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Long-Term Common Agricultural Policy (Cap) Vision

Introduction

Can we agree fully with the statement, that "agricultural spending is a major distorting factor in the EU economy and a distinct obstacle to the Lisbon agenda's implementation"? (Gros, 2008) Is it true in all cases, that member states are in a better position to execute the agricultural policy and there is a need for non-intervention at EU level? Is it a good option to phase out Common Agricultural Policy (CAP), if the CAP can be considered to be much more than a factor (tool) having put into force the UK rebate which allows a special treatment of one member state and results in a more opaque budget? Is it unambiguous in every respect, that the challenges facing the sector – globalization, trade liberalization, climate change, water management, Lisbon process, enlargement, changing preferences – could be answered at national level utilizing exclusively national financial sources? Is it without question that Europe's agriculture is in position to become sustainable and competitive without certain kind of common policy with no Community financing? (Sustainable development at sectoral (here agriculture) and territorial (rural areas) level represents a priority objective of the European Union strategy, as can be derived from many of the most recent documents.) Shall one consider agriculture to be more than economic activity? The answers to these questions are complex. So the purpose of the paper is the assessment of the progress of the CAP towards the path of sustainability and outlining a possible sustainable alternative.

Sustainability of agricultural activities

The first crucial aspect attains the definition of sustainability. Sustainable agriculture has attracted great attention in recent decades. Several studies were developed on this issue by FAO, OECD, USDA, the European Union etc. However, there is no universally agreed definition of the concept of sustainability, nor general consensus on its representation.

In our paper we adopt the definition included in the Brundtland report (WCED, 1987) which is the most widely quoted and generally accepted. According to this very broad definition sustainable is the development that meets the needs of the present without compromising the ability of future generations to meet their own needs.

Whatever the adopted definition, the operational interpretation of the concept of sustainability includes three dimensions: economic, social and environmental. And these need to be considered in an interdisciplinary and integrated approach covering also a wide range of spatial and organizational scales that allows an all-round understanding of the issues facing stakeholders. Globalization, trade, policy, climate change, supply-chains, business structures and stakeholder preferences, consumer preferences all have profound effects on the sustainability of farming systems. (Furthermore the aggregate effects of decisions in farming systems also have significant spill-over effects into related sectors.)

a) Globalization. Globalization means more intensive competition, significant global trade flow and market opening. Supply side adjustment and product differentiation becomes more and more important. At the same time, with the increasing global trade flow the risk of food safety, animal and plant health is higher too. Structural adjustment is inevitable.

b) Trade liberalization. Trade liberalization further broadens international agricultural trade, increases international competition and therefore the need to improve the competitiveness of agricultural market players.

