Communications & Opinions

CAP reform process

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Our Nine Major Challenges

Land managers are faced with a number of challenges that are changing their industry quite radically. Agriculture is becoming more and more a production and service industry with growing multiple goals. It must contribute to provide food, energy, water and environmental security in a sustainable way, caring not just for environmental, but also for economic and social sustainability, and for the preservation and enhancement of Europe's cultural heritage. It has to face nine major challenges:

1. **Population growth**: 75 million people more per annum (210,000 a day), 9.4bn people by 2050 with 60% living in urban areas, 3bn with less than $2/day
2. **Growing demand for crop** products (cereals, plant fat, proteins), and feeding stuff as meat consumption grows with living standards
3. **Growing demand for energy,** including bioenergy based on renewable raw materials
4. **Globalization and urbanization**: production moves to the most competitive regions, trade grows faster than production, trade tends to become more open, but also more and more managed, becoming less predictable in food crises
5. **Climate change**: agriculture contributes to emissions, but can both suffer and benefit from changing climates
6. **Increasing market volatility** due to yield fluctuations, food market segmentation, end stock fluctuations, input and output price volatility and €/$ exchange rate volatility as food balances worsen in time, and consumer sensitivity for food safety, quality and price increases
7. Growing public interest in **agricultural public services** such as food and feed, rural landscapes maintenance, environmental protection, animal welfare, value for money
8. **Social problems** such as aging of farmers, farm successions, competition for land
9. **Uncertainties** with the timing and application of **innovations** such as biotechnology (GMOs, Nanotechnology), precision farming, carbon sequestration, information technology.

Let me just comment today on "Global Future Agricultural Market Trends and their Impacts on European Union Agriculture", the subject of a recent working paper by the Humboldt University in Berlin.

World population growth is the biggest trend-making factor affecting all major challenges we face. **Slide 4** gives growth figures for 1950 to 2050. Although annual growth is pointing down, we still are expected to be nearly 9 billion people 17 years from now. **Slide 5** shows

that only eight years from now Africa's population will grow by nearly a quarter and Asia's will rise by nearly a half billion. **Slide 6** indicates that world grain consumption will swell by over 40% from 1997 to 2025, practically all of the increment taking place in developing countries. **Slide 7** shows that one quarter of the increase will be in China alone.

Wheat, corn and rice prices have tumbled 40% to 60% from all-time highs, but the world's food import bill has surged above one trillion US dollars, 23% more than last year and 64% more than in 2006, and developing countries will actually spend this year one third of the world's food import bill, or 35% more than last year. The 2008 World Food Report of FAO warned against a "false sense of security" as it expects the current combination of low food prices, high input costs, tightening export finance and conditions for bank letters of credit, that farmers cut their plantings, that there will be a price surge in the 2009-2010 harvesting season, "unleashing even more severe food crises than those experienced recently". (Financial Times, 31 October 2008).

A minority claims that the commodity boom of 2003-2008, the biggest, widest and longest this century, has come to an end, and that slower population expansion and income growth will easy commodity demand in the next decades. But I suspect that, despite recent price reductions, the mega-trend of declining world agricultural market prices has ended since the turn of the millennium, because global demand growth will soon tend to outstrip the growth in global supply, and globally available agricultural land is limited in scale. To meet world demand the necessary production growth will to a large extent have to be met by a rise in the productivity of the land already being farmed today. However, this will be difficult to accomplish as global agricultural productivity growth has been in decline since the Green Revolution of the 1960s and 1970s. **Slide 8** shows how dramatic global crop yield increases have been declining, down from 4% per annum in the sixties to eighties to barely 1% in 2000 to 2030 (forecast). As **Slide 8** shows, this is so despite substantial expected yield increases in India the USA, Russia and the Ukraine.

