

After the Common Agricultural Policy: towards an EU policy for Sustainable Food and Rural Environment?



Discussion paper



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onderzoek & advies



Colophon

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1. Introduction

The future of the Common Agricultural Policy (CAP) is subject to serious discussion. An increasing number of governmental and non-governmental organisations are, or have been, preparing their views. In November 2007, the European Commission published its proposal for the so-called Health Check, a series of short-term policy adjustments. The Health Check also looks beyond its original scope to ensure that the proposals will not be detrimental to longer term policy reform. However, generating ideas on the longer term has only just started. This may be a handicap for a solid evaluation of the short-term reforms.

The Centre for Agriculture and Environment, Paul Terwan Consultancy and Alterra are running a short project on the longer term future of food production, landscape and biodiversity and the implications for the CAP. This project included the following activities:

- an analysis of international developments relevant to the CAP;
- an inventory of opinions on the future CAP, from literature and by (telephone) interviews with European stakeholders;
- a round table discussion with Dutch experts.

This position paper summarises the results of these activities. It consists of three parts:

- A. The State of the Art:
 - a short CAP history;
 - NGO positions on the CAP;
 - reforms already announced;
 - arguments for serious reform.
- B. Elements for future policies:
 - principles and objectives of a future policy;
 - instruments of a future policy;
 - relevance for short term reforms.
- C. A concluding summary.

Part A: The State of the Art

2. A brief CAP history

The CAP was introduced in 1957 not long after World War II, when Europe had faced hunger. The CAP objectives as defined in the original Treaty of Rome are:

- to increase productivity;
- to provide a reasonable standard of living in the countryside, especially to increase farm incomes;
- to stabilise markets;
- to ensure food supply;
- to ensure reasonable prices for consumers.

These goals were pursued mainly by a system of border protection, export subsidies and intervention. They were more or less achieved within a few decades. From 1980, the EU became self-supporting in grain, and grain and dairy surpluses arose which could only be sold at increasing cost. Reforms became inevitable. New policy instruments such as dairy quota and set-aside were introduced to control production. From 1992 production-stimulating subsidies were gradually replaced by direct income support, a process that will be completed during the next years. Likewise, export subsidies are being phased out. Meanwhile, new goals and policy instruments were introduced, firstly as so-called accompanying measures, later under the umbrella of rural development policy. While direct income support has been "re-coupled" to conditions related to food safety,

environment and animal health and welfare (cross-compliance), targeted subsidies were introduced for less favoured areas, agri-environment measures and Natura 2000 areas.

3. NGO positions on the CAP

For years, national and European NGOs have been quite active in criticising the CAP and proposing alternative or additional objectives, measures and financial mechanisms. Their positions can be summarised as follows:

1. **Environmental NGOs** have criticised the CAP for its negative environmental impact:
 - the CAP still includes important adverse incentives for the rural environment, e.g. adverse production subsidies (for maize, energy crops etc.) as well as rural development projects with negative impact on environment, biodiversity and/or landscapes;
 - the way environmental (especially biodiversity and landscape) protection has been incorporated in the CAP is perceived to be rather unsustainable (voluntary schemes coupled to primary production): sustainability is still not 'in the heart' of the CAP;
 - the budgets for environmental measures (nowadays under Axis 2 of the Rural Development Regulation) are far from adequate and are only compensating for income foregone: there is no market for environmental services.

The NGOs are generally in favour of substantially increasing Axis 2 budgets (by a strong increase of modulation), of decoupling payments from primary production (by introduction of a separate market for public goods) and of securing that other rural development budgets are spent in a sustainable way.