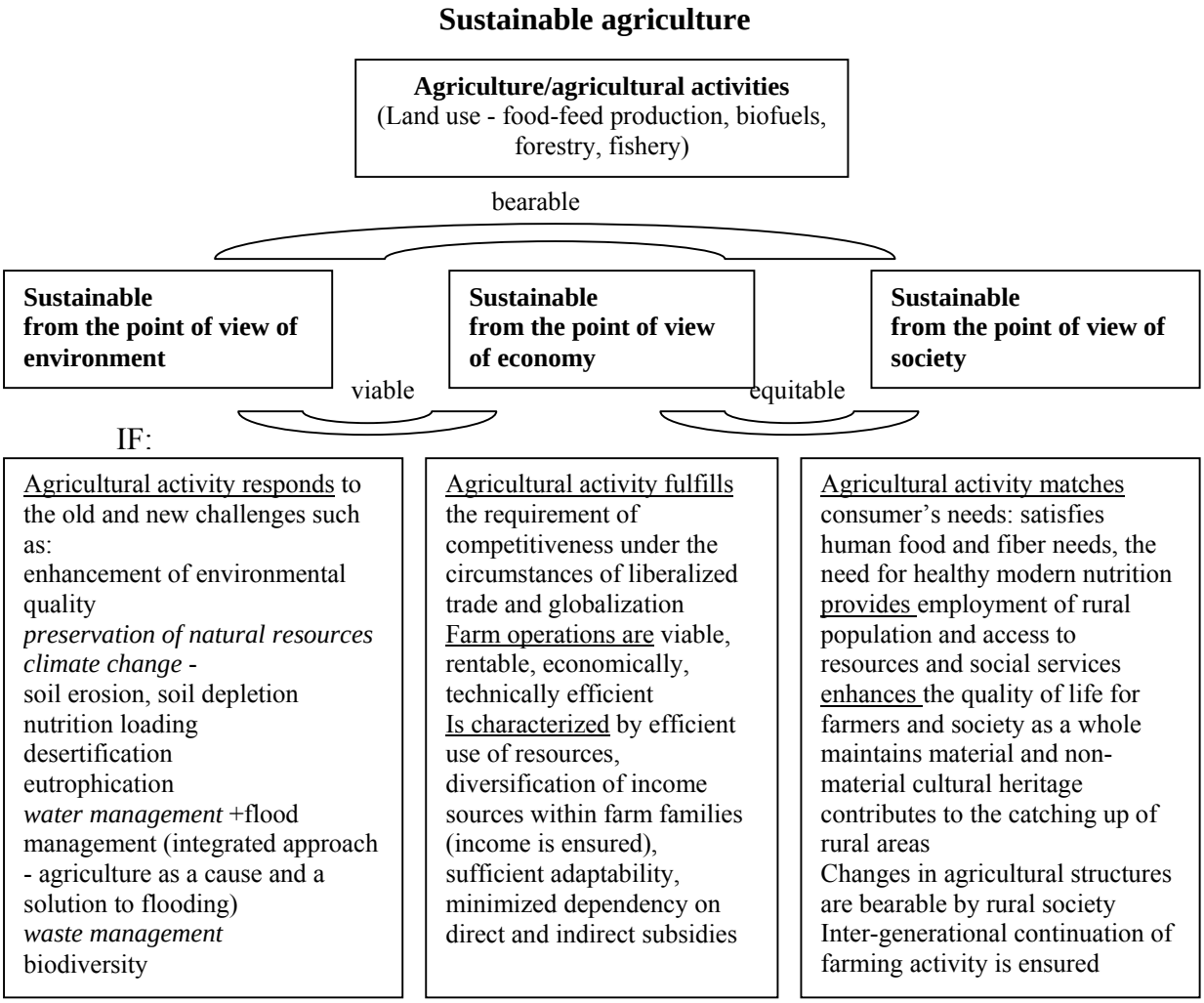
c) Climate change. Increasing concentration of CO_2 and the higher average temperature may result in higher yields. The letter increase may be limited by the difficulties in the water supply. Agriculture is also an important climate influencing factor: land management adjusted to the changing climatic conditions may limit unintended changes.

d) New sources of demand. Increasing attention is focused on renewable energies (e.g.: agriculture based bio fuels) as resources of carbohydrates are limited, their price is increasing and both fossils and nuclear energy are accompanied with unfavorable environmental effects.

e) Structural reforms. The Lisbon strategy aims to strengthen economic growth, broaden employment and improve competitiveness while at the same time insuring sustainable utilization of natural resources.

Agriculture/ agricultural activity (Figure 1) under the abovementioned circumstances could be sustainable if it is backed up also by a sustainable agricultural policy.

Figure 1



An agricultural policy is sustainable if it is 1. aimed at certain well defined goals and 2. equipped with adequate instruments to help stakeholders to reach these goals.

Goals that should be aimed at and policy tools to be used by sustainable agricultural policies

In environmental context agricultural policy instruments should contribute to:

– **conserving resources** (e.g. Farmers should diversify the spatial organization of their fields through the insertion of new patches of natural vegetation well connected with the surrounding habitat. The presence of vegetation (hedgerows) along the farm boundaries reduces windspeed thus minimizing soil loss by wind erosion and water loss by excess of transpiration./ Minimum tillage and cover cropping management can

be used to conserve soil. In irrigated orchards drip irrigation and irrigation planning can be used to conserve water.)

