affordable, high quality, nutritious food and other agricultural outputs which are used to produce a wide range of non-edible products including renewable energy, ornamentals, biodegradable plastics and pharmaceutical products. Second, in the process of producing these land based marketed products, Europe's farmers and other land managers also provide a wide range of other non-marketed services which citizens desire, namely: resource protection of water, soil and air, biodiversity, and cultural landscape and heritage. These services also underpin vital rural recreation and leisure activities. **In summary European citizens expect their land managers to provide them with Food and Environmental Security.**
6. Because of the necessarily fragmented and geographically dispersed nature of 'agriculture' based mostly on small, private, family businesses which is the dominant land-using activity in Europe's rural areas, and because it is the longest established activity there are also strong and important social and cultural dimensions to agriculture which citizens value highly and want to maintain. Furthermore, farming is key part of a highly developed food chain. As it has developed over the millennia, and particularly in the last two centuries, agriculture has also spawned a very important set of upstream and downstream connections to the industries which provide inputs – feeds, fertilisers, plant and machinery, crop and animal protection products, finance, legal and other professional services, advice and training – and the industries which deal with the produce – abattoirs, crop and livestock product selling and processing, transportation, storage and retailing. Likewise the food service sector has been a highly innovative growth sector in the economy. In addition, the very beauty, tranquillity and wide open spaces of the countryside provides the venue for a huge range of leisure, cultural, tourism and recreational activities. These provide further employment and income, but perhaps more importantly they provide critical physical and psychological health benefits for the population too.
7. Pulling the two sets of outputs, food and environmental services, together with this web of economic connections around farming and the social structures surrounding this whole rural activity, we can say that **citizens expect a sustainable agricultural system, or more broadly, sustainable rural communities.**

Why do we need a Common agricultural policy?

8. First we explain **why we need a policy at all for agriculture, and the countryside**. Then we explain why we strongly support the need for a Common European based policy.
9. There are six cogent reasons which, in combination, explain why it is not sufficient for government to sit back and let markets alone determine the

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Broad definition of agriculture. Bearing in mind the context of this paper which is about the future of the CAP and the fact that the CAP is already involved in a very wide range of land management activities, we include in the simple word of agriculture (or farming), **all** these activities including horticulture, woodland and forestry, recreational land management including hunting, and of course environmental, or nature, management. Our view is that most European farmers, or what we would term land managers or rural businesses, are involved in several of these activities going well beyond the usual narrow definition of agriculture.

quantities and prices of the complex mix of marketed and non-marketed services provided by agriculture. These unique characteristics of food, agriculture and the countryside mark the sector out as quite distinct from all other economic sectors, and thereby justify special policy treatment, i.e. an agricultural or rural policy. Agricultural exceptionalism lives!

10. **Necessities.** Food and the other eco-system services provided by our land managers are all necessities of life. Wise governance ensures that structures are in place to ensure their long-term security of supply. We explain more specifically the policy actions necessary to do this later in the paper. It is essentially by maintaining a healthy and resilient capacity for food and environmental service provision, and by enabling continued productivity growth to keep the sector competitive. Above all this means keeping agricultural land in good agricultural and environmental condition.
11. In addition, just because agriculture produces our food we have a great deal of regulation to ensure that it is safe to eat, the production methods are safe for farmers and their workers, they are safe for the environment and that we maintain high standards of animal health and welfare. Many of these issues are, rightly, incorporated into European Agricultural Policy, although many others are the responsibility of other parts of EU and national policy.
12. **Fragmented structure – and imperfect competition.** The agricultural sector comprises a very large number of micro businesses, and even the largest businesses are classified as SMEs. This has two critical consequences.
13. First whilst farming itself exhibits the characteristics of perfect competition, those with whom farmers deal are strong exhibitors of imperfect competition, in particular, oligopoly³. Farmers are price takers for the inputs they buy and produce they sell. The industries providing the most important inputs (fertilisers, crop protection and animal health products, and machinery) and processing and selling most of the produce (the food processing industry and food retailers) are amongst the most concentrated in our society. This severe imbalance in structures gives farmers the weakest bargaining position in the food chain. Farmers are therefore constantly exposed to risk of misuse, if not abuse, of the market power possessed by the other sectors, and as a consequence returns on capital in farming are consistently low, and certainly lower than the returns thought as 'normal' for the up-and down-stream sectors. Competition policy offers no practical relief to this problem because, as currently constituted it is designed to deal only with the impacts on final consumers offering little or nothing for suppliers. The crisis in the European milk sector has caused some examination of this issue and whether competition policy can and should be adapted to deal with this issue. Agricultural policy has an important role to provide help in dealing with it by assisting the creation and functioning of stronger primary producer controlled buying and selling organisations.
14. The second consequence of the small size of farm businesses concerns their capacity to provide the necessary risk management, this is considered next.
15. **Volatility.** Agriculture by its very nature is a biological process which is highly dependent upon uncontrollable natural forces of weather, climate change, pests and disease. This is in addition to the volatility of economic variables, prices, costs, interest and exchange rates which, of course, all businesses face.

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Oligopoly means competition amongst the few.