2. **Agricultural NGOs** (farmers' unions) have been reluctant to phase out traditional market instruments for the sake of liberalisation, as they foresee an increased exodus from agriculture. They are in favour of maintaining the CAP budget and income support, but accept the increasing coupling to public services. Modulation is not popular, as the shift to rural development budgets is perceived to be too bureaucratic and not sufficiently targeted to farmers.
3. **Consumer organisations** are generally in favour of liberalisation, expecting a downward effect on consumer prices. In addition, their priorities include the transparency of agricultural production (such as origin and production methods) and high safety and health standards for food. Also the multinational **food industry** is generally in favour of liberalisation (abolishment of trade restrictions, especially import restrictions).
4. **Animal rights NGOs** are gaining importance. Many of them have national rather than EU agendas, varying from higher standards for animal welfare to sometimes even the abolishment of the livestock sector as a whole.
5. **Development NGOs** criticise the effect of the CAP on developing countries by market protection in the EU and 'dumping' (by export subsidies) on the world market. They are in favour of phasing out the old market instruments, but are at the same time concerned about the effects of global liberalisation on farming perspectives in developing countries.

4. Changes already announced by the European Commission

The Commission has announced the following reforms:

For the **short term** (Health Check, Budget Review):

- a. adjust the Single Farm Payment:
 - full de-coupling (reform the last 'coupled' payments);
 - harmonisation of implementation throughout the EU (coupled to the farmer or to the land, based on historic reference or not). In its latest proposal, the Commission suggests a flat-rate approach on a regional basis (but leaving the

decision to the member states), accompanied by a payment ceiling for large-scale farms;

- b. simplification of cross-compliance;
- c. evaluate intervention policies and adjust them if they keep farmers from market-oriented entrepreneurship;
- d. perhaps: abolishment of obligatory set-aside (still in discussion);
- e. anticipating the abolishment of dairy quotas in 2015: gradual decrease of the dairy levies and/or gradual increase of national quotas;
- f. increasing obligatory modulation from 5 to 10%, and in its latest proposal even up to 13%. The additional modulation budgets will not be added to Pillar 2, but might be spent through Article 69 of Council Regulation 1782/2003 (targeted to specific production areas, e.g. to specific types of farming that are beneficial to the environment);
- g. integration of climate change measures and a stronger focus on water management and biodiversity preservation in rural development policies;
- h. review of the Less Favoured Areas scheme, especially with an eye to its socio-economic criteria and benefits.

For the **longer run** (2013 and beyond), the Commission proposes:

- further reform of the Single Farm Payment (especially the budget consequences; during the negotiations on the 2007-2013 budget, a budget cut after 2013 was agreed);
- evaluate traditional market instruments;
- abolishment of dairy quotas in 2015.

In short, the Commission's proposals are directed to:

- a gradual increase in production (abolishing set-aside, increasing the possibilities for dairy production);
- further liberalisation of market instruments and Single Farm Payment;
- further shift from income support to rural development support.

5. Ten arguments for a fundamental CAP reform

As the world is changing rapidly, the CAP is under continuous pressure to change more drastically than already envisaged. There are at least ten reasons why the CAP is ready for drastic reform:

1. **Food is becoming less abundant.** Global demand for food is growing more rapidly than food supply. Although there is still a huge potential for increasing productivity per hectare, without necessarily increasing pollution, and for cultivation of additional farmland, this potential is exceeded by:
 - the rapid growth of the world population (estimation: from 6.6 billion now to 9.4 billion in 2050);
 - changing consumption patterns. Due to demographic developments and urbanisation (in 2007, for the first time in history, more than half of the world population was living in urban rather than rural areas), there is a shift from plant to animal production and consumption. The increasing demand for dairy products has already led to higher prices. The consumption changes are very pronounced in Asia, with its 4 billion people (60% of the world population!);
 - loss of farmland by urbanisation (e.g. in fertile deltas in China and Bangladesh), marginalisation and abandonment, erosion (loss of soil), salinisation and drought (desertification).

