



EUROPEAN COMMISSION

DIRECTORATE-GENERAL FOR AGRICULTURE AND RURAL DEVELOPMENT

## **WHY DO WE NEED A COMMON AGRICULTURAL POLICY?**

### **DISCUSSION PAPER BY DG AGRICULTURE AND RURAL DEVELOPMENT December 2009**

#### **1. WHAT DO WE WANT FROM AGRICULTURE IN THE EU ?**

Agriculture in Europe is expected to fulfil a variety of functions. It contributes to the supply of European citizens with safe and high quality food in a competitive market, to maintain valuable cultural landscapes across Europe through sustainable land management and to help rural areas to remain attractive and viable. At the same time, agriculture is undergoing fundamental changes which require farmers to adapt to new conditions and seize new opportunities. Particular challenges will result from the need to adapt to climate change.

The Common Agricultural Policy (CAP) of the EU aims at responding to the public demand for a sustainable agricultural sector in Europe by enhancing the competitiveness of the agricultural sector, ensuring sufficient and secure food supply, preserving the environment and the countryside while providing for a fair standard of living for the agricultural community.

The CAP has undergone fundamental reforms over time, which demonstrates its proven capacity to respond to changing economic conditions as well as societal expectations and demands. In this process, the CAP has moved to a policy putting emphasis on market orientation and competitiveness, income support, environment, and the development of rural areas.

##### **1.1. Food security**

The first and foremost role of European agriculture is to supply food. Recent developments have shown that the issue of food security is not to be neglected and may be accentuated by climate change and increased water scarcity. The potential to respond to this issue depends on a functioning farming sector, a maintained production capacity and a stable system of trade relations

European farmers face the challenge of providing food in a more and more open market. They are expected to produce at competitive prices and, at the same time, to respond to societal expectations concerning high product quality, high levels of food safety, animal welfare, and environmentally sound farming practices.

Thus, the functioning of an economically sustainable agricultural sector in Europe depends, among others, on developing the farmers' capacity for adapting to new market situations and responding to new economic and technological opportunities.

## **1.2. Land management**

The unique feature of agriculture is its presence throughout the European territory. Agriculture is the main land user and the resulting high visibility leads to widespread perceptions matching “rural” with "farming". Farming is a key factor in shaping the visual features of rural areas. Agricultural land management has been a positive force for the development of the rich variety of landscapes and habitats, including a mosaic of woodlands, wetlands, and extensive tracts of an open countryside. The functioning of the ecological system, the scenic value of landscapes, and the related notion of cultural heritage make rural areas attractive for the establishment of enterprises, as a place to live in, and for the tourist and recreation business.

Whilst the farming past has shaped the rural character, often the specific farming practices that helped generating those features lost their competitiveness. In some areas, notably those with a low productivity of soils or economically unfavourable structures, agricultural activities and land management as such are at risk. The disappearance of farming results in losing the associated environmental and cultural assets, such as typical landscapes and valuable habitats. Those assets have the characteristics of public goods, because the demand and supply cannot be satisfied through market mechanisms. Policy measures are needed for ensuring delivery of these goods. However, public goods cannot be delivered without the necessary farming capacity being in place - "public money for public goods" can only be delivered where there is an agricultural presence to which this condition can be attached.

## **1.3. Viable rural areas**

Agriculture is an irreplaceable element in rural areas and is closely linked to the other driving forces in these regions which determine economic, environmental and social development. Different farming systems produce many different types of landscape and contribute to successfully developing the natural potential of EU's rural regions. This is fundamental to the attractiveness of an area which is in turn, in combination with specific regional food products, part of the identity of a rural area. These elements are also an important factor in the tourism value of a region and the amenities it provides for neighbouring urban centres.

As regards the economic potential of rural areas, agriculture provides a platform for economic diversification in rural communities. The diversification activities of the farmer and the farming household not only allow agricultural activity to continue, but create employment and additional income in rural areas. The combined agricultural and food sector (including beverages) is the third largest employer in the EU. Furthermore, and in spite of the decline in the relative economic weight of the primary agricultural sector, its economic role remains significant, particularly in remote areas where agriculture as such has a significant share in employment.

Thus agriculture is an important part of viable rural areas. Yet despite structural adjustments, incomes in the agricultural sector remain below average income levels in other sectors of the economy. Their development since 2000 also lags behind the national income growth in EU-15 and only keeps up with it in EU-10, where income increase has been substantial (see graphs 10 and 11 in annex). At the same time, farmers face income disparities, subject to region and size.

Other attributes for economic development have to be in place: the presence of infrastructure and services plays an important role for farmers, as well as for other

inhabitants of and visitors to rural areas. New information and communication technologies make connections between rural and urban regions easier and help to create a greater variety of employment possibilities outside urban zones. Access to services of general interest is also vital for the economic development of a rural area and for maintaining the quality of life for its inhabitants.

Although an important number of rural areas still suffer from depopulation, there are other rural areas where the trend has changed and the number of inhabitants is increasing. If further concentration in urban centres in certain parts of Europe is to be avoided, rural areas have to maintain their attractiveness for younger people, e.g. through leisure amenities and opportunities for training and higher education as well as subsequent employment opportunities.

#### **1.4. Competitiveness in a global market**

Within the context of *globalisation* and the emergence of new economic powers, the move of the agricultural sector to market orientation and less protection (through continuing multi- and bilateral trade liberalisation) in particular adds to the competitive pressure. This also underlines the challenge for the agri-food sector of exploiting newly emerging markets with high quality and high value added products. Globalisation and liberalisation of trade may also be accompanied by greater market volatility which creates new challenges for farmers and the food industry such as the need to rapidly adapt to market signals and to manage the inherent risks. The overall reduction in tariffs will lead to lower prices for the consumer and consequently a reduction of market receipts for the farmer. A successful conclusion of the WTO Doha Round would certainly offer new opportunities and would at the same time for EU farmers amplify the challenge to face increased competition on agricultural markets. The increased openness requires constant restructuring and innovation of the food chain as well as changes in agricultural production patterns to enhance competitiveness.

The European farmers will have to confront these challenges at the same time as they have to respect high standards arising from environmental, food *safety*, quality and animal welfare objectives. The resistance in the general public to a widespread use in Europe of GMOs could at the same time lead to higher input costs (animal feed) and prevent further productivity increases compared with international competition. An adequate response for European agriculture to these challenges will be to ensure increased product quality.

#### **1.5. Responding to Climate Change**

Agriculture is particularly vulnerable to the impacts of climate change. The most significant effects on European agriculture in the short and medium term will be manifest through the increasing frequency and severity of extreme weather events and through changes in the availability of water.

Climate change will have the most severe impact in regions that are already under pressure and at risk of marginalization. Climatic changes are likely to increase both the volatility of markets, by changing production patterns, and the economic disparities between rural areas.