16. The importance of this factor for policy is that combined with the next characteristic of farming it calls for some collective action to ensure enduring stability of essential food supplies. Current direct payments together with the residual safety net intervention system are two of the main policy elements providing income surety and stability.
17. The highly fragmented structure of the industry makes it hard for it to follow some of the market-based risk management practices which larger industries can adopt. For many years the farming industry has been encouraged to follow the example of the financial services sector and get more familiar with the sophisticated range of financial engineering techniques to manage risk. Despite many efforts to spread this expertise, their use in agricultural markets in Europe remains limited.⁴ Farmers evidently find it difficult to utilise these techniques.
18. It also has to be acknowledged that the EU's ultra precautionary decisions on the use of biotechnology in agriculture and the highly risk averse approach to the use of crop protection chemicals, Europe is denying its farmers important modern sources of productivity growth available to farmers in the rest of the world and at the same time restricting the range of choice of some products and techniques of risk management.
19. The EU has frequently debated the best way to provide some degree of income assurance. The general conclusion, which the ELO supports, is that the risk management strategy is based on the combination of three instruments:
 - o the residual safety net commodity intervention (as was activated for the dairy sector in 2009) which benefits the whole internal market. Residual safety net stabilisation of this kind must remain in place;
 - o the provision of significant support in the form of annual payments to farmers. These are currently in the Single Payment Scheme, Agri-Environment Payments and Less Favoured Area payments. Together these provide, and their successors (see below) should continue to provide, an element of relatively stable and predictable financial support to these businesses⁵;
 - o the provision for Member States to decide to divert funds (currently allocated to direct payment national ceilings) to assist crop insurance and animal disease insurance;
20. **Diversified and pluriactive businesses.** Farming in all countries in early stages of economic development is a very small scale, private, family activity. As development occurs agriculture sheds labour. This has a two beneficial effects – labour is available for more remunerative employment in towns and cities to which most of the population migrates and material living standards in society rise. This leaves the remaining farmers more land which enables them to increase their output, expand their businesses, employ new technologies and raise their living standards too.

⁴ It is interesting to note that the country with the most developed and extensive commodity futures markets for agricultural commodities, the USA, is also the country whose agricultural policy devotes the bulk of the assistance provided to provide countercyclical price support and subsidising crop insurance, which it is hard to maintain are not coupled, and thus trade-distorting, policy instruments .

⁵ As we discuss when we come on to the tools required for the CAP we are not defending the current nature and distribution of these annual payments. Our point is that payments for public goods also will provide an element of income stability for farmers. The stability and predictability of these streams of support is of course subject to policy change. These payments are generally fixed in nominal Euro so there is an inflation risk and, for the non-Eurozone countries, an exchange rate uncertainty too. Environmental payments are also subject to review and can be adjusted up or down.

21. These processes take decades and occur unevenly between and within countries. The result is that increasingly a relatively small proportion of the largest farmers produce the majority of the marketed farm output, and the majority of smallest farmers survive by diversifying their farming activities, taking on non-farming activities and having other family members contribute to household income. Policy has an important role in helping this farm restructuring and rural economic diversification.
22. **Market Failure.** Agriculture, as defined and described briefly in paragraph 5 (and footnote 2) above, is associated with pervasive market failure. By this we refer to the wide range of public goods which are produced, or could be produced, as co-products of the marketed food and other produce supplied by farmers. Most of these services are environmental, some are social. They include water capture, storage and filtration, water quality improvement, soil management, carbon sequestration, the creation and conservation of species and habitats and thus biodiversity and the maintenance of landscape and many aspects of culture and heritage. These services all display some combination of the characteristics of what economists term public goods⁶. Markets will not spontaneously come into being for these services so they will typically be under-supplied or not supplied at all. This necessitates collective action.
23. There is now an extensive literature on the scope and scale of these public goods. Two recent studies on Public Goods and Agriculture, set up by the Commission (DG Agri) and the RISE Foundation and referenced at the end of this paper, explain what the public goods associated with farming are and the evidence on their scale. An important conclusion is that in Europe we are consistently underestimating the scale of these services and therefore the scale of the policy response and resources which must be deployed to deal with them. For a significant part of the EU farmed area it is likely that the value of the public environmental goods provided is in excess of the marketed agricultural value.
24. Until comparatively recently, and in fact in some parts of Europe especially the EU12 even now, the structures, technology and intensity of farming was such that these public goods were plentifully provided alongside the marketed agricultural products without any further action being required. However as agricultural productivity rises by the application of machine power, modern farming techniques and management, and as field and farm size expands to make efficient use of this technology, some unpaid environmental services are displaced by the higher agricultural output, and of course pollution may rise. A driving motivation of the CAP since its inception in 1958 has been to increase its productivity (for food production). This tendency is further increased by the drive –which we support – for a more market-oriented agriculture. But the predictable consequence of a market-oriented agriculture is, of course, that the non-market outputs are under provided. Because European Citizens most definitely do want these non-market services too, then their provision becomes a steadily more important objective for agricultural policy.
25. **Agricultural and rural infrastructure.** The combination of the small scale of agricultural activity, its geographical dispersion and thus the relative sparsity of population in rural areas is such that without active policy the needed

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The two classic properties of a public good are that they are non rival in consumption (one person's consumption does not diminish another's) and non excludable (it is impossible or costly to exclude non-payers from enjoying them). Market processes will not supply sufficient of goods or services with these properties.

agricultural and more general rural infrastructure will not be sufficiently provided.

26. Agricultural infrastructure refers to everything from research, development, advisory services, information and market intelligence to drainage, flood defences, and abattoirs. Rural infrastructure, services and social capital includes: roads, telecommunications, ICT, and schools, hospitals, police and other social services. It is all too common that standards of such services in rural areas lag behind those found in the urban areas. Of course we do not expect the rural development part of European agricultural policy to deliver all these services but a well integrated European agricultural policy will continue to have an important role in these aspects of rural development.