It is estimated that global demand in 2030 requires a 50% increase in cereal production and a 85% rise in meat production. This development has major economic, social and ecological consequences:

- a. **food prices** will rise and become less stable. This may be good news for arable farmers but is bad news for livestock farmers and poor consumers;
 - b. **food security** is becoming a problem for many more people than it is today. At this moment, 800 million people are food-insecure and this amount is expected to increase;
 - c. a global **food race** seems to be emerging. Rich food-importing countries are securing their food supply, undermining food security for poor food-importing countries. **Geopolitics**, which already re-appeared in the energy market, is now re-appearing in the food market as well;
 - d. the EU can now increasingly export at world market prices. After decades of surpluses, stocks are rapidly being sold at high prices. As a first result, the EU has recently lifted the set-aside obligation as cereal stocks had reached a historic minimum. If this situation becomes permanent, **the CAP may lose two of its *raison d' être***: to secure food supply and to secure fair farm incomes.
2. **Pressure on natural resources and valuable landscapes** will increase:
 - with rising food prices, more price fluctuations and more open competition from the world market, farmers are likely to respond by further upscaling, 'rationalising' and increasing their production. As a consequence, cultural landscapes will rapidly deteriorate. It also entails more **fallow land will be reclaimed for food production**. Production may intensify, possibly (but not necessarily) resulting in an increase of **environmental damage**: more soil erosion, water use, emissions of pesticides and fertilisers. Emissions of greenhouse gases (methane, nitrous oxide and carbon dioxide) will increase as well, particularly from increasing numbers of ruminants and other livestock;
 - all the above will cause sustained **biodiversity** loss on and around farmland. Finally, in marginal areas, the threat to **valuable landscapes** and associated biodiversity by abandonment (loss of farmland to urbanisation and other non-agricultural use) will continue.
 3. Major countries such as the US, Brazil and the EU are promoting **biofuel production** and consumption, intensifying the problems mentioned before. The aim of promotion is to increase energy security by reducing dependency from fossil energy. In addition, the EU aims to reduce greenhouse gas emissions, for which biofuels are hardly effective. Food security thus competes with energy security. The rapid shift from food and feed to non-food production is already leading to expansion of farmland (cereals, sugar cane, oil palm, maize, sunflower) in vulnerable regions (e.g. accelerating the loss of tropical forests) and will also in other regions have serious environmental impact. In the EU, NGOs heavily criticise the EU target for the biofuel share in fuels (5.75% in 2010) as the environmental damage may exceed the benefits (due to the very different energy efficiency of biofuel crops) and for the expected biodiversity and landscape effects, starting with set-aside land.
 4. **Liberalisation** enhances global competition, creating the risk of a "**race to the bottom**" in terms of sustainable production. To comply with the WTO agreements, parts of the 'old' CAP have or will be dismantled (especially export subsidies and/or import barriers). On the other hand, there is growing concern on the position of so-called *non-trade concerns* (including landscape, biodiversity and animal welfare) in trade agreements.
 5. The food web is rapidly **globalising**. Multinationals are increasingly dominating the food chains and markets. Retailers are gaining power as well. This reduces the relevance of the CAP and increases the relevance of an EU food policy.
 6. Rich countries are increasingly facing **obesity epidemics** caused by over-eating and under-exercise. In response, governments and the food industry are putting more

emphasis on the health and quality of food. Agriculture and agricultural policy will have to adapt as well, requiring a European food and nutrition policy.