On the positive side agriculture can play a role in the mitigation of climate change by reducing dependency on fossil fuels and diversifying supplies (by providing the feedstock for bio-energy) and as a carbon sink. In Europe with its man-made landscapes

and rural environment, it can also play an important role in safeguarding biodiversity and water resources.

European agriculture will have to contribute to both reduced greenhouse gas emissions, and the development of its role as a carbon sink. This forms part of the public service function of agriculture.

Adaptation to climate change is already taking place by European agriculture and will continue, but the changes required are likely to go beyond the capacity of individual farms.

## **2. WHY DO WE NEED AN AGRICULTURAL POLICY ?**

Market mechanisms alone cannot provide for the manifold roles and services to be provided by European agriculture, i.e. safe food, sustainable land management, the contribution to socially and economically viable rural areas, and meeting new environmental challenges. Public support to farmers is needed to face increasingly volatile markets, to ensure the provision of public goods and to facilitate changes in farming practices in order to ensure a farming sector that meets societal demands.

### **2.1. Volatile markets**

More than any other economic sector, agriculture is dependent on natural and environmental factors. Its specific production patterns, in particular long plant growing and animal rearing cycles, make quick adjustments in production difficult or impossible. Unforeseen events, such as flood, fire, drought and animal diseases, can disrupt the agricultural activity of whole regions. The frequency of natural disasters is likely to increase in the future as a result of climate change.

More and more open market conditions for agriculture add to farmers facing increasing market volatility, with strong disturbances in terms of price and quantities. Policy mechanisms are needed to provide for a safety-net helping the farming sector to survive bad years, ensure food supply over time and the viability of the sector in the long run, also to the benefit of the upstream sector, processing industry, retailers and consumers. A safety-net policy should help agricultural enterprises to overcome crises. However, it must not constitute a permanent form of market intervention, influencing the production choice of farmers. Farms will have to adapt to competitive pressure on open world markets and use available risk management tools as these are a precondition for European farmers making full use of the advantages of global trade.

### **2.2. Public goods**

Environmental and cultural assets generated through agriculture have the characteristics of public goods that will not be delivered through markets. Some public goods are a by-product of agricultural activity, others are services provided by farmers as an extra effort. In view of ensuring the provision of public goods associated with agricultural land use, policy measures are needed to incentivise farmers to opt for the type of land management that delivers the best outcome. In some regions farming activities associated with public goods depend entirely on policy support, as the production of agricultural commodities is not economically viable, thus support is necessary to ensure the delivery of baseline requirements opening the way for provision of public goods.

### **2.3. Sustainable rural environment**

Withdrawing public support for farmers would intensify structural changes pointing into two different directions. On the one hand, agricultural production would be concentrated in some areas that provide particularly favourable conditions, with highly intensive farming practices applied. On the other hand, less competitive areas would face negative impacts, including marginalisation and sometimes even land abandonment. Both the concentration and abandonment of land use would result in increased environmental pressures and the deterioration of valuable farm habitats with serious economic and social consequences. This would also change the look of rural areas that European citizens know and appreciate today. Maintaining attractive landscapes goes certainly beyond farm interests, as they are valued as a place for recreation and provide ecological services. Also traditional products providing for regional identity add value to rural areas, thereby contributing to economic development.

## **3. EU VALUE ADDED**

Support at European level provides for a coherent agricultural policy, targeted towards European objectives and based on a common policy discourse. An agricultural policy at EU level can be understood as “meeting ground” for shared values and understanding differences. This policy is guided by common strategic objectives providing the very basis for achieving synergy, mutual learning, and economic and social cohesion. Delivering those objectives is guided by common disciplines and common criteria for best practice. At the same time, the implementation of this policy can reflect the diversity of economy, ecology and cultural values, because there is room for discretion in the implementation by Member States.

### **3.1. Level playing field**

A Community approach towards supporting agriculture ensures a level playing field for farmers competing in the internal and on the global market with a common set of objectives, principles and rules. Furthermore, the implementation of policy measures should benefit from mutual learning and experience, as a resource for economic and social development. It allows mobilising joint forces to enhance the competitiveness of the sector and, thus, contributing to the Lisbon agenda.

There can be no doubt that without a common policy, Member States would proceed with national policies with variable scope and with different degrees of public intervention. A Community policy ensures common rules in a single market; addresses market volatility where needed; safeguards the progress made in recent reforms towards increased competitiveness of European agriculture; and provides for a common trade policy allowing the EU to negotiate as one vis-à-vis the global trading partners.

Re-nationalisation of agricultural policy has a high risk of distorting the common market principle, with diverging support levels and types of policy mechanisms. Experience shows that a wide degree of discretion on the side of Member States bears the risk of reorienting agricultural support back towards potentially market and trade distorting support mechanisms such as (re-)coupled direct payments.

### **3.2. Trans-national objectives**

Several objectives of agricultural policy can only be addressed at a trans-national level as they concern either common interests or refer to balancing differences in development and opportunities, to the benefit of farmers acting under unfavourable economic and structural conditions. Re-nationalisation of the agricultural policy would be detrimental from a cohesion point of view, as some Member States would probably invest more in supporting the agricultural sector than others, depending on the budget available. Cohesion, via transfer of funds towards Member States and regions facing stronger needs for structural adjustment, can only be ensured at European level, reinforcing the solidarity between the Member States and regions while contributing to agreed policy objectives.

Common action is needed to achieve cohesion across Member States and regions, the preservation of the common natural and cultural heritage, and to address cross-border problems in the field of the environment as well as global challenges such as climate change, water management and biodiversity. European solutions are necessary for making progress towards meeting these challenges. In targeting policy measures towards these objectives, a common agricultural policy provides across all Member States for a coherent and efficient support, contributing to Lisbon objectives, cohesion and the sustainability challenge embedded in the Gothenburg strategy.

## **4. POLICY CONSEQUENCES**

Agricultural policy in Europe needs coherent rules for the common market and a common approach towards providing basic income support. It needs a common safety-net mechanism and specific measures targeted towards national or regional needs in view of ensuring that agricultural activity can be sustained throughout Europe, even under less favourable regional situations. This is a particular challenge in the face of open and volatile markets and unpredictable natural events.

No single instrument can meet all of these needs, nor can these needs be addressed in isolation. There is a clear interdependency amongst the needs which means that measures targeted at meeting one objective will also influence other objectives, e.g. an agri-environmental measure will also provide an income support, but is at the same time dependent on an existing agricultural presence to provide the additional environmental benefits (going beyond the baseline).