Why we need a Common EU policy

27. Here we argue that it is right that European policy for agriculture and the rural areas should be a common policy with a common budget. We believe it is vital that the CAP continues as a strong Common European Policy with appropriate EU resources under EU Budget Heading 2, which is very appropriately named 'Management and Protection of Natural Resources', with the objectives of seeking Food and Environmental Security. To do this the policy must cover the major rural land using activities of farming and forestry and the whole range of marketed goods and public goods produced from land. The CAP must enable EU land management to contribute to reducing climate change in many ways but in particular by contributing land based renewable energy and sequestering carbon in soil and trees.
28. We point to five arguments, five-Cs, which justify a common European approach, these are: Competence, Competitiveness, Cross-boundary effects, Common EU goals, and Cohesion.
29. The **competence** argument is that the Member States, since the late 1950s, have given competence for food, agriculture, environment and trade to the EU. The CAP has been a cornerstone of the European construction since its creation and we see no reason to undermine or change its Treaty status. Over five decades the CAP has adapted to enormous changes in social, political, economic and environmental circumstances. In the process we have accumulated a weighty experience of legislating on agriculture, the rural environment and rural development. It makes good sense to capitalise and build on this investment.
30. The **competitiveness** argument is that it is essential to maintain a level playing field within the EU internal market across the Member States through common measures, funded largely from a common budget, carefully monitored by the European Commission. Agricultural products are easily and widely traded. It is easy to see how this trade could be distorted by re-nationalised policy. This is particularly so as more emphasis in the policy is devoted to paying farmers for the environmental public goods they deliver. There is a strong 'jointness' between agricultural outputs and environmental public goods. They are produced in parallel from the same farming businesses, so differential measures to promote the environment in one member state can easily distort, or be perceived to distort, competition for the related agricultural products creating problems both for food and the environment.

31. The ***cross-boundary*** effect is that many of the public goods such as water flows, biodiversity and climate change do not respect national frontiers. Measures therefore have to be implemented on a pan-EU basis.
32. The ***common goals*** argument is that there is a strong belief across Europe of the importance of the countryside, rural values and cultural heritage. Economists talk of the 'options' demand for these public goods across the European Union. Citizens do not only care for the environment on their doorstep, and the creatures, landscapes and nature that they can see but for landscapes and habitats that they have the option to visit in other parts of Europe too. The high standards for these environmental services are all determined through common EU regulations and environmental directives for birds, habitats, nitrates and water, with further discussion of soils and climate change in process.
33. EU policies must also contribute to ***cohesion***, helping the least developed regions and Member States catch up with the more developed regions. There are good grounds for expecting that a well structured CAP along the lines proposed here would indeed contribute to this EU objective too. Given the strong current dependence on agriculture in the new Member States policy measures to help agricultural and wider rural development are a very important part of their general economic development too. This is to the benefit of the wider European economy.
34. The ELO believes that given these characteristics of agriculture and reasons for policy interventions it is perfectly rational that the EU should devote up to 0.5% of its GDP to the policy which seeks to ensure a sustainable food production base and high standards of environmental land management across 70% of its territory which is agricultural and forest land. We would defend this even in circumstances of tightening public budgets. The policy must however show that it is well-tuned to achieving what citizens want and expect, and that its measures are implemented in a cost effective way to achieve these objectives. The reform steps already taken since 1992 have moved the policy a long way in the correct direction from an over-extended agricultural commodity support system towards a more balanced policy to maintain food production capacity, to deliver environmental services and help maintain vibrant rural communities. These reforms have further to go – we explain the pressures for change and suggest the changes necessary in the following two sections.

Why reform the CAP?

35. There are five main pressures for change concerning: the overall budget cost; the legitimacy of the single payment system; the distribution of supports; continuing low and volatile farming incomes; and to deal with market failures especially climate change and the under-provision of public goods. These are now briefly reviewed.
36. **The overall budget costs of the CAP.** We reject the claims that the CAP is self-evidently receiving too much public support and occupying too large a share of the EU budget. This share has been steadily falling for decades. We argue that the current budget, especially for the enlarged EU, is reasonably in proportion to the scale of what citizens want from the policy. The facts are that despite the existing supports farming incomes are low, and the environmental public goods are not being sufficiently delivered to achieve EU environmental goals. We specifically refer to goals for water quality,

biodiversity, landscape care, carbon sequestration, renewable energy production and Green House Gas emission reduction. In these circumstances to reduce the CAP budget would be to imperil Europe's Food and Environmental Security.

37. **The legitimacy of the Single Payment System (SPS)** The origins of the 2004 Single Payment System are clear. The sharp reduction in the use of commodity market supports since early 1992 brought about a system of commodity-linked, compensatory, direct payments. Since 2004 these have been steadily decoupled and consolidated into the Single Payment System. As the EU enlarged in 2004 and 2007 the decoupled direct payments were extended to the acceding Member States in a simplified system. Their purpose here was not compensatory as most of these countries enjoyed producer price rises on accession, not cuts.
38. The general conditions for the receipt of the Single Payments are that the recipients must keep their land in Good Agricultural and Environmental Condition, obey the Statutory Management Requirements and, in total, not reduce the permanent pasture area below its 2002 level. The precise specification of these conditions, the timing and extent of the decoupling, and the method of calculating the payments whether based on historic (2000-2002) receipts, average payments per hectare, or a hybrid of the two, was left to each Member State to decide.
39. The result of all this is that there is a very large range of payments across farms in the EU both within and between countries whether expressed per hectare, per recipient or in relation any other variable. The purpose of the payments is a mix of: (i) supporting living standards, (ii) maintaining food production capacity, (iii) stabilising incomes, (iv) offsetting costs of higher EU regulatory standards and (v) partially paying for public environmental services. These are sensible enough aims, however it is hard to deny that the precise distribution of the payments and their scale is not very precisely targeted to these objectives. The support instruments have been simplified and consolidated to the Single Payment System, yet the multiple objectives remain. There is consequently pressure from both within agriculture and from outside to rationalise this situation to get better alignment between the payments and the declared objectives.
40. **The distribution of supports between the Member States** has created an active discussion. Commission figures showing the wide dispersion of the average support levels per hectare and per beneficiary have been widely discussed. The November 2008 Council agreement on the Health Check stated that “ *the Commission are committed to thoroughly examine the possibilities for development of the direct payment system in the Community and addressing the differing level of the direct payments between Member States.*” This is another pressure therefore for reconsidering the balance of objectives for the CAP and how its supports should be distributed.
41. The ELO strongly urges that any redistribution of CAP supports as part of the reforms must be made on an objective basis motivated by agreement about the *future* purposes of the support and objective measures of needs around the Member States. It is vital that the CAP and its supports should be future facing and not as it has been and is, rooted in the past. Equally we argue that this must apply to all supports, not just the SPS.
42. **The continuing low and volatile farming incomes.** This is certainly a further pressure for reviewing how the CAP can help farming improve its productivity and competitiveness and to assist necessary further farm

