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Accounting for Public Goods; the Social and Natural Capital Imperatives
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According to **UNEP's** International Resource Panel, globally, "food systems are responsible for 60% of global terrestrial biodiversity loss, around 24% (by 2050 even 30%) of the global greenhouse emissions, 33% of degraded soils, the depletion of 61% of commercial fish populations, and the overexploitation of 20% of the world's aquifers. A 2010 TEEB study on the economics of ecosystems suggests that the welfare losses in terrestrial biodiversity is of the order of €50bn, close to 1% of GDP a year, and rising steeply. In this context, accounting for public goods is of the essence to save the environment. My focus will be on European agricultural policy and its forthcoming modernization.

While **European Agriculture** plays a positive role, notably as regards soil carbon and renewable energy, it continues to cause environmental damage, notably as regards soil degradation, water extraction and non-CO2 gas emissions. The next CAP reform must also take into account the international commitments entered into with the UN Sustainable Development Goals (SDGs) and COP 21 on climate change, and the conclusions of the Cork 2.0 Conference and of the agro-market task force regarding the food chain. They notably call for enhancing the delivery of public goods by farmers. Policy adaptations appear anyway inevitable for internal reasons, notably because our current food production is unsustainable, and eventually becomes a threat to our own food security.

The ELO underlines the obvious: the future sustainability of agriculture depends above all on the **land managers**. These engage practically the whole farmed area, invest in it and absorb a substantial amount of public finance support. Hence, in addressing the pervasive environmental externalities which surround agriculture it is imperative to enhance, better integrate and streamline the role of the land managers.

However, the fact of the matter is that many EU farmers run their often small businesses sandwiched between the immense market power upstream of input suppliers and that of downstream processors and retailers, not to speak about the pursuit of further liberalization of international agricultural trade. This leaves them **little leeway** to produce more sustainably and cater for the environment. If ecological objectives are to be enhanced on farm, those other issues must be addressed so that farmers are not left to pay bills beyond their capacity to enhance public goods production.

As the delivery of public goods benefits everybody, consumers, producers, and citizens at large, it cannot depend on land managers alone. While according to the polluters principle the environmental impact of farming should in the first instance be paid by the farmer, is it still acceptable that the trade and consumers don't as yet contribute to internalise into food prices the cost of environmental damage caused by the production of the food they are purchasing?

The CAP is not well adjusted to steer EU agriculture to a well-structured viable and environmentally sustainable industry. It is actually falling short for environmentalists and isn't even working for farmers either. That policy is therefore **outdated**. This may explain why at

Berlin's Green Week Phil Hogan has struck out for a modernization of the CAP, announcing a stakeholder meeting in July and a proposal early 2018. To contribute to the current consultation process, the RISE Foundation is undertaking an "out-of-the-box study" on the CAP post-2020.

Laying down strategic goals for sustainable agriculture is the task of public policy. Implementation requires appropriate data about the value of natural capital in order to measure improvements or deteriorations resulting from land management. This is why work on **Natural Capital Accounting**, in particular ecosystem accounts, such as undertaken by the European Commission, the European Environment Agency, and by the UN, as well as MS experiences – which Delgado will tell us about – are so important.

In its recent study on Sustainable intensification the RISE Foundation has stressed that sustainability improvements depend on the availability of appropriate **indicators**. These have been found wanting. More research is of the essence for effective agro-ecological policy and land management. We need environmental impact and environmental threshold indicators of agricultural production. We need benchmarking of practicable farm level indicators of environmental performance, and assessing the unsustainability of parts of European agriculture with respect to specified indicators (such as regarding water quality, GHG emissions, and biodiversity). We must devise frameworks helping land managers judge the environmental value and economic cost of adopting practices to improve environmental performance. We ought to include farm-level environmental performance into the Farm Accountancy Data Network (FADN). It would also be useful to assess the past and prospective contribution of commercial certification and sustainability schemes to improved environmental land management. Without vast additional research work on sustainability indicators by the JRC, the Commission and others it would be difficult to effectively design, implement and measure policies enhancing our social and natural capital in European agriculture.

The predominant role of area-based **direct payments** – accounting for 72% of the CAP budget and 28% of the whole EU budget – causes growing **controversy**. They provide substantial annual support to farm incomes, but are badly distributed with only 5% going to farms with incomes below the median farm. They are also very badly targeted, and they leak to landowners outside agriculture, to suppliers of other factors of production and downstream to food processors and distributors. Even the latest greening provisions seem to have very limited benefits, if any, although they command twice of the funding of the rural development measures devoted to the environment. To conclude, there is little evidence that direct payments are an effective, efficient or equitable way of achieving the objectives of supporting farming incomes, food security, farmers' resilience to shocks, or sustainable agriculture.