The existing Common Agricultural Policy provides a package of measures and policies divided into three main types, market expenditure, direct aids and rural development, but they are all designed to meet different aspects of interdependent objectives. A review of these existing instruments should address the following needs for a European Agricultural Policy whilst taking account of the cross-cutting links that exist between them.

### **Common rules**

Agricultural policy needs to ensure common rules for the European market, thus providing a level playing field for agricultural production at European level. This includes harmonised approaches towards defining basic standards and rules in the field of food safety, animal and plant health, animal welfare, and the environmental requirements. Furthermore, it includes a common approach towards supporting

agriculture and applying measures targeted towards market stability. However, common rules only meet part of the needs for European agriculture, which is a primary sector delivering public goods and which is subject to volatile markets and climatic conditions only worsened by climate change. A regulatory approach to agriculture is a necessary but insufficient measure in order to meet the needs of the sector.

### **Basic direct payment**

A basic direct payment is needed in order to maintain agricultural activity while facing increasingly volatile markets and secure a production capacity as a basis for providing public goods and to supply the important agri-food sector. The concrete implementation and design of such (a) direct payment(s) remains an open question. It is important that this basic payment is decoupled from farmers' production decisions and does not influence their market orientation. Direct support provides a reasonable income level for farmers facing volatile market conditions or disasters. In addition, by helping to maintain farming activity and reducing the risk of land abandonment, a decoupled direct payment provides a solid fundament on the basis of which complementary, more targeted measures remunerating the provision of public goods can be applied.

### **Safety-net**

Agricultural policy must provide, also in a long-term perspective, a basic safety-net intervention mechanism that does not influence the normal functioning of markets, but reinforces a consistent food supply in Europe and supports farmers in overcoming difficult production periods.

### **Targeted measures addressing specific needs**

Agricultural policy needs, in addition, targeted measures to address specific regional or national needs in rural areas. Targeted measures should reflect the specificity of regions, while designing the measures according to the needs for development and the regional potential. The diversity of rural areas has to be reflected in the approaches towards governing the process of programming and additional resources are mobilised through a co-financing mechanism. Targeted measures should help farmers to adapt to open and competitive markets, in diversifying their activities, and in responding to societal demand concerning challenges related to the environment, climate change, and water management. They will contribute to achieving the objectives of the Lisbon agenda and the Gothenburg strategy.

### **Review**

A number of approaches can be considered for how a future policy for management of natural resources in Europe should be designed. Clearly, it must take as its basis the needs set out above, but in view of their interdependency, approaches different from the existing ones merit a much closer look.

## Annex

### A BRIEF SUMMARY OF THE CAP REFORM PROCESS

#### 1. The CAP today

Following a path of successive reforms since 1992, the Common Agricultural Policy is currently centred on three main policy axes, which aim to respectively support product prices, producer income, and structural adjustment. With the CAP constrained by a fixed budgetary allocation, its reform process has been consistent with a gradual, but systematic improvement in the efficiency of its policy measures by gradually replacing the least policy-efficient by the most policy-efficient measures, while at the same time decreasing its relative share in the EU budget. Graphs 1-4 graphically depict this reform process both in terms of the relative size of each axis in nominal budgetary terms and in terms of the declining share of the total CAP budget in the EU GDP.

#### 2. Product support

The core element in the CAP reform process has been the decline in support for products and their prices towards support for producers and their income. This process implied a parallel shift of the cost of the policy from consumers towards taxpayers. The decline in support prices has been significant in all sectors, ranging from 1%-16% in dairy products to 57 % in rice (table 1). In some sectors, support prices have been abolished all together.

*Table 1. Cumulative change in nominal terms in CAP support prices (1991 to date)*

<i>Product</i>	<i>Soft wheat</i>	<i>Durum wheat</i>	<i>Rice*</i>	<i>Sugar*</i>	<i>Beef</i>	<i>Butter</i>	<i>SMP</i>
Price change	- 48 %	- 61 %	- 57 %	- 39 %	- 29 %	- 16 %	- 1 %

*\*(1992 to date)*

*Table 2. Cumulative change in real terms in CAP support prices (1991 to date)*

<i>Product</i>	<i>Soft wheat</i>	<i>Durum wheat</i>	<i>Rice*</i>	<i>Sugar*</i>	<i>Beef</i>	<i>Butter</i>	<i>SMP</i>
Price change	- 80 %	- 85 %	- 84 %	- 77 %	- 73 %	- 68 %	- 61 %

*\*(1992 to date)*

The results of this reform process have been:

- The decrease in the gap between EU and world market prices.
- The decrease in the exportable surplus of all supported EU products, or even the transformation of the EU into a net importer where previously it was the major world net exporter (in beef, and now potentially in sugar), driven primarily by the increase in domestic consumption. The decline in budgetary expenditure related to market measures, that represented 74% of all EU agricultural expenditure in 1992 to just 10% by 2007.

- The move away from these measures of the CAP that are generally perceived to be the most trade-distorting, such as market intervention and especially export subsidies.
- The decline in the level of stocks going to intervention, and thus the decline in the downward pressure the put on market prices (graph 5).

### **3. Producer support**

To compensate producers for the potential income loss as a result of the shift away from product support, the CAP initially introduced in 1992 coupled payments to producers, based on either fixed areas/yields or a fixed number of animals. This move resulted in the reversal of the previously declining trend in agricultural income in the late 1980s.

Subsequently, with the 2003 reform, producer support became more and more decoupled, promoting more market orientation and a fixed level of income safety net available to farmers. To guarantee "value for money", cross compliance provides a mechanism which contributes to the respect of a set of mandatory standards by penalising producers in case of non-respect.

Yet despite structural adjustments, incomes in the agricultural sector remain below average income levels in other sectors of the economy. Their development since 2000 also lags behind the national income growth in EU-15 and only keeps up with it in EU-10, where income increase has been substantial (graphs 6 and 7). At the same time, farmers face income disparities, subject to region and size.