The net trade position of the EU-27 can be expected to deteriorate (**Slide 9).** Between 2003/05 and 2013/15 European Union demand for grains and oil seeds can be expected to increase by 15-20% and 50%, respectively as against supply increases of corn below 10%, and of oilseeds over 30%. Consequently, if net imports of corn will diminish, net imports of oilseeds should go up by 70% (mostly due to a shift to bio-fuel). For wheat, the EU will move from a net exporter to a net importer position (because of a growth in bio-energy production). The EU capacity to help fight world starvation will be reduced at a time in which food production will decline predominantly in those countries who already record increasing food import needs. Nevertheless Europe will become a more secure production location in comparison to other world regions, while higher food prices will boost deforestation there. "Consequently, Europe has to take responsibility to significantly contribute to world food security and also to combat global warming by utilizing its production potential."[1]

But Europe is only one player, however big. All countries will have to improve their food security policies. In many of them, in particular in Africa, one cannot expect to boost agricultural production without land reform and courageous food price policies favouring the farmer and costly to the urbanite. Where policy matters are not enough, consumption patterns will have to change, notably reducing beef intake. There is already a fight for food in many a country. But we see also signs of an international scramble for food, and beyond it a scramble

[1] Humboldt Universität zu Berlin, Working Paper no. 84/2008

for land to produce it. According to FAO the race by some countries to secure farmland overseas risks creating a "neo-colonial system". For instance, Daewo Logistics of South Korea, the fourth largest maize importing country declared it had leased 1.3m hectares of Madagascar's farmland for 99 years, that is half of its arable land and half again as large as the whole of Belgium. It planned to thereby satisfy about half of its internal demand for maize and part of that for palm oil using South African labour. Although Madagascar has just denied it, or backtracked, Korea's intention is clear, and shows how important food security has become from now on. There are precedents starting with Japan, who bought land in the American West to produce beef for Japanese consumers. A poor country such as Ethiopia, infamous for more than one food crisis, has just openly offered Middle Eastern countries to lease hundreds of thousands of hectares of its farmland in order to help them ensure their own food security. (FT., 19/XI/08) One can well imagine what sort of political problems may eventually arise if a country hosting foreign investment in faming faced a serious food crisis at a time in which rich foreigners exported all the food produced there for the exclusive benefit of their richer and better fed people abroad.

CAP Reform post-2013

The next reform will have to respond to questions about the objectives of the CAP in light of the challenges it faces in the first half of this century and find new justifications for a substantial share of future EU budgets to be devoted to the Single Farm Payment and Rural Development.

The first question is to **define the objective of SFP** (Single Farm Payment). Is it social/income support, is it income stabilization, is it compensation for higher EU standards, is it primarily an environmental payment, and is it a means to provide food and environmental security for Europe and/or the world? From the answer(s) depends any adjustment of the SFP, which incidentally raises and/or may raise critical problems of equity. If the motivation is income support, is it fair to provide the same farm payment in countries with different income per capita levels? If it is income stabilization, how can one accept fixed payments regardless of production and prices, and why should these be made by the EU instead of the Member States? If payments concern quality standards, and food and environmental security keeping the land in good conditions, why not uniform, flat-rate payments by hectare? Can a flat payment be applied equally for all sectors regardless of productivity and value added? And if not, does that permit some recoupling? If cross-compliance rules are legal obligations, is it justified to pay for respecting them, or is this the only way to ensure the respect and control of such rules; and if so, wouldn't it betray the "polluter pays" principle?

Above all, there will be those who wish to discuss **the distribution of the SFP**, because the historical distribution based on production makes no sense since the payments were *decoupled* from production.

The differences in **payments per hectare** (2012) are staggering with Latvia getting twenty-six times more than Bulgaria or Romania. Equalizing payments per hectare would benefit above all Romania and Bulgaria, but also the Baltics, the Visegrad countries, Portugal, the UK and Spain to the detriment of Greece, Germany, France and Italy, four of whom are net contributors to the EU budget. A redistribution equalizing payments per hectare to the EU

average of €222 would amount to €6.5 billion or 16% of total payments, involving large transfers

The difference of **payments per recipient** is even bigger with the Czech Republic at the top getting forty times more than Malta and twenty-one times more than Poland. Equalizing payments per farmer to the average of €5684 would amount to €14.2 billion or 35% of total payments. The biggest beneficiaries would be Poland, Italy, Greece Lithuania and Portugal, and the biggest losers would be France, Germany, the UK, the Czech Republic and Denmark.