- **using renewable resources**
- **adjusting to local environments**
- **managing ecological relationships** (e.g. In organic olive orchards minimum tillage can be used as well as mulches, minimizing disturbance. Cover cropping and an ecological infrastructure can be used to enhance beneficial biota and beneficial insects. Management of pruning residues, cover crops and animal manures recycle nutrients. Insect pests, diseases, and weeds can be managed with the use of cultural practices, mass trapping methods and biological control. Patches of natural vegetation provide important habitats for the propagation and protection of a wide range of natural biological control agents of agricultural pests.)
- **minimizing toxics** (e.g. use of organic farm regulations/ The use of trap crops can drastically reduce the quantity of pyrethroids sprayed in the environment. This broad spectrum insecticide can be used only in a small area and not on the crop. The reduction of the use of insecticides enhances beneficial insects in the agroecosystem. It allows the natural control of other important pests. By not applying insecticides directly on the target crop, there can be a reduction in the amount of insecticides used, which greatly benefits human and environmental health.)
- **diversifying** (e.g. Undisturbed areas of native species encourage the creation of a more complex and diverse agroecosystem with a variety of living organisms.)
- **managing whole systems** (Landscape ecology and geographical information analyses emphasize a whole-system approach of the agricultural landscape focusing the attention on the relationship between farms and natural systems.)
- **maximizing** long-term benefits (e.g. By reestablishing the balance between an exotic weed and its herbivorous pest, certain insects act as a permanent weed management tool.)

In economic context agricultural policy instruments should contribute to*:*

- **eliminating market distorting effects** (e.g. distortion of input markets through machinery support)
- **producing competitive outputs**
- **decreasing policy-related transaction costs**
- **diversifying income sources of farms**

- **establishing and implementing special design methodologies** (Appropriately designed farming methods are essential for achieving the objectives of sustainable farming systems. E.g. Designing and Disseminating Ecological Production Systems for Perennials.)
- **finding the best-management-practice options**
- **creating instruments to enable producers using sustainable practices to market their goods to a wider public.**

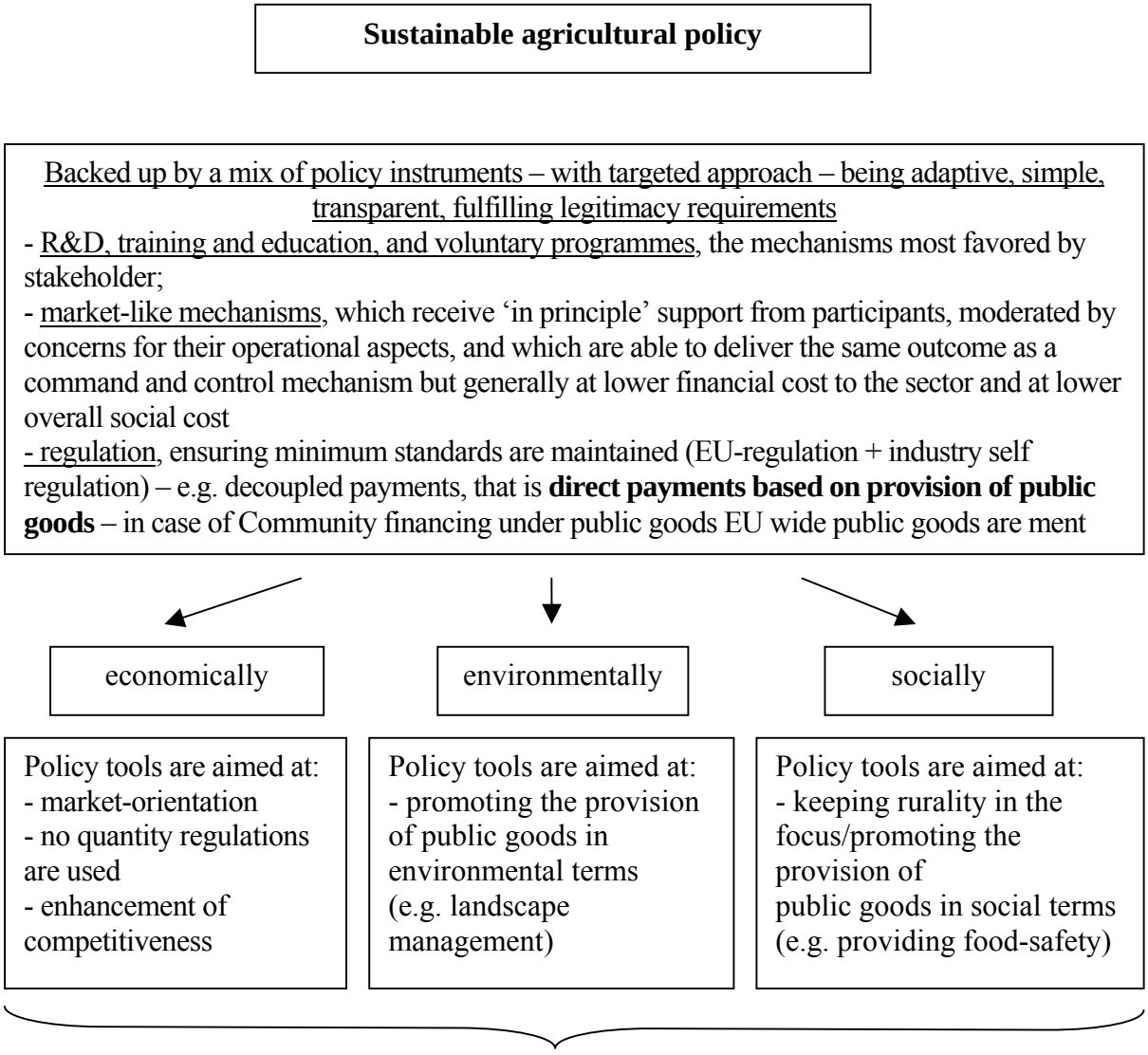
In social context agricultural policy instruments should contribute to:

- **finding strategies that broaden consumer perspectives**, so that environmental quality, resource use, and social equity issues are also considered in shopping decisions.
- **valuing health** (e.g. use of native medicine, cultural celebration, healthy food education and ecological restoration.)
- **empowering people** (An agri-environmental group can promote an ecological knowledge system in the rural area.)

In order to make sure of reaching the goals aimed at assessment tools have to be used. For sustainability evaluation of production systems, a variety of assessment tools has been developed in the past, including Life Cycle Assessment (LCA), Cost–Benefit Analysis (CBA), Environmental Impact Assessment (EIA) and Sustainability Standards with Principles, Criteria and Indicators (PC&I). These and new ones help measuring the level of sustainability. (Van Cauwenbergh et al., 2007)

In order to attain the objectives agricultural policy has to be backed up by a mix of policy instruments that are simple, transparent, adaptive, accepted by the whole society and shaped through a targeted approach. The aims of funds have to be dissociated. One specific objective should be attributed to one payment. (Certain payments with multiple objectives e.g. direct payments need to be restructured, not necessarily abolished)

Figure 2



According to OECD operational criteria for agricultural policy measures are the following:

- Transparent: having easily identifiable policy objectives, costs, benefits and beneficiaries
- Targeted: to specific outcomes
- Tailored: transfers no greater than necessary to achieve clearly identified outcomes
- Flexible: reflecting diversity, able to respond to priority changes, appropriate duration
- Equity: taking into account the effects of the distribution of support between sectors, farmers and regions (OECD, 1998).

Criticism on the Common Agricultural Policy

Comparing ideal agricultural policy with actualities of the CAP following facts need to be taken into account:

The CAP clearly fails to achieve its objectives efficiently and cost effectively. (See also Núñez Ferrer, J. – Kaditi, E. A., 2007)

Although there have been significant changes to the CAP, its current system is still not sustainable. As far as *decoupling* is concerned, which was meant to be pivotal to the reform, progress *has been limited*; the most recent (2003) reform decisions – against the European Commission's more radical proposal on full decoupling – involve only partial decoupling. (Nonetheless, even this compromised solution is a great step forward compared to the earlier situation; in addition each country may decide to introduce full decoupling.)