restructuring. These processes still have some distance to go in all Member States, and there is a strong need for restructuring in some of the new Member States. It is vital that the discussions of reform options are fully informed about the extent of the current dependence of farming on existing supports, and how this will change under future market and proposed policy developments.

43. **Market failures and the under-provision of public goods.** The weight of argument concerning the importance of this element of policy has been steadily growing for the last two decades. There has been a particular focus on biodiversity, and to a lesser extent cultural landscape and heritage. Despite these efforts, EU targets on Biodiversity have not been met and there is a determination to 'do better'. In the last decade the specific market failure of climate change has soared up the political agenda, along with the related issue of renewable energy. It is also clear that agriculture (widely defined as land management) is hugely important for these issues. Agriculture will require help to reduce its Green House Gas emissions, especially when required to go beyond efficiency gains. However, it also has much to offer on the so-called new challenges of climate change, renewable energy, and water quantity and quality management. Most of the needed public goods are land based, it is only land managers practically, who can deliver them. Yet if the main commercial, farming and forestry, activities are not profitable these businesses will have no capacity to deliver the public goods too.
44. Our conclusion is that these pressures demand further evolution, not revolution, in the CAP and how its resources are shared out, but that the total quantum of resources cannot be far from the current level for the next financial perspective until 2020.

What tools do we need for the CAP of tomorrow?

45. The architects of the two Pillar approach to the CAP in the late 1990s designed a CAP structure and evolution which has not worked out quite as expected. The first Pillar contains the market supports for the agricultural sector and the direct payments to farmers. It has been obligatory expenditure, in annual programmes, 100% financed from the EU budget⁷. The second, Rural Development, pillar was supposed to deal with territorial rather than sectoral dimensions of the policy covering: agri-environment, the less favoured areas and rural development actions. Pillar 2 was set up on a programming basis, region-by-region, with multi-annual (7 year) programmes in which regions select measures from a menu of options. Pillar 2 is co-financed.
46. The neat partitioning of measures into the two Pillars by purpose or approach was never clear from the outset. Much of Pillar 2 – in axis 1 – concerned with competitiveness of agriculture and forestry is essentially sectoral in approach; and it can be argued that much of the justification for the single payment in Pillar 1 is essentially territorial in the sense of ensuring a high basic level of environmental management of the countryside.
47. From the launch of Agenda 2000, the resources for the CAP were 90% in Pillar 1. It was generally supposed that there would be a gradual shift of

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The obligatory nature of Pillar 1 expenditure had huge significance, it dictated 100% EU funding and also that the European Parliament (EP) had no real say over the regulations. As the support payment logic has been transformed from commodity market support to direct farmer payments for land management, and as the Lisbon Treaty has given the EP full co-decision powers, this automatic EU funding can no longer be taken for granted. Hence proposals from some quarters for co-financing all the CAP which we strongly resist.

resources from Pillar 1 to Pillar 2 over the years. However, the instrument chosen to make this switch, modulation, combined with the different funding of the two Pillars proved to be significant barriers to change. Only the UK and Portugal have made significant use of the option (and these only because their 'historic' based shares of Pillar 2 funds were unacceptably low). Indeed some new Member States have used the latitude provided to switch funds in the opposite direction to supplement their single payments using Pillar 2 funds!

48. The Mid-Term Review of 2003, and Health Check Reforms of 2008 served to further muddy the purpose of the two pillars. More environmental programmes were introduced into Pillar 1 under the Specific Supports (Article 68/69) provision, and the use of Pillar 2 (Axis 1) funds for renewable energy development is not particularly territorial in its approach.
49. Given this situation it is suggested that there is no point in being dogmatic about which pillar is good and to be expanded, or less good and to be shrunk. This paper therefore makes no explicit proposals about this. It is suggested that instead the debate proceeds first by agreeing the jobs to be done by the CAP, i.e. their purpose. Second, the debate must focus on the kinds of measures needed to do these tasks in the most cost effective, least bureaucratic, most simple and securely funded, way. Then, third, it is appropriate to decide how to distribute the total budgetary resource between measures and between the Member States.
50. There is a rapidly growing set of calculations being done by various interest groups, Member States, and no doubt by the Commission too, on how to carve up amongst the Member States the total CAP budget and the expenditure ceilings for the two pillars. Four criteria, or distribution keys have been suggested for doing this for Pillar 1 funds:
 - Utilised Agricultural Area (and sometimes broken down to arable, permanent and temporary grass)
 - Annual Work Units (i.e. the agricultural work force)
 - GDP per head, sometimes adjusted by purchasing power parity to take account of differences in costs of living
 - Gross Value Added in agriculture
51. For the distribution of Pillar 2 funds this list is supplemented by various indicators of the environmental and rural development needs. Candidates for the environment suggested are areas in: environment schemes, forests, wetlands, protected land (Natura 2000), high nature value farming, and organic farming. Candidates to reflect rural development needs are labour productivity, long term unemployment, and broadband coverage. There are difficult technical issues in finding robust, comparable data on such indicators for all Member States.
52. These indicators can be combined and weighted in many different ways. Each combination produces a different set of distributions both for the shift of assistance towards the new Member States (nMS) and the effect on each Member State. For example one set of calculations for the redistribution of Pillar 1 funds shows gains for the nMS at the expense of the EU15 ranging from €700million to €12billion (of the total pot of about €42billion). ELO suggests that key variables to use are agricultural area, income levels adjusted for rural costs of living, and areas engaged in environmental schemes.