If the purpose of the CAP is redefined away from commodity market management towards rural development and the environment, the current distribution of CAP resources should logically change. Payment uniformity at EU level in whatever form is out of reach, because there will be no qualified majorities for that. The challenges faced by different MS are different. None wants to be a loser from redistribution. This should not however impede a policy shift even if the shift in resources does not match it. But redistributions per hectare within member states like was done with the regionalization of the SFP may well spread.

The tendency of the CAP to **shift payments to non-market elements** like landscape, biodiversity and resource protection will continue regardless, let alone because it helps maintain public support for the CAP. The focus will soon shift to the definition of public goods produced by farmers, notably on better defining them, in particular eco-system services and how to pay for true environmental benefits. This is no easy matter. Per hectare, probably regionalized payments may become more appropriate to reward agricultural management systems under clear conditions. Whether these can be considered coupled payments or not does not depend on whether they take place under Pillar 1 or Pillar 2 and will be of relevance in WTO negotiations.

One will perhaps also need to review the scope for Pillar 1 actions (without co-financing) as compared to Pillar 2 actions (with co-financing) in addressing CAP financing more thoroughly. There will no doubt be also those who wish to recouple part of CAP support for sustainability and other purposes.

An important lever for continuing public support consists in highlighting and enhancing the public and private services - including carbon sequestration, the preservation of less favoured areas and the protection of the cultural heritage - that agriculture provides, which are not paid for by the market. The **justification of payments for public goods** provided by farmers, notably those benefiting ecosystems, should help avoid or limit significant CAP budget cuts. The eco-system services are related to climate change. As farm prices rise, the opportunity cost of reducing farming intensity and using land to produce biodiversity and habitats rises as well. In order to encourage farmers to deliver those services one has to pay them more for that. When crop and meat prices are on average high over time, a greater shift from Pillar 1 to Pillar 2 via additional modulation becomes possible, using the money under Axis 2. But the weight of agriculture and downstream production services in Pillar 2 is currently too high. More of Pillar 2 should go to the non agricultural population (which includes members of farmer families). One should not make too much of a difference between the 1st and the 2nd Pillar of the CAP. They are man-made and we should not make icons of these structures, which are amenable to change. The purpose of policy is more important than the instrument used to reach it.

One may of course use Article 58 to find a way to do rural development within Pillar 1, promoting the agro-environment, helping disadvantaged areas, quality and marketing. Art. 58 can also be used to help with crop insurance premiums, or with compensation for animal and plant disease. This can be justified by the increase in the volatility of climate, food production and prices, and animal disease (due to increased movement of goods and people). But, it is not clear if Article 58 funds are subject to Pillar 1 rules regarding modulation and financial discipline. There is a risk of recoupling Pillar 1 payments in this way, and reducing their simplicity by diverting more of it to five other uses. The result of applying Article 58 could be more decoupling from agricultural production, more coupling with the environment, and smaller or greater simplicity. Article 58 may indeed confuse the public service issue by allowing environmental payments in both Pillars to reduce simplification and complicate further reform debates.

Farmers generally dislike Pillar 2 for siphoning off funds from them. Many administrations consider Pillar 2 bureaucratic and rural funds hard to get. Both tend to prefer to green the CAP via Pillar 1, which does not require co-financing, but it is unlikely that implementation would thereby become less complex. While Pillar 2 appears the best instrument to pay for externalities due to its multi-annual character, beyond a certain limit, greater modulation of support in that direction may depend on dropping (or reducing) the requirement for co-financing. If the money is to be where the mouth is, it would stand to reason that the EU pay more for public services without asking the Member States to co-finance them, the more so that some of the most environmentally degraded members, those in eastern Europe would otherwise lose out because of lack of funds, and thus forego the use of Pillar 2, as has already happened. If this continues, Pillar 2 will lose the support in Council that is necessary to strengthen it after 2013.

The next reform of the CAP will have to take into account that agriculture has become a capital and know-how intensive sector, that modern agriculture requires more R&D and more risk capital, more education and training, more extension services, measures to reduce market volatility, modernization and restructuring of farms, income combinations on-and-off farm, and start-up programmes for young farmers. Agriculture needs to look at new materials for industrial purposes and bioenergy provided it is competitive without additional ad-hoc subsidies and import protection beyond current levels.