Other critical notes that are to be drafted:

Present CAP doesn't back up economic sustainability because:	- Market distorting effects of the system on the way to decoupling has significantly weakened, still a great proportion of *direct payments* may capitalize in land prices and land lease fees, i.e. it *may distort input markets* and the transfer rate of agricultural subsidies (i.e. the rate of one unit of subsidy received by the agricultural producer) may worsen. - Paradoxically, the reformed system is *more complex and bureaucratic* than the original model. - The reform of 2003 promised the simplification of the system; however, the compromise (a system of different national implementations including various possibilities of coupling) disrupts the existing unity of the system, and endangers the implementation of the "single market" principle. - Furthermore, this could lead to significant redistribution; while the regulation of cross-compliance and the implementation of the rules result in even more complex conditions, thus more transaction costs. - The value added of direct payments in the present form – covering multiple functions: income support plus cross compliance - is more likely negative. Lost opportunities within the agricultural sector and rural areas – even elsewhere in the economy - are high. - There are serious issues in relation to the lack of a link between the costs of the required farming practices and direct payments. The payments do not relate well with the issues (income support, environmental actions) being addressed. This would be a violation of the principles of efficient public intervention and can be considered a violation of interpersonal equity principles of EU support.
Present CAP doesn't back up economic sustainability because:	- "The CAP direct payments are not based on any analysis of the individual needs of farms and as such fail in targeting low-incomes farmers. The CAP is benefiting the owners of primary factors or production rights, and these are not the intended main beneficiaries of the CAP." (Núñez Ferrer, J. – Kaditi, E. A., 2007) - The elements of *quantitative regulations* may still cause disorder, the mandatory set-aside is still in force and the elimination of the milk quota may be placed on the agenda only after 2013. - Difficulties can be expected as regards the financing of direct payments and the budget review may further limit the CAP's financial possibilities. - Conclusion of the WTO Doha round and the resulting new agreement(s) may challenge the CAP too.

Present CAP doesn't back up social sustainability	- Regardless the declarations the role of *rural development* is still limited. - It has to be noted that in 2004 the CAP system was expanded by ten new member states. As far as support is concerned significant *disparities* have evolved making the new member states handicapped: while the producers in wealthier member states receive high amount of payments falling in the scope of the first pillar fully from the common budget, the poorer countries' share is much smaller. - Direct payments are *based on historical payments*, reflecting neither social aims, nor the value of public goods provided. - The system is very complicated and lacks of transparency so it is difficult to get the society approve it.
Present CAP doesn't back up environmental sustainability	- Direct payments are *based on historical payments*, reflecting neither social aims, nor the value of public goods provided.

(Critical notes see also CEPS Tasks Force Report, 2007 pp 14-16)

Future sustainable CAP

Unlike in the overseas counterparts, the European agriculture plays an important role in the economy, in the management of natural resources, shaping the environment and in the social structure. European agricultural activity cannot be considered exclusively economic activity. Besides production, the agricultural sector provides additional services for the society. That is why one of the most important characteristics of the European model of agriculture is multifunctionality.

So the goals of a sustainable furthermore multifunctional agriculture should be aimed at by using direct support based on the agriculture's additional services: on positive externalities or European public goods. (Table 1 lists the most important public goods and their spill-over effects.)

This type of direct support wouldn't impose market distorting effects it wouldn't be bound to quantitative regulations and it could be accepted by the society to a great extent.

These multifunctional elements serve significant cross-border externalities. The condition of the surface has a significant impact on cleanliness of surface water, air, the drainage areas of rivers and the climate. The standard application of animal and plant health and environmental management criteria is a priority in the EU member states. The fundamental question is firstly – as policy instruments require adequate financial sources - how to promote the provision of public goods, and secondly at which level - national or community - financing can be justified.

Table 1: Certain public goods provided by agriculture

	Public goods	Spill-over effects
Environment friendly agricultural production practices	Protection of natural resources Stable ecosystem Biological diversity Protection of valuable natural areas Carbon sequestration	Local, regional, European Regional, European, global Local, regional, European, global Local, regional, European European, global
Ethical agricultural production	Food safety Animal welfare	Local, regional, European Local, regional, European, global
Socially sustainable agriculture	Buffer function on the labour market Cultural diversity	Local, regional, European Local, regional, European, global
Land management	Stable ecosystem Biological diversity Carbon sequestration	Regional, European, global Local, regional, European, global European, global
Preventing deforestation	Forest biodiversity Stable ecosystem Wildlife Reduction of greenhouse gas Carbon sequestration	Local, regional, European, global Regional, European, global Local, regional, European, global Local, regional, European, global European, global
Combating desertification and drought	Carbon sequestration Watershed protection Biodiversity conservation in drylands	European, global Regional, European, global Local, regional, European, global
Sustainable mountain development	Stable ecosystem Hydrological stability Carbon sequestration	Regional, European, global Local, regional, European European, global

Source: Own compilation based on FAO, 2002 and 2007

How to promote the provision of public goods?

