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The EU´s Common Agricultural Policy. Why reform is overdue

38% of the EU´s budget is spent on the Common Agricultural Policy (CAP). Mindful of the enormous challenges of mass migration or the deteriorating security situation in and around the EU, at least a partial redirection of these funds is warranted.

Preparations for setting up the EU´s new budget, the Multiannual Financial Framework for the years 2021 to 2027, have started. In the past negotiations among Member States on the budget were highly contentious and showed the deep divide between those members which receive more money out of the budget than they pay in, and the so-called net contributors.

One does not have to be a genius to predict that the coming negotiations will be even more contentious for at least two reasons. First, with the United Kingdom exiting the EU, the second biggest net contributor in absolute terms after Germany will have left, tearing a hole of roughly €7 billion annually into the EU budget. Second, there will not only be less money available but heightened pressure to spend more money on the manifold new challenges confronting the EU. These challenges range from strengthening the euro area to digitalization and from mass migration to Islamist terrorism.

Accordingly, the EU is faced with the question of whether it still can afford to dedicate more than a third of its budget to subsidizing farmers who have over the last 60 years become a highly competitive economic sector, or if there are strong arguments to reform the CAP and redirect parts of its funds to add European value to spending on foreign and security policy, development, research and not least on migration.

The authors of this policy brief are **Stephan von Cramon-Taubadel**, University of Goettingen, and **Friedrich Heinemann**, ZEW Centre for European Economic Research.

Goals and performance

Common Agricultural Policy spending primarily takes the form of direct payments to farmers in what is referred to as the ‘First Pillar’ of the CAP. Direct payments account for roughly 70% of total CAP spending and almost one-third of total European Union (EU) spending. Most of the remaining CAP spending (roughly 25%) falls under the ‘Second Pillar’ which is used to finance development measures in rural areas.

Two main justifications are provided for direct payments today: income support and compensation for non-market environmental services provided by farmers (so-called ‘greening’). However, the goals of the CAP in Article 39 TFEU do not foresee any form of direct income payment to farmers. According to Article 39, one goal of the CAP (b) is “thus to ensure a fair standard of living for the agricultural community”. However, the word “thus” clearly stipulates that this goal is to be reached by means of goal (a) “to increase agricultural productivity”.

Even if income support were explicitly listed as a goal of the CAP in the TFEU, the CAP’s record in pursuit of this goal is poor. The goals of the CAP in the TFEU refer to “a fair standard of living”. Standards of living are not determined by income alone, but even if we accept the focus on income, the term “fair” suggests progressive redistribution that targets low-income farm households. However, the distribution of CAP direct payments is not at all progressive.

One inherent problem of direct payments (apart from capitalization in land prices) is their low degree of precision. An efficient income protection system should concentrate support on those in need. In 2015 roughly 18% of the recipients of direct payments in the EU-28 received 80% of the volume of these payments. Using Farm Accountancy Data Network (FADN) data, Matthews calculates that the 80% of the farms in the EU with the lowest incomes receive only roughly 25% of the direct payments. At the other end of the scale, the 750,000 farms in the highest income decile receive 55% of all direct payments, or roughly 15% of all EU spending.

Policy makers and farm lobbyists often claim that direct payments account for a large share of farm incomes, and that any reduction in direct payments would thus cause severe hardship. These claims ignore the fact that many farm households earn not only farm income but also farm-related and off-farm income. The European Court of Auditors has repeatedly criticised the Commission for failing to compile comprehensive data on farm-related and off-farm income as a basis for targeting CAP support. If these data were available, they would reveal that the oft-cited shares of direct payments in farm incomes systematically and often substantially overestimate the importance of income support provided by direct payments. In summary, direct payments provide poorly targeted and wasteful income support.

Since 2015 30% of the direct payments have been linked to three greening criteria; crop diversification, ecological focus areas, and the maintenance of permanent grassland. If a farm does not fulfil the applicable greening criteria, its direct payments can be reduced.

The consensus among experts is that greening is unlikely to produce substantial increases in the provision of environmental services by farmers. There is no evidence that greening will produce more environmental benefits per euro of spending than alternative environmental measures. This lack of environmental effect and efficiency is not surprising, because greening was not primarily designed to generate environmental benefits, but rather to shore up the justification for direct payments to farmers without disturbing the distribution of direct payments between and within member states.

Opportunity costs

The increasing European opportunity costs of current CAP spending are immense. Money spent on direct payments or rural development programs is unavailable for urgently needed alternative uses. Some examples clearly demonstrate that the weight of CAP in the budget is way out of proportion to its relative importance for the future of Europe.

40% of one annual CAP budget would have been sufficient to finance the full reception costs including the asylum processes for all of the refugees who entered the EU in the crisis year of 2015. 15 to 20% of the annual CAP budget would be sufficient to compensate for the loss of the UK net contribution. 52% of the annual CAP budget would be sufficient to fully close the EU's development aid spending gap to the UN spending target of 0.7%.

The opportunity cost argument is crucial and could be powerful. Its power would be weakened if the budget constraint is softened. Early signals that European public goods are to be financed on top of the existing budget must be avoided.

Future priorities

The objectives of the CAP outlined in Art. 39 TFEU appear outdated given the socio-economic situation of modern European agriculture. Policy makers increasingly refer to other objectives to legitimize this policy (e.g. food quality, cultural landscapes, animal welfare, provision of public goods, development of rural areas). Inflating objectives is a standard strategy to immunize a policy against a changing environment and/or an unconvincing performance.