Food processing and the food chain require further innovations, modernization, vertical integration, promotion and marketing, protection of origin. Anti-trust policies, producer cooperatives, farmers' markets, direct sales and other measures should help farmers to recapture a higher share of the final product price.

Likely Changes

- Abolition (definite) of set aside
- Abolition of dairy quotas, and a new European dairy strategy
- Phasing out of export subsidies (even without Doha Round)
- Abolition of classic intervention (as against a safety net)
- A new safety net against market volatility
- Total *decoupling*
- Strengthening of *cross-compliance*

- Regional and hybrid models of direct payments
- Closer link between level of payments and service provisions
- More modulation
- Strengthening of Axis 3 and Leader-Type programmes
- A stronger rural development policy
- Support of producer organizations and the food chain
- Simplification
- Changes in biofuel policies
- Better R&D with availability of risk capital

The speed of change is higher than the speed of adaptation; particularly in agriculture. We notably depend much on research capacity and our ability to adapt our crop protection systems to new climate conditions. Research needs time.

The speed of adaptation notably depends on the developments of b**iotechnology**. A certain environmental risk with GMO crops remains. There is no zero risk. Do we take that risk or not? It depends on the objective. If we do take the risk in order to tackle climate change, then we should. In the context of accelerated climate change, ultimately, the risk of not using GMOs is probably greater than that of using them. Of course, there is the question of liability. In German law, producers of GMO crops are liable for damages. This is reasonable, but not common so far. In Europe there is zero tolerance (no traces) for unauthorized varieties. Abroad it is different. This can only lead to trade problems. The more there are unauthorized varieties produced abroad, the less EU importers will take the risk for bringing contaminated products into the EU. So, either we speed up authorizations in Europe, or we introduce tolerance levels for unauthorized varieties. This is a hot potato. But how come that we tolerate the importation of biotech animal feed produced with unauthorized GMOs? We too are Jesuits.
I doubt there will be much of relevance on **capping payments**, without the possibility of getting around it. Economically speaking, degressivity of payments according to farm size is a better approach. It means that 1ha of a big farm gets less support than one hectare of a small farm. But that system is difficult to administer and should have been introduced before the last enlargement. It would notably have allowed avoiding excessively supporting the big collective farms in Eastern Europe.

To sum up, we face a future of food scarcity, with high, albeit very volatile prices both for inputs and outputs. Agricultural policies will have to be adapted accordingly. Farm subsidies, possibly not distorting trade, will have to stay if food scarcity is not to worsen. Southern hemisphere countries will have to introduce land reforms allowing the poor to accede to the land, and adopt more appropriate food pricing policies. But this will not suffice. If there is going to be enough food for everybody, we shall also have to change our food habits, not to say our life-styles.

Our leaders in Europe will have to recognize the fundamental role Europe is called to play in feeding the world in a context of food scarcity. Our challenge is to devise a CAP that allows us to preserve our capacity to sustainably produce the food we need and satisfy a growing world demand. Our farmers have a key role to play and have the right to ask how they can contribute to meet world food demand, save energy and water, conserve the environment, all

at the same time while attacks against the CAP continue to grow as if there was no ongoing, remarkable reform process.

We will have to take a stand when the time comes, soon after the appointment of the new Commission for the period 2010-2014 and prepare our position in the second half of next year.