The multifunctional factors result in economic policy action, if *there is no private market for certain welfare increasing or decreasing joint outputs*. If there is a need for political action in such cases for the internalisation of externalities, the characteristics of the affected activity will have an impact on planning and the application of the corrective measures.

As a basic principle, the non-product outputs of agriculture should meet the needs of the society as regards their quantity, composition and quality. According to certain OECD countries (including the EU member states) the decrease in support linked to production (coupled payments) and the liberalisation of trade will decrease positive joint non-product output of the agriculture that has no market through the reduction of production. *In case of the joint production of private and public goods* efficiency will require that private goods are

produced, used and traded governed by market mechanisms. In addition, *for the production of public goods required by the society targeted and decoupled economic policy measures are necessary.* The eventual goal is to establish principles of good policy practice "that permit the achievement of multiple food and non-food objectives in the most cost-effective manner, taking into account the direct and indirect costs of international spill-over effects." (OECD, 2001d p. 10)

At the same time *the calculation of economic costs of such agricultural externalities is rather difficult.* Such costs may vary depending on the different conditions. It is also difficult to calculate the value of natural resources. Research on preferences related to environmental goods may bring interesting results. (Through for example the examination of a hypothetical market, the intention to pay of those questioned for multifunctional services.)

Not much is known about the actual value and costs of such public goods. Yet we know that these are not free goods; the positive externalities generated as tied output have additional costs. (Eliminating these would result in less cost.)

To what extent community financing can be justified?

There are several factors which justify the community level intervention. Theoretical frameworks ensure the possibility of financing agriculture at EU-level.

According to the *fiscal federalism* theory (Pelkmans, 2001, Baldwin–Wyplosz, 2004, El Agraa, 2004) centralised (or Community level in this case) financing may be justified in case of significant, positive and negative *cross-border externalities* and spill-over effects[1] (see Table 1 in case of agriculture). (The bottom line of the "decentralization theorem" that centralization is welfare superior when spill-overs are sufficiently high was proved e.g. by Koethenbuerger, 2007.)

"Given the present budget structure, several authors like Tabellini (2003) or the Sapir commission (Sapir, 2004) have demanded a higher involvement of the EU in those policies which can be expected to create a European added value[2]. This would imply a shifting of resources from the distributive spending to public goods in areas like international affairs,

[1] The question arises, however, how the difference in the utility of centralization and decentralization changes with respect to the level of spill-overs.

[2] "Reports by the European Court of Auditors, academic studies and even the Sapir report (Sapir et al., 2003) commissioned in July 2002 by the then European Commission President Romano Prodi, also criticise the goals, implementation and added value of the EU budget. Consequently, the contributory solidarity of member states has practically disappeared. Reluctant net contributors agree on a suboptimal policy mix apparently dictated mainly by political pressures and the wish not to cause a breakdown of EU structures."

immigration or security policy (external aid, border controls), as well as R&D and innovation policies, hence areas, where economies of scale or positive external effects prevail." (Osterloh et al, 2008) It definitely implies a shifting but as agricultural policies are also able to create *European added value*[3] EU financing in the agricultural sector cannot be totally eliminated. Agriculture does have such expenditure objectives for which spending by a supranational structure are more efficient than national expenditures. Let's name the environmental objectives. "Given the enormous priority of the environment for the future, it is rather unfortunate to see it having such little relevance. Because of the cross-border nature of pollution, environmental actions quintessentially need to be solved at the multinational level. Even admitting that convergence policies and R&D have some environmental aspects and that much of the EU's action is regulatory, spending on the environment is surprisingly low. Given the challenges posed by climate change and the need for adaptive and mitigating practices, there are reasons for substantial budgetary allocation in this area." (CEPS Tasks Force Report, 2007) Let's mention the income support objective as well. Direct payments –as income support tool - could create a value added if low-income farmers benefited and the policy ensured that farming stays in areas where it is socially desirable. In economic terms the desired value added of the impact and the society's willingness to pay to preserve the benefits of agriculture, especially in areas in decline is in line with the cost of the policy. (Núñez Ferrer, J. – Kaditi, E. A., 2007)