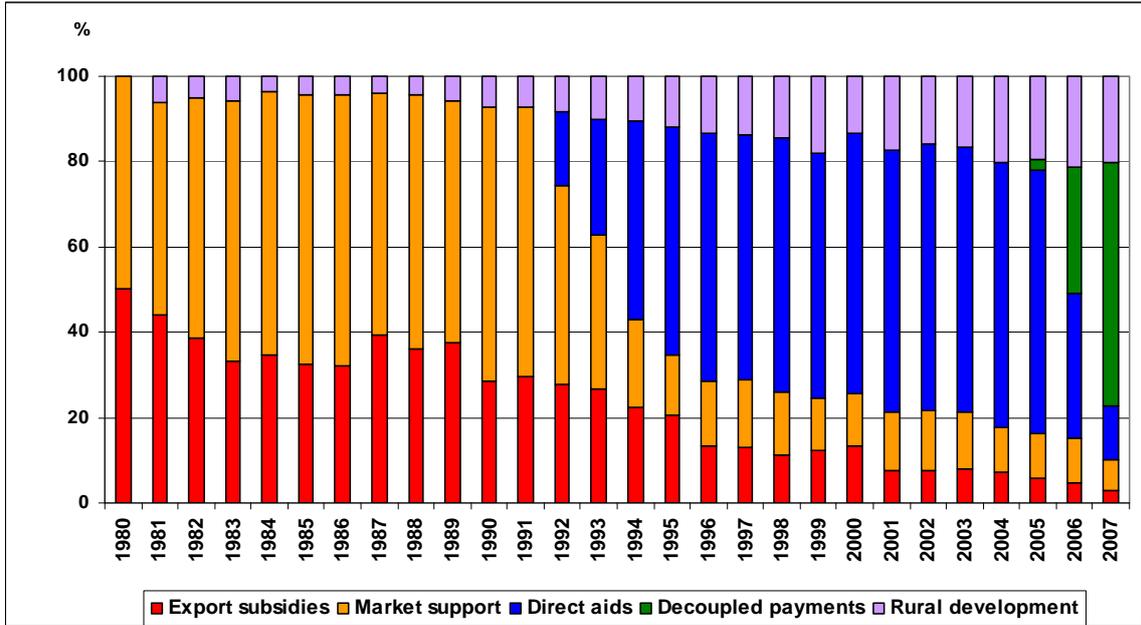
The move of support towards full decoupling in 2003 has raised certain questions with respect to the balance of support, both among farmers within the same member states and among member states, which will have to be addressed with future reforms. The situation is characterised by a very different picture of the distribution of support depending on the criterion used - per beneficiary or per area, as a share of GDP or public expenditure, with respect to farm income or average wage, etc.

### **4. Adjustment support**

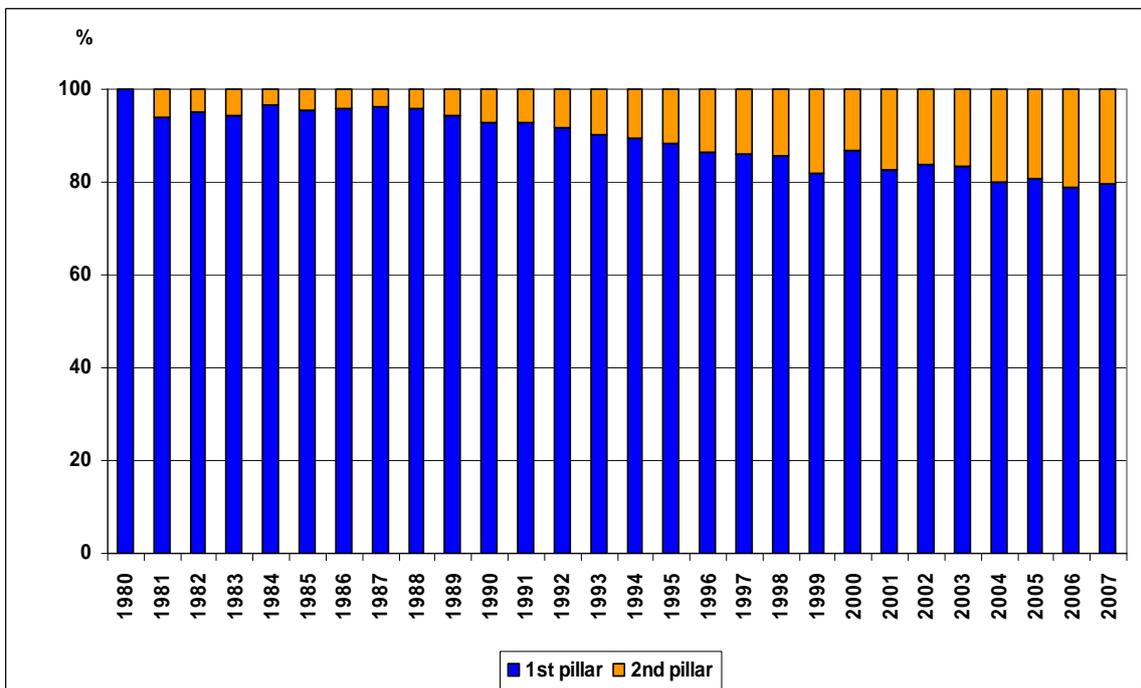
An integral part of the CAP reform process has been the parallel reform of Rural Development measures that assist the overall process of structural adjustment of the sector in three broad areas: investment and modernisation, agri-environmental measures, and measures related to the support of the wider rural economy. To further strengthen the budgetary allocation towards Rural Developments, modulation introduced a cut in direct payments, with the corresponding funds channelled to Rural Development.

The balance of Rural Development support between the community budget and the Member State budget, as well as the balance between the three broad axes of Rural Development, differs from Member State to Member State because it is exactly in this area that subsidiarity applies. Adjustment challenges and needs are not uniform across MS, and the measures required are naturally different. Yet these measures move in a complementary direction to the overall reform process by enhancing the general market orientation of the policy while providing the necessary product and producer safety-nets.

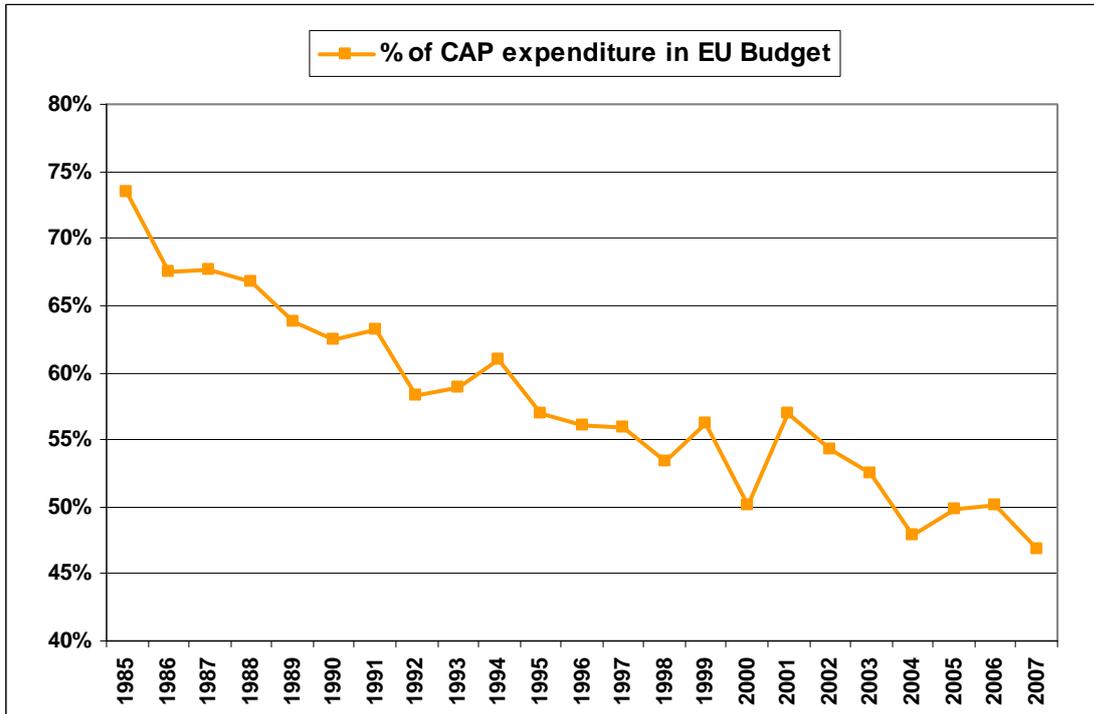
**Graph 1: Evolution of CAP expenditure and CAP reform path**