53. We propose that whatever the method is used to distribute support *between* the Member States, the distribution of funds *within* Member States should be left to the Member States to decide.
54. As on several occasions in the past, discussion about payment rates, and payment levels will inevitably be accompanied by suggestions to cap or progressively reduce large payments to large holdings. We strongly resist such proposals for payment capping. As more of the justification for the payments is acknowledged to be for land management then capping or tapering makes no sense; large businesses managing large areas deliver large such services. Capping or tapering formulae also ignore differences in farm structures and employment, the impacts on competitiveness of farming, and, critically, the quantum and value of public goods delivered. Crude devices such as payment caps are a sign of inappropriately designed instruments.

Proposed elements of the post-2013 CAP

55. To meet the food and environmental challenges we believe the reformed CAP for the sustainable development of European agriculture and its rural areas for the period after 2013 requires the following five elements⁸:
 - A. Agricultural Productivity, Competitiveness and Stability
 - B. Basic Decoupled Payment scheme
 - C. Tiered Agri-environment Schemes
 - D. Measures for Marginal Areas
 - E. Wider Rural Development

These are discussed in turn.

Element A. Agricultural Productivity, Competitiveness and Stability

56. The core business of farming is the production of safe, wholesome, affordable, nutritious food. Production systems should be productive and competitive, and economically, environmentally and socially sustainable with appropriate standards of animal health and welfare. The CAP has vital roles to play to help ensure conditions for profitable and sustainable food production. Given that agriculture is a biological process dependent on the weather, and has a highly fragmented structure not well suited to sophisticated risk management, it is necessary also that the CAP helps provide some basic safety net for the incomes of those engaged in farming and environmental management.
57. The main measures in the present CAP dealing with productivity, competitiveness and risk management in agriculture are listed in paragraph 61 below. These measures are already available, some in Pillar 1, and the rest in Axis 1 of Pillar 2. Continued use of these measures is essential for two reasons.

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It is necessary to spell these out separately and individually although they are highly interrelated, and should be delivered in an integrated way.

58. Farming is an entrepreneurial, private, activity. It is essential that farming productivity continues to grow year by year or it will slip behind productivity growth in the rest of the economy and farmers' living standards with it. Future productivity growth will mostly come, as it has for the last two centuries, from technical change embodied in new inputs (seeds, animal genotypes, crop protection and animal health products, mechanisation, plant and equipment and management). It will also come from innovation and entrepreneurial decisions of farmers themselves and from structural change in farming. This productivity growth applies equally to food and renewable energy produced from land. As the provision of environmental public goods becomes a core activity of farmers it will apply to the provision of these goods too. In particular, there is little prospect of achieving 80% reductions in Green House Gas emissions from crop and livestock production in the next half century without significant technical change in plant and animal breeding, nutrition and management.
59. The processes of productivity growth and farm restructuring can and should be encouraged by policy. Technical change will also be the key to finding ways of applying fertilisers, using crop protection products and feeding animals with less leakage into the environment (water and atmosphere). Progress towards high precision farming and land management has to be assisted. Adoption of these changes often demands significant investment or certain scale of operation and thus structural change in farming, and of course constant development of knowledge and skills in the sector. Given the fragmented structure of farming a strong case exists to provide assistance for these processes, and for ensuring that the key infrastructure, such as drainage, slaughter houses, markets, crop storage and processing facilities which surround farming, is adequate to the task. The CAP has key roles in these processes.
60. Second, there is particular need to continue to assist agricultural development in the new Member States. Whilst they have advanced considerably since the shock they all suffered as they liberalised themselves from their previous state-controlled regimes, there is still a long way to go in restructuring and productivity enhancement. Resources deployed for these purposes through the CAP will also serve the cohesion objective.
61. The ways in which the CAP currently assists (and where these measures are found in the current structure are as follows):
- i.* Help with training, knowledge transfer and skills (P2, A1⁹)
 - ii.* Aids for farm restructuring, new entrants and helping retirement (P2, A1)
 - iii.* Aids for producer groups, to stimulate farmers working together, to be able to access professional management for input purchasing, output processing and improved marketing, (P2, A1)
 - iv.* Help with crop insurance and animal disease insurance as part of income stabilisation (A68 of P1)
 - v.* Residual, safety-net, market intervention to stabilise commodity markets¹⁰ (Single CMO in P1)

⁹ P1 and P2 refer to Pillars 1 and 2 respectively. They are shown to illustrate how there is no obvious logic why they are in different Pillars. The Pillar are explained in paragraph 12. Pillar 2, the Rural Development Regulation contains three subdivisions or 'axes'. Axis 1 is for agricultural and forestry competitiveness, Axis 2 contains the agri-environment and Less Favoured Area (LFA) schemes, and Axis 3 deals with Wider Rural Development. In Pillar 1, A68 etc refer to Article numbers in the Single Payment Regulation. In Pillar 2, A1, 2, 3 or 4 refer to the 'Axes' in the Rural Development Regulation.