Taking into account these considerations and the criticism European added value and the quality of the CAP have to be, however, increased significantly. In this regard the aspects to be improved are the following:

- Targeting
- Widening the scope of intervention to non farm activities
- Evaluation quality

Direct payments should be:

- restructured and aligned further to their objectives; (There is a need for tightening eligibility criteria to ensure that funds are allocated where needed.)
- based on a cost-based analysis;

[3] European value added is dependent on objectives having a greater impact by being implemented at the supranational level and not at other secondary decision levels.

In economic terms European value added means that the economic return to recipients after an investment by the EU should be higher than without the investment. For agricultural policies, however, value added is not bound to be quantifiable in economic terms, but substantial and important in political terms. (Danell,– Östhol 2008)

- targeted – thus freeing resources which could be used first of all for holistic rural development actions.

Rural development support (payments for rural areas, food safety, food quality standard and environmental protection):

- should be aimed at generating endogenous growth, generating economic development on a 'territorial' basis;
- should be carefully devised and targeted.
- The eligibility rules for these supports should be refined. (Núñez Ferrer, J. – Kaditi, E. A., 2007)

Provision of public goods supposes public finance: either from the common or from the national budget or both of them. Among others it is to mention, that a relatively large share of environmentally sensitive areas is of international importance. Protection of these areas can not be exclusive liability of member states. It is a common interest to have the landscape in less developed countries and regions meet the requirements of the European model. *Provision of European public goods under common frames can provide compensation for uneven distribution of costs.* Also Gros (2008) suggests, that "one guiding principle for the EU budget: expenditure at the EU level is appropriate mainly to safeguard a *European public good*. Over time, the EU budge structure should reflect this simple principle." But if we continue to quote him we can not agree fully with his statement, namely: "There is no justification for spending a major part of the EU's scarce resources over decades on a declining industry such as agriculture." As European agriculture is in position to provide EU-wide public goods - *multifunctional elements serve in deed significant cross-border externalities* – financing at EU level is justified. The question – to what extent, however, remains (as mentioned earlier).

Threats arising from eliminating EU-level financing:

In case of re-nationalization member states could support their agriculture at different level. This would threaten the internal market and weaken the social-economic cohesion.