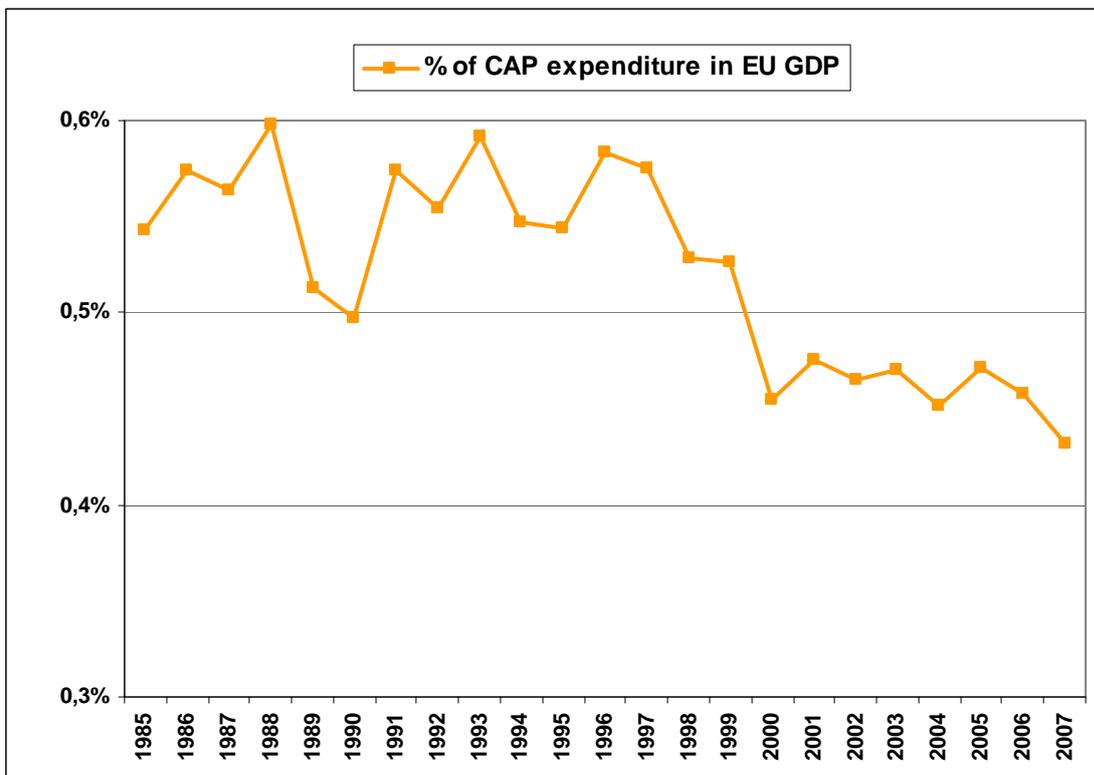
**Graph 2: Evolution of 1<sup>st</sup> and 2<sup>nd</sup> pillar expenditure**



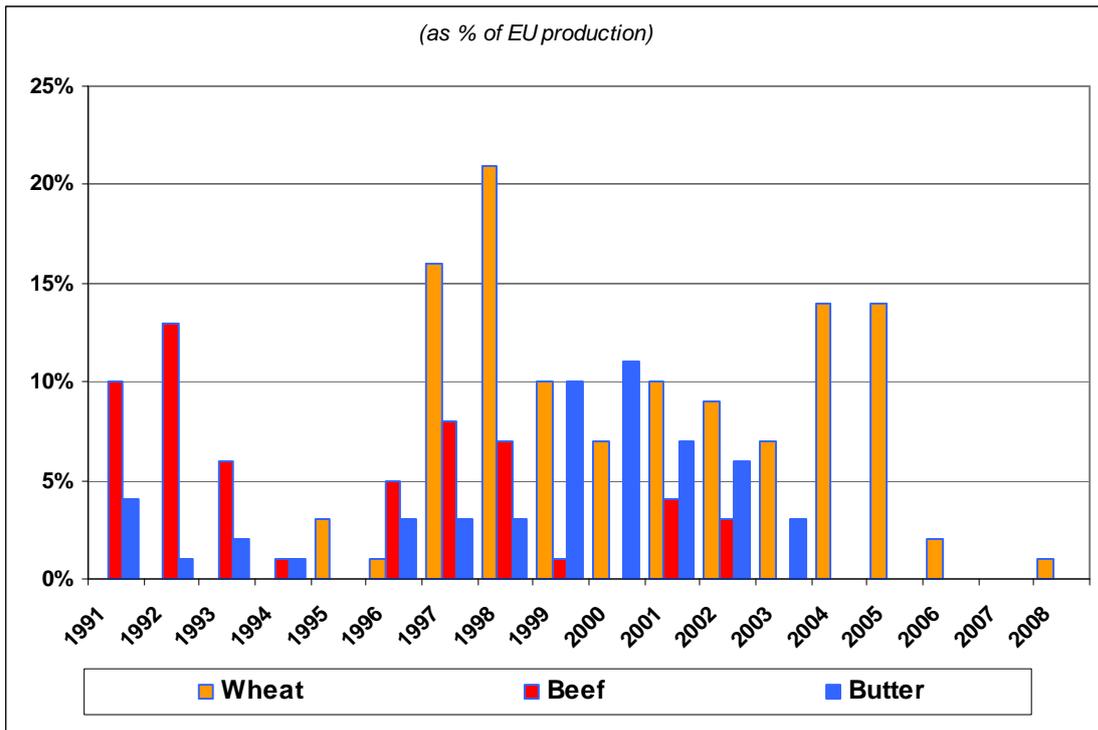
**Graph 3: Percentage of CAP expenditure in EU budget**