¹⁰ Paragraph 19 explains the combination of stabilisation measures in the CAP.

- vi. There is little or no provision for R&D in the CAP, it should be debated if it is appropriate to include such provision within the CAP (i.e. separate from the budget of DG Research).
- vii. Aids for investment to assist the new challenges of green growth:
 - Renewable energy development, biomass, biofuels and biogas, and anaerobic digestion
 - Reducing Green House Gas (GHG) emissions
 - Waste management
 - Meeting Water Framework Directive (WFD) Objectives.

Element B. Basic decoupled payment scheme

- 62. Starting from the present circumstances where the Single Payment System (SPS) is a dominating element of the CAP and where there is a high degree of dependence of EU farmers on these payments, a key continuing element of the CAP will be a basic payment decoupled from agricultural products and their prices. As explained, these payments, unevenly distributed as they are, can be supported because they:
 - Provide the basis for keeping agricultural land in good agricultural and environmental condition which is an intelligent contribution to food security
 - Provide some surety and stability for farmers' incomes
 - Compensate for higher regulatory costs in the EU¹¹
 - Pay for some public goods provision
- 63. However, as discussed in the previous section, there is insufficient targeting and scaling of the payments to these objectives and so there are irresistible pressures for changes in the policy. As the Single Payment Scheme accounts for over 70% of the CAP budget, this is a core part of the next reform. The ELO insists that the pace of any such change must be carefully moderated taking account of farmers who have made leases, taken loans and committed themselves to investments on the basis of the continuation of these supports. Changes must therefore be phased in over a period of years.
- 64. Since 2004 the direct payments have gradually been decoupled. This was done in order to reduce the trade distorting nature of the previous direct payments which were linked directly to crop areas and livestock numbers. This was a critical part of the EU's offer in the Doha Round of WTO negotiations. The process of decoupling is not complete, and all Member States should be required to complete it in the post 2013 period.
- 65. In calibrating their Single Payments, the majority of Member States chose to do this on an historical basis. Several, for example the German Länder and England, chose to move slowly from the historic to a flat rate payment basis. The arguments were that such payments are more fully decoupled, they can more obviously be explained as a land management payments, and would ultimately simplify administration as there is then no need for separate concepts of entitlements and land to activate them. However, the countries and regions which chose historically calibrated payments did so for their own

¹¹ This matter is disputed. Some argue that equally high standards apply to much non-EU produce in many parts of the world and especially sources supplying highly demanding EU food processing and retailing companies. For some specific regulations (e.g. Natura 2000 sites, there is no compensation for forgone activity).

reasons and it is not suggested that they should be required to shift to regional average payments after 2013.

66. In particular the ELO sees no merit in a uniform flat rate payment across the EU-27 because productivity, wages, input and living costs, demand for public goods and value of those goods are all different across the EU. Essentially we are suggesting that the hit-and-miss, optional, article 68, specific supports approach in the Direct Payment regulation be replaced by a common restructured Single Payment System in all the Member States as explained below. If this is done then the distributional unfairness of the current uneven payments across the EU should be resolved by the more objective and forward looking redistribution of the totality of CAP financial support, as explained in paragraphs 41, and 50 to 53 above.
67. We propose that consideration be given to adapting the SPS to be an instrument more engaged in delivery of public goods. As argued above it already does this to some extent, but this should go further and be made more explicit¹². We are seeking to reconcile several pressures: better targeted payments for public good delivery; yet not invoke the need for additional Member State co-financing which is simply not available, and also not to inflame opposition to what is perceived by farmers as leaky, bureaucratic Pillar 2.
68. The essence is that the rearranged part of the SPS should show three sorts of change:
 - Its **purpose** explicitly changes from the origins which were compensation for previous policy change, to payment for public good delivery.
 - The **period** of the payment changes from annual payment based on an annual application process to a multi-annual (say 5 or 7 years) payment.
 - The **character** changes from a cross compliance concept to a more conventional compliance with a contract voluntarily entered into.
69. We don't wish to be dogmatic whether this is tantamount to Pillar 1 taking on the character of Pillar 2, or the other way round. We are selecting the best aspects of both pillars; the dependability and 100% EU financed aspect of the first, and the multi-annual, clearer purpose and contractual character of the Second. Of course if the new basic payment is to be defined as a payment for public goods, then the level of public goods expected must be above the reference level which is defined as the current legislative requirements, i.e. above the current cross compliance standards. How much above is for discussion and negotiation.
70. Broadly speaking this switch could be seen in either (or both) of two ways. The first is to offer to deliver a basic suite of the environmental services scaled somewhat above the legal reference levels to protect natural resources and landscape and deliver biodiversity. The second approach focuses more narrowly to 'do' the support of marginal farming in what we currently call Less Favoured Areas. The difference between these two options is that the first is available to all farmers and so it must contain options suitable to all kinds of farming system, whereas the second is available only to farmers qualifying as marginal. Marginal farming could be defined as certain geographical areas or by farm characteristics. The specific issues of marginal farming are discussed further under Element D below.

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This idea is not dissimilar to suggestions by others writing on the future of the CAP, for example Pack (2009), The Dutch Social and Economic Council (2008), Bureau and Mahe (2008), George Lyon (2010), Paolo de Castro (2010), BirdLife International (2009), and a group of Twenty Agricultural Economists (2009) although the latter wanted the policy to be financed nationally.