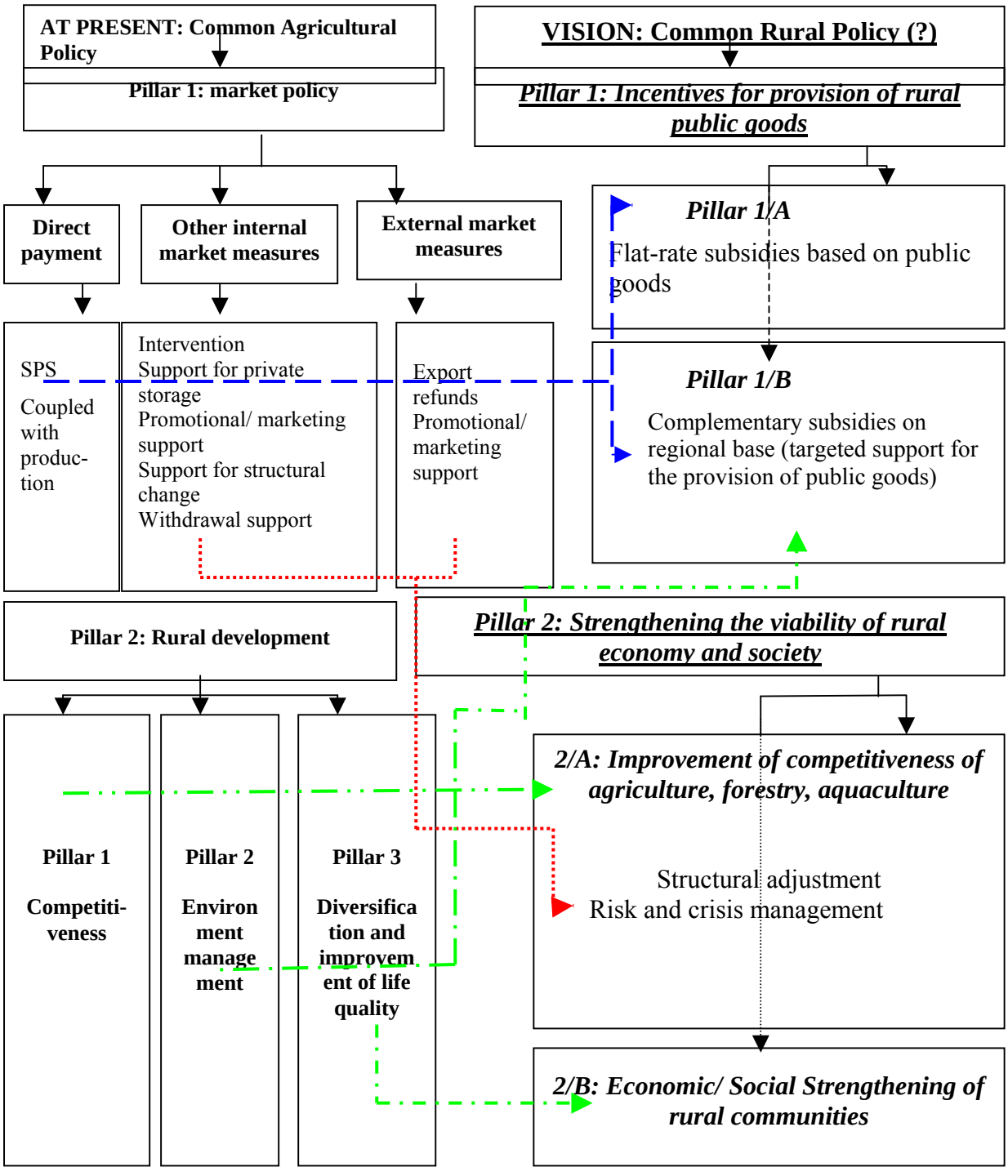
As an increasing share of producers' income comes from non traditional production activities, competitive advantage becomes more important. *Common frames insure transparency and fair competition.*

Due to limited financial resources member states will not prioritise investment in declining areas even if they are valuable socially. EU contribution can enhance national conservation programs.

Conclusion – a draft of changes in CAP proposed by the authors

The European Union is not able to maintain CAP in its current form any more: radical reform is unavoidable. Current review of the CAP (Health Check) may help to reach a healthier CAP, but the proposed changes are not enough to overcome the difficulties. The future CAP meeting abovementioned criteria – such as providing European added value – could contain the following new pillars with their new contents.

Figure 3
Structural change in Common Agricultural and Rural Development Policy



The Common Agricultural and Rural Development Policy depicted in Figure 3 shows that also the new policy is based on two pillars. But these are totally different ones. In the new pillar 1 there is a switch from direct payments to a flat rate payment based on public goods and fully decoupled - pillar 1/A - plus complementary subsidies on regional base – pillar 1/B, that is considered indeed to be targeted support for the provision of public goods. (Community financing is proposed but in the last resort co-financing is possible, the share of national contribution has to be, however, agreed upon.)

Pillar 2 with co-financing is aimed at promoting and strengthening the viability of rural economy and society. Pillar 2/A serves structural adjustment - in the framework of which EU contribution in poorer countries is higher and in richer member states the national share of support is greater – and new integrated risk and crisis management. The objective of pillar II/B is the developing, strengthening of rural communities (improvement in the quality of rural life, support for local communities, maintenance of landscape are of higher importance). *The vision – as a paradigm shift – proposes and describes rather a Common Ruralt Policy than a Common Agricultural Policy.*

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