The modernisation of the CAP suggests **abandoning its obsolete two-pillar structure**, and revising the existing instruments which are over-complex for farmers and administrators alike, lack coherence and have doubtful cost-effectiveness. Instead, one should deploy a wider set of instruments including inputs from the private sector.

One could notably adopt **multi-annual land management schemes** and measures for the provision of public goods the market does not pay for, reducing negative externalities. These

could be flanked by safety-net measures to help farmers until direct payments are phased out over time preferably over 10-15 years.

Such a transition to a significantly **different model of production** where land managers pursue a wider range of goals with greater provision of ecosystem services **can only be durable if** these earn **sufficient returns** for their farm products from the market, and receive sufficient remuneration for the public goods they produce. The challenge is **how to do** this with instruments that are less cumbersome, less over-lapping, less complex and less centrally controlled than at present.

Considering growing EU and national budgetary pressures due to new priorities such as immigration and security, the key question is how to remunerate land managers for the delivery of public goods.

Past experience shows that reforms have not gone far enough to make European agriculture more sustainable and its management simpler and less bureaucratic. More needs to be done. There is in particular a need to find new ways to incentivize farmers to revise their production models. As far as possible this should be done through the market.

One can indeed devise instruments to submit ecosystem maintenance and enhancement to the market system. For instance create cap-and-trade systems like the European Emission Trading Scheme (albeit with a serious carbon price) to control environmental bads, or promote contracts for services through the private purchase of environmental services provided by land managers, or encourage offsets , whereby developers are asked to offset environmental degradation connected with their projects by paying an amount into an Habitat Bank that would then finance farmers committed to supply environmental services over the long term.

If such kind of measures did not provide the farmer with sufficient revenues from public goods production, public authorities could promote a shortening of the food chain to increase the farmer's share of food income, directly align payments with public goods objectives, more stably reward farmers for the delivery of public goods than for food production, or also spread water rights and introduce water management schemes, and incentivize land managers' actions to engage in carbon sequestration by raising the price of carbon.

Annex – Examples of Instruments for Investments in Rural Public Goods

Habitat banking is a market instrument by which credits from actions that create, restore or expand different types of habitats, benefitting ecosystem services may be purchased to offset the debit from environmental damage caused by a range of developments, from housing to industry to infrastructure. Through the Habitat bank, a developer that uses a piece of land to build will need to purchase credits to allow to recreate ecosystem services (eg. biodiversity, soil composition, water quality via eg. Buffer strips, hedges, no till soil management or crop rotation) “offsetting” those lost by land development. National or regional governments should demand that local planning offices make offsetting a condition of building permits. Banks can insure against the failure of habitat restoration and there is a system of recourse in case land managers default.

A concrete instrument of public goods promotion is Germany’s flexible **Eco-Point System** which aims at asking developers to compensate for damages caused to the environment, making the money available to land managers as eco-loans for public goods production. The former buys eco-points, which are then sold to land managers to pay for their losses for environmentally restricted land use or as extra pay for public goods production.¹

As the bulk of the farmers are still small and medium scale, their support could include microfinance on the **Grameen banking model** combining conventional, commercial banking practices with a mission, not be just combating poverty (as in Grameen’s case), but improving sustainability. One could actually take the **Kiva model** of a non-profit facilitator of microloans, which encourages partnership relationships through the internet, whereby prospective entrepreneurs have a profile page with a description of the use of their requested loan, and the potential lenders choose the loan request they would like to finance and the amount (as little as €25) and then team up with other lenders to fund the full amount of the requested loan.²

As rural areas tend to be neglected by the market, rural development could also be fostered through a new EU instrument to be set up within the EIB on the model of **FAO’s Investment Centre and related Banker’s Program**, which engage with the private sector, microfinance and value chain development. A dozen experts could help advise and even work out rural development projects, setting up a network of banks who would in principle be prepared to finance projects outlined by the Investment Centre that they wish to support. The investment centre could also promote increased corporate private sector investment in agribusiness through studies and involvement in local government plans, when requested. It could also help design microfinance projects and help include smallholders in value chains.

¹ The eco-point system has been inscribed in Germany’s federal laws for the Protection of Nature and for Buildings, and is managed by the German Länder. To that effect, Rhein-Pfalz has created an eco-pool and an eco-account.

² Over one hundred field partners in various regions of the world make the loans (totaling some €200m so far) weeks before the loan requests are posted on the Kiva website. The field partners set the interest rates for the loans. Kiva pays no interest to its lenders. After the loan is paid back in full, the Kiva lender can relend the funds to another entrepreneur, donate them to Kiva, or withdraw the funds. (Source :The Third Industrial Revolution by J. Rifkin)