71. There are precedents for these kinds of adaptation of the SPS. The door to do this was opened by the introduction and widening of the Article 68/69 approach so this is not revolutionary. The reasons behind such moves are the general dissatisfaction amongst farmers for modulation and shifts to Pillar 2, and the unwillingness, indeed inability, of most Member States to provide more national co-financing incurred by switching funds to Pillar 2. A most important difference between what is being proposed here and the existing article 68 is that the new stewardship payments (whether applying everywhere or just in marginal areas) are all arranged through EU-wide structures with the characteristics spelled out in paragraph 65 above. This is intended to remove the concern with the current Article 68 measures that they can be back-door recoupling of supports to agricultural production and thus a distortion to competition.
72. If this approach is to be followed then it requires much more debate about the details: what proportion of the current SPS should be paying for public goods in this way, which public goods, at what payment rates? The main attraction of moving in this direction is that the core payments are given an enduring, future-facing purpose and justification. Also the move from the current annual basis to, say, a five year, contractual basis could – once the transformation is made – offer a significant reduction in bureaucracy both for farmers and administrators.

Element C. Tiered Agri-environment schemes

73. The rural environment provides pervasive examples of public goods. Biodiversity, landscape and heritage, and resource protection of soils, water and atmosphere all show characteristics of public goods. Spontaneous markets will not provide the desired levels of these environmental services. Therefore a key role of the CAP is to make arrangements for contracts between farmers and society to supply such services. It is likely that there will be tiered schemes ranging from wide-application, relatively less demanding schemes providing basic environmental services, through intermediate schemes based for example on specific management regimes like Integrated Farm Management or Organic Farming to more, demanding and costly contracts for specific environmental management¹³.
74. These schemes are most suitably delivered through multi-year contracts, as developed in many Member States e.g. Austria and the UK. Payments will be a mix of annual payment for specific actions designed to achieve targeted environmental outcomes, or capital sums for specific investments, or compensation for coping with environmental restrictions as in Natura 2000 areas. There are many further questions to be considered about the way the schemes are set up and administered. Clearly it makes a big difference if the single payment scheme evolves as suggested above.
75. Because there are many environmental services with quite complex interactions, some complementary, others competitive, it is not a completely straightforward process to devise, implement and police the schemes. The general principles must be agreed on a common basis at EU level but the precise details must be tuned to regional, and sometimes quite local needs. It is essential that farmers and land managers are actively involved in these

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Although this paper, naturally, focuses on the important role of public payment through the CAP for public goods, the ELO acknowledges there are other routes to supply public goods. These are through food markets, by clubs and societies who acquire land and manage it for environmental services, and by creating market-like exchanges business to business, e.g. for water or carbon sequestration. These are examined in the RISE Foundation paper, Public Goods from Private Land.

processes and to minimise bureaucracy the more they can build on existing private sector certification schemes the better.

76. The point is that the public good justification for support to farmers is already a significant part of the CAP and this is destined to grow. As it does so we have to address the following matters.
- i. Ensuring that farmers who have maintained habitat are not disadvantaged compared to those who have destroyed it and may be paid to restore or create it.¹⁴
 - ii. The number of tiers required to cover all the environmental services with appropriate incentives.
 - iii. Agreeing the principles of the payment rates.
 - iv. Ensuring that payment rates acknowledge that the opportunity costs differ e.g. from an intensive vegetable farm to one growing feed wheat.
 - v. Ensuring that the schemes are equally and equitably available on owned and leased land, and dealing with situations where lease and contract lengths differ.
 - vi. Devising the least bureaucratic ways of conducting monitoring and evaluation. Farmers expect to deliver their marketed products to agreed specifications and payments adjusted if the standards are not met. There is no reason to expect that public goods would be any different. The key is to make the inspection regimes (and any penalties) risk-based, proportionate and practicable for farmers and the administration, the more this can be built from existing private sector assurance schemes the better.
 - vii. Because these schemes involve public payments they have to be subject to monitoring and evaluation.
77. There is no avoiding the fact that the current regulatory framework for the payment principles in these schemes is based on income forgone, direct costs and a profit element. These principles they are deeply enshrined in International Agreements (the Green Box of the Agricultural Agreement in the WTO) and in EU regulations. The key is to maximise the use of the flexibility in the way these regulations are framed.

Element D. Measures for Marginal Areas

78. European Farming is characterised by having a significant area of land occupied by long-established, relatively low intensity, mostly livestock grazing farming systems which are economically highly marginal. The landscape and biodiversity associated with such farming systems has evolved over centuries and is treasured in its own right. These farming systems are economically fragile even with current supports. Without support for these systems large tracts of land will be abandoned with associated food output, environmental, cultural and social loss. The CAP has a special role to help avoid such abandonment.
79. The concept is to identify farms and regions for which special additional payments per hectare should be made over and above both the basic payment, and any agri-environmental payments. This is a way of dealing with

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This is the EU version of the same question which is posed globally, can we find ways to incentivise landowners who have not destroyed vital habitat like rain forests to keep them intact?

the problem of the uplands, mountains and peripheral areas. The latter may well be lowland, but distant from markets or in inhospitable climes¹⁵.