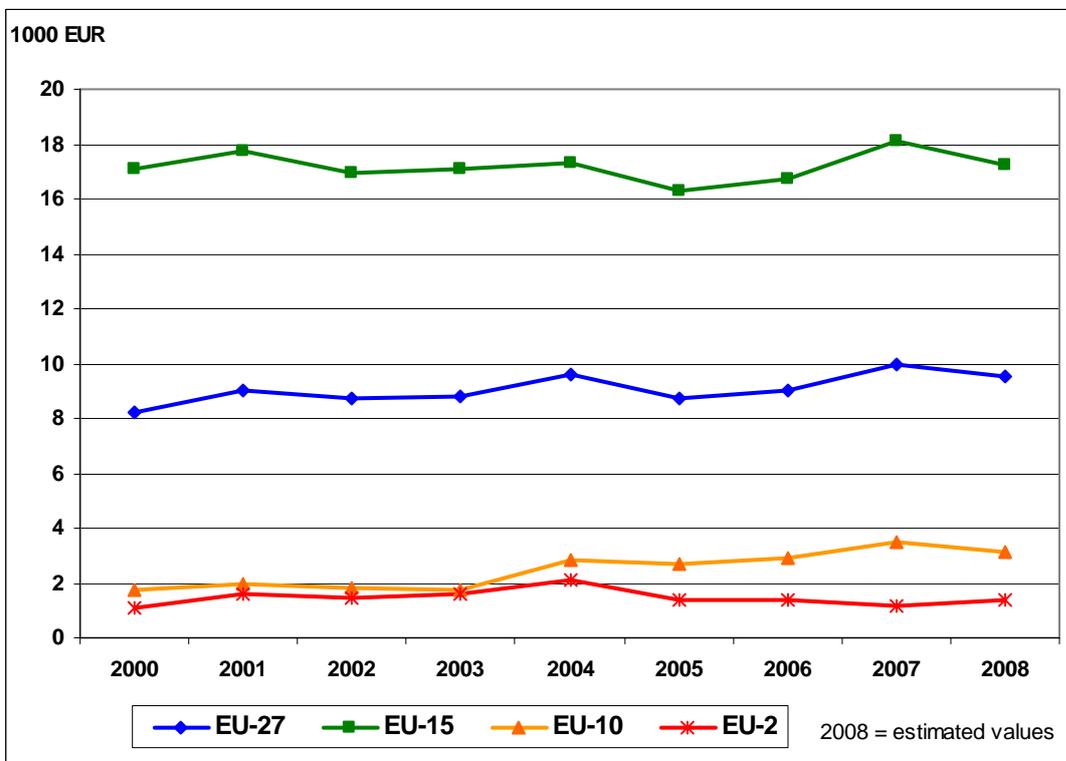
**Graph 4: Percentage of CAP expenditure in EU GDP**