Annex from AgraEurope

UPDATE ON HEALTH CHECK AND REFORM

Compulsory Modulation: Roughly €3.24 million of 1st Pillar funding will be shifted to Rural Development to meet the "New Challenges" through the new compulsory modulation rates *[+2% in 2009, +1% for 2010-2012, plus 4% for amounts above €300 000 from 2009 onwards]*, according to unofficial Commission estimates. For both the UK & Port, there will be no net increase in RD funding from the EU budget because the new amounts triggered *[not quantified in the figures]* are lower than the amounts already committed under the so-called Voluntary Modulation commitments. For the 10 New Member States where the phasing in of the Single Farm Payment reaches 90% in 2012 (the 2013 budget), the 4% rate of progressive modulation will apply in 2012 – generating a shift of €16m in 5 of them, relative to the €19m likely to be generated in Germany alone, & estimated €150m EU-wide (probably inc. UK). For these countries – where the SAPS system means that there are no "unused funds" in the national envelope – this will be the only EU money available for addressing the New Challenges. For Est, Lat & Cyp and Bul & Rom, there will be no new RD funds at all. (For Mal & Sln, which do not apply the SAPS scheme, it is unclear whether there are any "unused funds" that might be shifted.) N.B. The final compromise also gives Member States the option of using their "unused funds from the national envelope" not only for Article 68 measures, but also for the RD New Challenges, as Germany is expected to do for the new Milk Fund". German government politicians have claimed today that the deal will allow a ***Milk Fund*** to be created worth €350m in 2013.

Dairy quota changes: With Germany & others concerned about the potential increase in actual milk production - & its impact on the EU market – from front-loading Italy's milk quota increase, the text includes a footnote (apparently offered by Italian Minister Luca Vaia) confirming Italy's intention to allocate the additional quota "in priority to those producers who have been responsible for the national quota having been exceeded". The additional superlevy penalty in 2009/10 & 2010/11 is aimed to provide a similar assurance that the front-loading for Italy will not provide a proportional increase in production in practice, because no other Member State has ever come close to triggering a quota overshoot of anything close to 6% [the triggerpoint for a 150% superlevy payment].

Cross compliance: An annex to the final agreement outlines a number of changes to the definition of "Good Agricultural & Environmental Condition", notably a move to make certain standards optional, rather than compulsory. These are listed as: retaining terraces for soil protection, setting crop rotation standards & appropriate machinery use, minimum livestock stocking rates, & banning the grubbing-up of olive trees where appropriate. The most controversial change, however, is the introduction of a new voluntary option for the "establishment and/or retention of habitats". Requested by the UK, the move would support rumours that England (but not Wales, Scot & N.Ire) is considering retaining a low percentage (e.g. 3%) of compulsory set-aside for arable producers.

Summary of reactions to Health Check: The political agreement on the CAP Health Check has triggered mixed reactions from across the environment & farm lobby divide. In general terms, the mood has been one of sober caution rather than celebration. Both Presidents of *COPA-COGECA* (the European Farm lobby umbrella group) have expressed their "disappointment" with the final result. *COPA* President Jean- Michel Lemétayer fears the lack of income security for European farmers "especially during this current crisis", whilst *COGECA* President Gert Van Dijk bemoans that this text "is one step closer to the CAP becoming less & less common and increasingly complex to implement & to explain to our citizens". On the environmental lobby side, *BirdLife International* was not shy in asserting that "the "patient is still ill & won't get any better with the prescribed treatment". Ariel Brunner, EU Agriculture Policy Officer has echoed that the end-deal was a "highly disappointing conclusion", notably the "drastic" scaling back of compulsory modulation & the

“half-hearted measures” *in lieu* of set-aside. In the context of the next EU budget allocation, *BirdLife* underlined the “missed opportunity to prove that the CAP can be re-orientated to the urgent task of ensuring Europe’s long term environmental security”. However, a generally positive reception came from the *European Council of Young Farmers (CEJA),* a nod to the decision to raise the installation aid ceiling from 55 000€ to 70 000€ for young farmers, which is a “badly needed” measure to bring new blood into the sector, currently estimated at just 8% of the EU farming population.

FRENCH PRESIDENCY CIRCULATES DRAFT CONCLUSIONS ON “FUTURE OF THE CAP”

French government hopes of draft Council conclusions on the future of the CAP – intended to go to the Dec 11-12 Summit of EU leaders – is likely to be more difficult than Paris originally imagined. A first 2-page draft outlined to last Monday’s Special Committee on Agriculture met with stiff resistance from a number of delegations, even though the text is reasonably vague. Particularly controversial, it seems, was the statement that “the initial principles of the CAP – financial solidarity, a unified market, Community preference – and the goals defined in the Treaty of Rome – productivity, security of supply, market