80. The proposal is to reverse the current way of dealing with the problems of these areas. Instead of focusing on the activities for which these regions are not internationally competitive, i.e. their agricultural production and the corresponding concepts of 'Less Favoured Areas' and 'permanent natural handicap'¹⁶, it is suggested they should be instead described and named for what they are good at – their valued cultural landscape and unique habitats.
81. By taking the former route we are forced into 'compensating for handicap'. This is an economically illiterate thing to do and is not done in any other economic sector. By turning the approach on its head we could prize certain farming systems or regions for their landscape, nature value and environmental service delivery and thereby pay for these public goods, and in the process incentivise the better delivery of such goods and services. Thus we should in future talk about defining farms or regions of High Environmental Value (HEV). This should in principle embrace all environmental aspects; water management (run off, water filtration, flood mitigation, water storage), carbon sequestration, soil protection, and of course biodiversity and cultural landscape management.
82. This approach is akin to, but wider than, the concept favoured by some Environmental NGOs who focus on the High Nature Value (HNV) farming systems, and who tend to focus most on biodiversity. This is a recognised concept on the Continent. It is based on farming system characteristics such as grazing regime, semi-natural forage, presence of specific habitats or species, and stocking densities. It is possible to accommodate HNV areas and schemes within the broader concept of HEV regions and schemes.
83. Defining what we mean by areas of high environmental value is not a trivial matter. Considerable effort is being spent on redefining the non-mountainous (intermediate) LFA areas based on a series of bio-physical characteristics of soil, topography and climate. This work has not yet reached an agreed solution. It is unfortunate that the focus has remained on defining the characteristics which make these areas difficult for agriculture rather than good for the environment. Likewise there is not an agreed mapping of High Nature Value farming areas for all Member States yet either. However if the new arrangements are not destined to come into force until after 2013 there may still be time to change course to the positive and broader concept of High Environmental Value areas.
84. Having decided how to define and delineate the marginal areas, the next question is what measures or supports should be provided in them. These areas can potentially deliver a host of environmental public goods so this provides the rationale for support. The critical thing is to ensure that the totality of the support available is sufficient to keep people in these areas practising their traditional farming methods. At present these farms survive on the basis of the Single Farm Payment plus the extra support provided by

¹⁵ Land capability and management is an intricate and complex subject and there are many examples where the above broad brush concepts of marginality don't readily apply. Thus in intensely arable parts of Europe there may be pockets of land, too steep, too dry, too wet with soil too heavy or too light for cropping where there are, or could be, extensive grazing animals which would have important beneficial environmental, landscape benefits by allowing more mixed farming. It is important that such areas are not overlooked if they 'fall between the slats' of Element C agri-environment schemes, element D marginal areas.

¹⁶ In the course of the current redefinition of the non-mountainous Less Favoured Areas using geo-physical criteria (steepness, climate, soils) the language is adjusting, but to Areas of Natural Handicap (ANH). This is no advance on the present terminology.

environment schemes and LFA payments. The future could be the redefined basic decoupled payment as explained under Element B above thereby consolidating support for marginal areas into Pillar 1. At present the payments available in LFAs are made from Pillar 2.

85. Whichever Pillar they come from the more important issue is whether the whole basis of the scaling of the payments in these regions of High Environmental value can reflect the opportunity cost of farmers compared to their best alternative – which will be outside farming. The current method of assessing Income forgone from farming less intensively in the LFAs will never be sufficient to maintain these farms in existence (especially if the Single Payment is cut) so abandonment of farming is likely to result if this issue cannot be resolved.

Element E. Wider Rural Development

86. The prime purposes of rural development policy are to encourage economic development and diversification of rural areas, and to ensure that these areas do not suffer from poorer service provision than urban areas are.
87. Of course the character of rural areas varies widely, partly depending on location and connection to centres of population. Agriculture and forestry dominate rural land use and thus they have a major role in determining the appearance and environmental quality of, or to put it another way the delivery of ecosystem services in, the rural areas. Together with the related up and downstream businesses which provide goods and services to farming and take its produce, agriculture also accounts for an important part of rural employment and economic activity in rural areas. However the economic significance of agriculture gradually diminishes over time especially in regions which are closet too and best connected with urban centres. In some rural regions counter urbanisation is a recognised phenomenon, and in some parts of some Member States with the highest population densities the very existence of distinctive rural areas is questioned. However other rural regions face continued depopulation and reduction of activities and services.
88. The rural development element of the CAP is never going to be a major part of the CAP, but neither will it, nor should it, disappear. The major factors influencing the economic, environmental and social health of rural regions will always be the general level of economic development in each Member State and their general policies for education, health, social services, planning, and infrastructure provision. Against these nationally financed instruments rural development policy delivered through the CAP will always be a relatively small player – but it can none-the less be an important contributor.
89. It is especially the case that the poorer Member States which have a higher proportion of their workforce engage in farming will make greater use of the measures available under this element. In this way the CAP has an important contribution to EU cohesion objectives. The measures to assist this wider rural development are summarised below.
 - Quality of life:
 - Basic services for the rural economy & population e.g. broadband (setting up & infrastructure)
 - Renovation and development of villages
 - Protection and conservation of the rural heritage
 - Economic diversification:

- Diversification to non-agricultural activities
 - Support for micro-enterprises
 - Encouragement of tourism activities
 - Presentation and management of the natural heritage
 - Training skills acquisition and animation:
 - Training and information
 - Skills acquisition, animation and implementation
 - **Climate change adaptation and renewable energy**
 - Farm scale renewable energy
90. An important role of the current axis 3 and 4 Rural Development measures is the maintenance and creation of social capital. In order to maximise the exploitation of the distinctiveness of rural regions it is important to bring together land managers (farmers and foresters), other local businesses conservation, environmental and recreational interests and local authorities to work together to raise product quality and promote local produce and land-based services. There are many examples where the LEADER programme has been an important catalyst in stimulating such social capital.

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