In recent years the Commission has used 'Consultations' in which citizens, organisations and other stakeholders are invited to provide assessments of the CAP's priorities and performance. The most recent example is the ongoing 'Consultation on modernising and simplifying the Common Agricultural Policy'. This 'Consultation' is a classic example of framing, whereby responses to questions are influenced by how they are posed. The results of the ongoing 'Consultation' are predictable and will be used by policy makers to claim a continued mandate for direct payments to provide income support subject to 'greening'.

The Treaties have been amended several times since 1957, but the goals of the CAP have been left untouched. Agriculture has changed over these six decades, as have society's priorities and expectations. Nevertheless, if policy makers wish to pursue new goals that reflect these changes, they should first secure a formal mandate by revising the goals that are stated in the TFEU. Framed 'Consultation' is no substitute for constitutional legitimacy.

In the meantime, in accordance with Article 39 of the TFEU, the CAP should foster agricultural productivity, also as a means of improving standards of living in agriculture. Research, education and technology transfer are important policy tools in this regard, as are measures to encourage early retirement and consolidation of land holdings in member states characterised by large numbers of small holdings and older farmers.

Direct payments should be gradually and completely eliminated over the next 10 years up to the end of the 2021-2027 MFF. The schedule for eliminating direct payments should be clearly communicated and strictly adhered to, so that farmers can negotiate land leases and otherwise plan their farm operations accordingly.

Assessing a system's productivity means comparing its inputs with a comprehensive measure of its outputs, including its environmental effects. The productivity goal in Article 39 TFEU therefore provides a justification for agri-environmental policy measures aimed at increasing (reducing) the production of environmental goods (bads). However, these measures should aim at the production of measurable outputs that have been prioritised by experts. EU agri-environmental policy should focus on European environmental goods (and bads) such as climate change, transnational watersheds, and cross-border measures such as corridors that link protected areas.

The Case for co-financing of CAP

Farm interests will demand compensation for the phasing-out of direct payments. Co-financing these payments is an option that may be more acceptable to those interests than outright cuts. Co-financing would allow for a substantial reduction of CAP spending in the EU budget and shift parts of the financial burden to the national level. This is highly appropriate given that many of the arguments used to justify the CAP relate to local or national public goods.

Increasing the national financial burden of agricultural support would set an incentive for better voter information. This would initiate an overdue debate at the national level about the fairness of providing sector-specific income support.

A frequently used but non-compelling counter-argument against co-financing is that a “renationalization” of CAP would threaten to kick off a destructive race of national subsidies. This is a misunderstanding. Co-financing is merely a financing tool and does not imply any changes to the rules of the European agricultural market. Co-financed direct payments would have to remain de-coupled to ensure that the principle of market unity is maintained.

Political-economic considerations

Phasing out and/or substantially co-financing direct payments would lead to a substantial reduction in CAP expenditure. This would disturb the delicate balance of net contributions by member states to the EU budget. Resistance to such redistribution has protected the CAP in the past, restricting the politically feasible set of CAP reforms to those that largely preserve the balance of net contributions.

Brexit provides an opportunity to free the CAP from this straightjacket of juste retour. Agricultural policy options should be debated and adopted based on their merits, and any remaining political needs for maintaining some pattern of net contributions by member states should be accomplished post-CAP reform by a system of fiscal transfers among member states.

A second related straightjacket that should not constrain agricultural policy reform in the EU is the logic of ‘communicating pillars’, according to which money that is saved in the First Pillar must be shifted to the Second Pillar. There is no compelling reason why CAP reform should be restricted to zero-sum reallocations between the pillars. Scarce EU budget resources should be allocated across policy areas according to European value added. CAP reform might lead to increased spending in the Second Pillar, but only after existing measures in the Second Pillar have been rigorously evaluated against alternative priorities in pressing areas such as migration policy, securing European borders, European infrastructure, European defence, and European education and research.

The current distribution of CAP net balances is such that today only a few Member States pay the price to the benefit of a majority of countries. For the reform inclination of the majority this is a bad result. Reform support is further weakened by Brexit. With the United Kingdom the most prominent and determined CAP critic is leaving the European Union.

The introduction of co-decision in CAP legislation through the Lisbon Treaty has increased the powers of the European Parliament. Recent research indicates that farming interests are strongly represented in the Parliament, so that this has in fact strengthened the forces defending the status quo.

Conclusions

Intellectually, the “greening” and “income protection” narratives must be exposed for what they are: flawed and misused arguments. A new green or social disguise for anachronistic direct payments is no progress. The CAP needs to be re-conceived, not re-labeled.

Left to their own devices, agricultural policy makers seldom propose progressive reforms. The reform trajectory launched by Ray MacSharry and continued by Franz Fischler was largely a product of external pressures, specifically the need to make the CAP compatible with the world trading system and to prepare the CAP for the Eastern expansion of the EU. Today the largest reform impulse should result from the existential crisis that currently confronts the EU and the urgent need to prove that EU membership does not only benefit special interests.

Note

The paper combines and highlights the arguments of two reflection papers written by the respective authors to prepare for an expert workshop “CAP and the next MFF” held in Berlin in the Federal Foreign Office on 30 March 2017.

The papers are available for download here:

https://www.bertelsmann-stiftung.de/de/publikationen/publikation/did/the-common-agricultural-policy-and-the-next-eu-budget-1/

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German Aeronautics and Space Research Centre (DLR)

Address | Contact

Stefani Weiss
Director
Brussels Office
Bertelsmann Stiftung
Phone +32 2 233-3891
Mobile +49 160 913 298 78
stefani.weiss@bertelsmann-stiftung.de
www.bertelsmann-stiftung.de