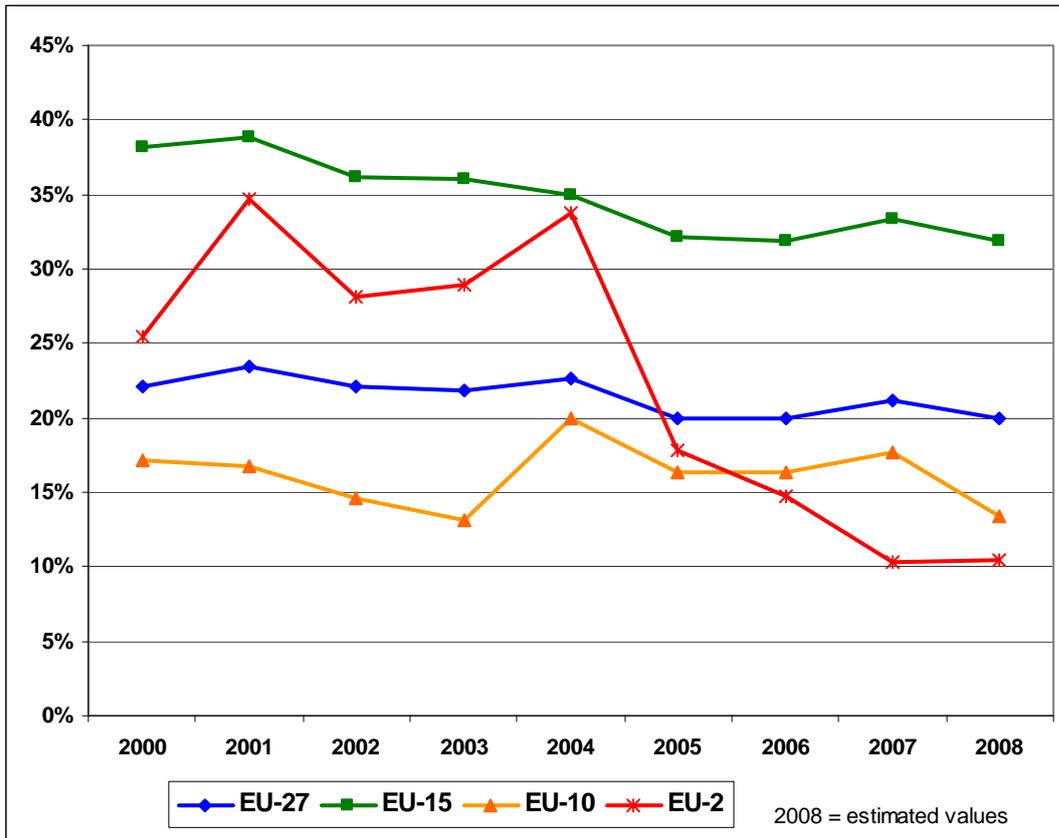
**Graph 5: EU public stocks**



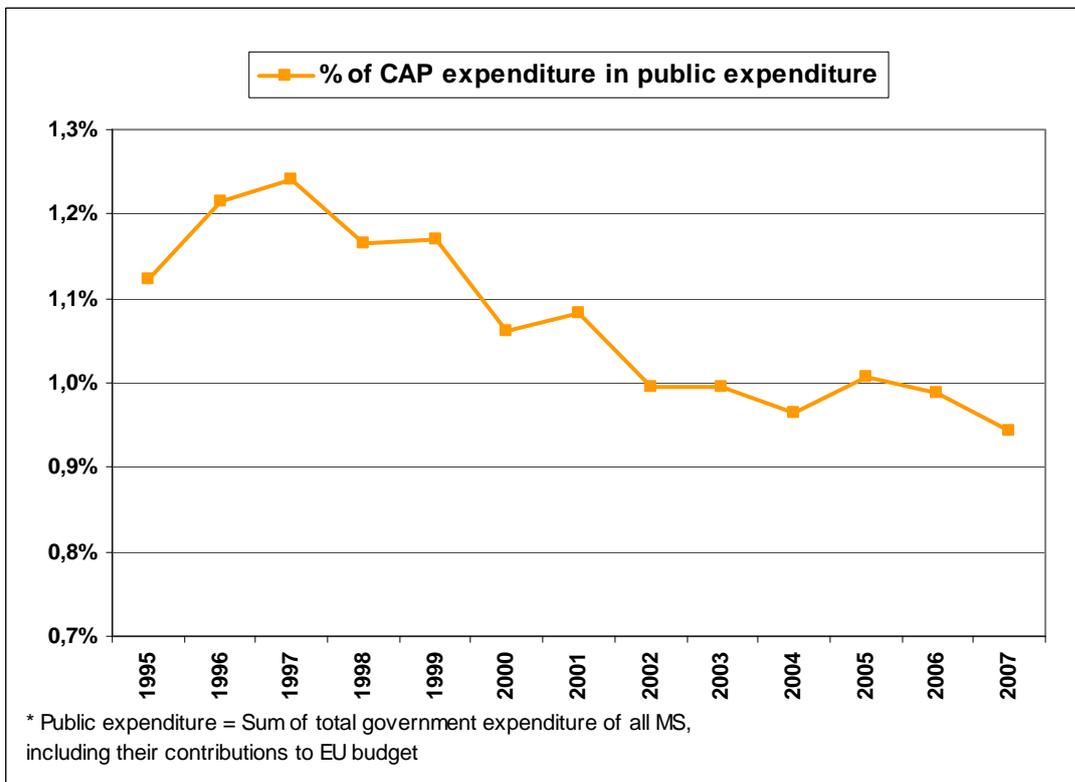
**Graph 6: Agricultural income/AWU in deflated Euro**



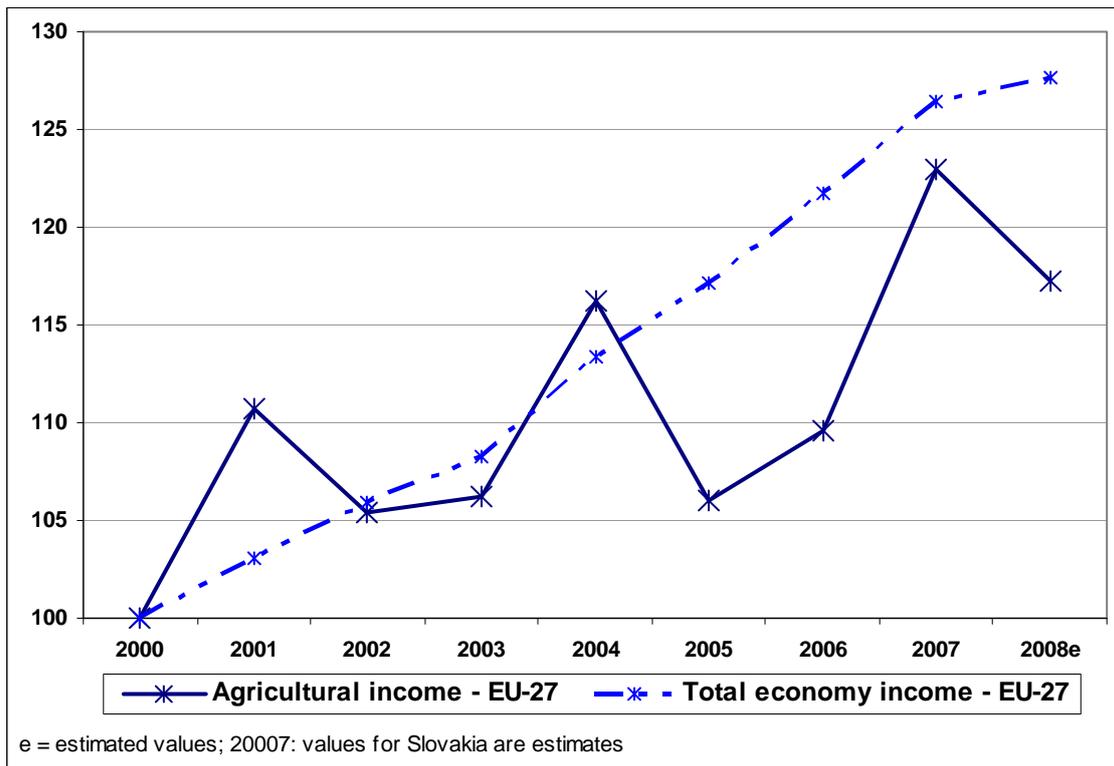
**Graph 7: Agricultural income/AWU unit as % of total economy income/labour unit (deflated)**



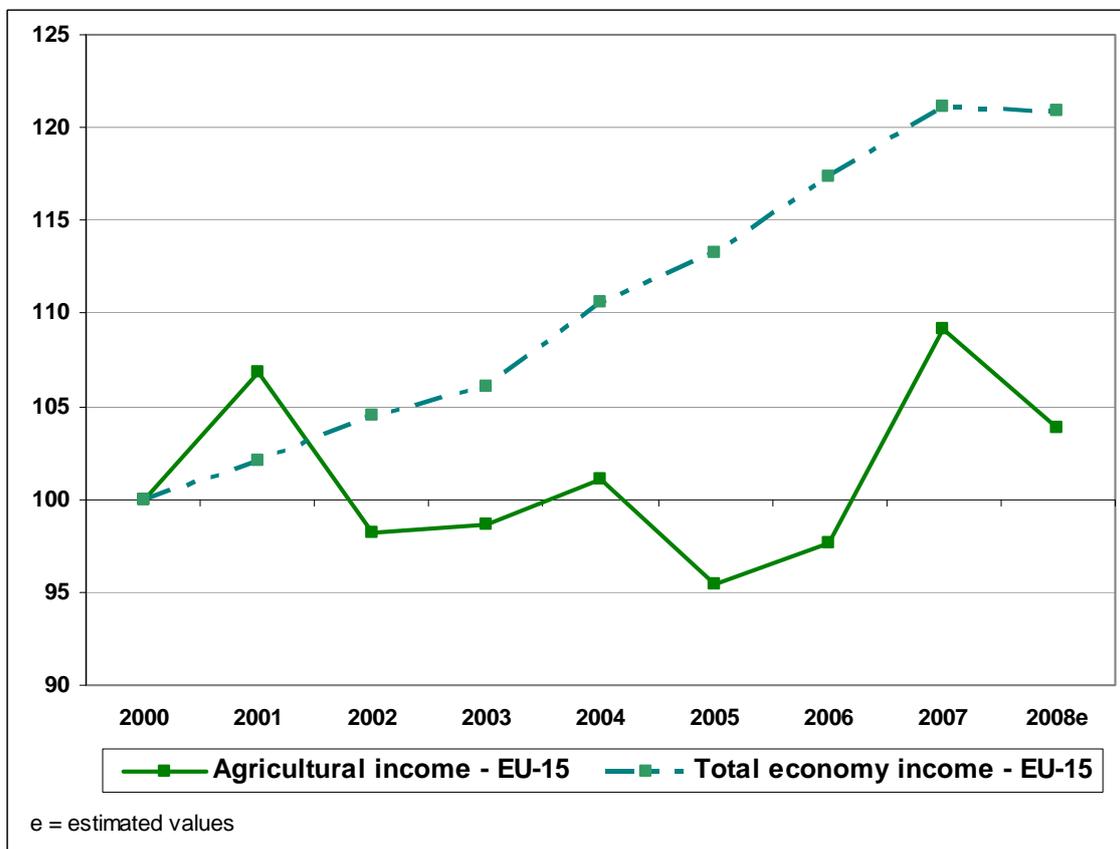
**Graph 8: Percentage of CAP expenditure in public expenditure\* (deflated)**



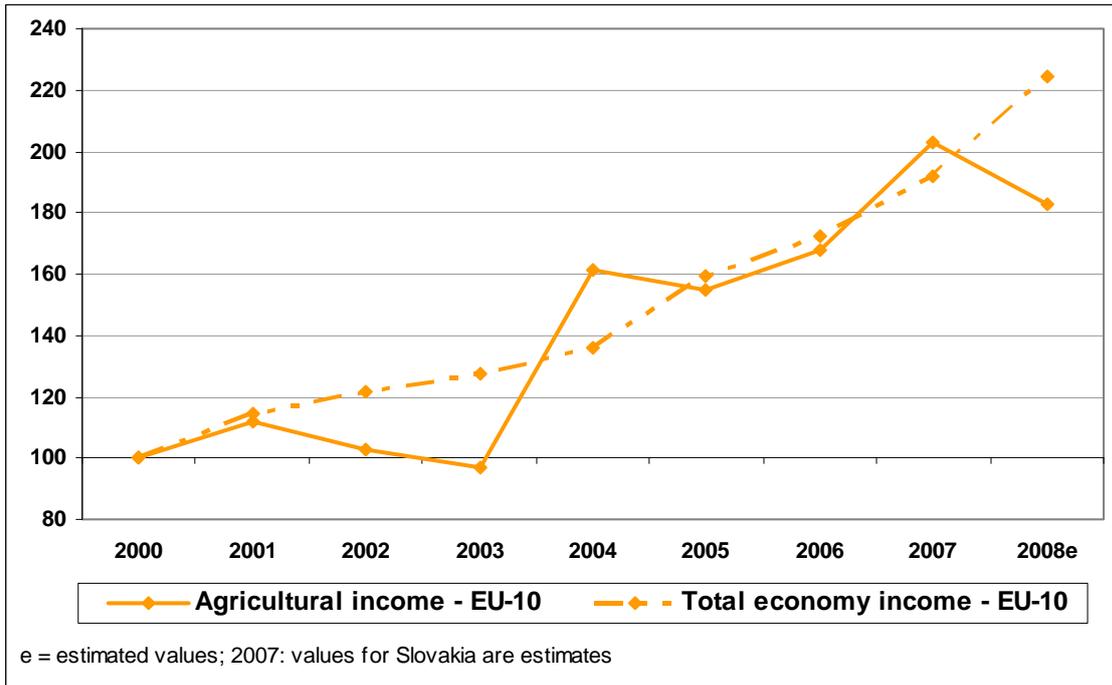
**Graph 9: Evolution of income/labour unit in the EU-27 (deflated)**



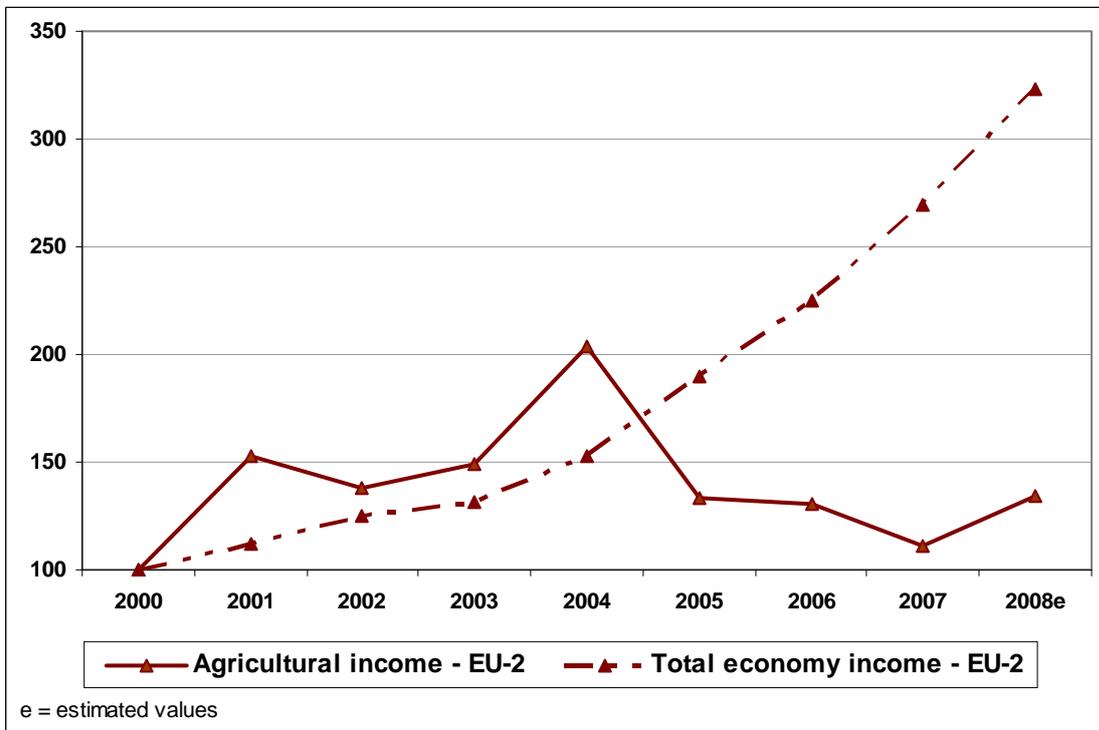
**Graph 10: Evolution of income/labour unit in the EU 15 (deflated)**



**Graph 11: Evolution of income/labour unit in the EU-10 (deflated)**



**Graph 12: Evolution of income/labour unit in the EU-2 (deflated)**



**Graph 13: Evolution of CAP expenditure and total public expenditure as % of GDP (deflated)**