7. Although the major food safety issues have been solved following the BSE crisis, **new safety and security issues emerge**, including bird flu, multi-drug resistant bacteria (even entering hospitals) from the livestock industry, the risk of bioterrorism and an increasing incidence of droughts and floods due to climate change. The CAP is not yet equipped to deal with such new challenges.
8. In spite of progress in environmental performance, some **major environmental problems** have not yet been solved or are even increasing:
 - a. **climate change** is proceeding at an unprecedented rate and will cause changes in natural ecosystems as well as agro-ecosystems. The IPCC expects that a worldwide temperature rise up to 2.5 °C will not lead to substantial net effects on agricultural production, markets and prices. Above this level, agriculture will have to deal with (depending on the geographic position) increasing drought, flooding, storms, pests and diseases. Cynically, this might lead to an even stronger position of agriculture in the more moderate climate zones, such as North America, Europe (perhaps excluding the southern parts), Russia and Australia / New Zealand. Agriculture is one of the causes of climate change, but at the same time one of the victims as well as part of the solution;
 - b. **water supply** (scarcity and distribution) is becoming a major problem. Up to now, agriculture uses about 70% of the water pumped up from natural sources. This share will decrease due to a stronger competition with urban and industrial water use, and will in 2025 (according to FAO forecasts) lead to a situation in which two-third of the world surface has permanent 'water stress' and 1.8 billion people will be confronted with absolute water scarcity. In some regions this development is enhanced by climate change. Increasing drought might lead to an increased food import from moderate climate zones;
 - c. **biodiversity** is still declining in most areas in the world and is facing a crisis. Agriculture is often a part of the problem, although it can also be part of the solution. In addition, without well-developed ecological networks, species will have increasing difficulties in adapting their ranges to the changing climate. A major adjustment of agriculture is needed both for mitigation of adverse impact and for adaptation to the changing climate.
9. **Animal welfare** is now high on the agenda, mainly in North-western Europe, but not in most other parts of the world. In a liberalising market, it will be increasingly under pressure, leading to conflicts between the livestock industry and society at large. The same goes for other topics arising from an increasing **ethical awareness**, such as the use of GMOs.
10. The CAP faces serious **governance problems**:
 - a. recent studies on the future of rural areas show that the countryside is increasingly driven by **urban economics rather than rural economics**. As a result, the CAP will have a decreasing impact on land use and land use change. The CAP hardly anticipates this tendency;
 - b. it has become almost **impossible to communicate** the CAP to the wider public, since it has become very complicated and its (budgetary) focus is still on income support, even in times of increasing farm prices. One of the underlying reasons is an increasing alienation of the urban population from rural life and food production in the EU and an increased call for a different legitimacy of agricultural support;
 - c. although the costs of the CAP have declined to a 45% share (€ 55 billion in 2007) of the total EU budget, there is a strong **budget pressure** due to political changes ('willingness to pay'). The member states' visions on the future of the

- CAP are mainly driven by budget considerations, and mainly by the wish to reduce their contribution to the EU (especially for net-contributors);
- d. the CAP does poorly comply with the **subsidiarity principle**. Although the EU has been embracing subsidiarity as a major principle, policies still tend to be (over-) centralised. Almost all major policy measures are implemented on EU level and many of the national measures have to comply with EU framework regulations and the EU state aid rules;
 - e. the CAP involves too much **bureaucracy**. The administrative borders of the CAP are reached or even already crossed. There is a strong call for simplification, but the progress is slow;
 - f. the **enlargement** of the EU has made the present centralised and detailed CAP even less realistic. There is an increasing call for policy differentiation. An EC survey showed severe differences between the member states' priorities: the Northern and North-Western countries stick to environment, sustainable production, animal welfare, while the new member states stick to protection of family farms, rural development and stable markets and prices.

Part B: Elements for future policies

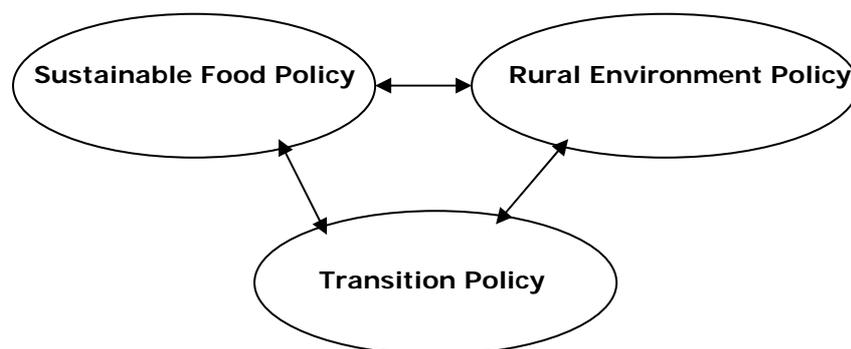
Paragraph 5 shows that a marginal reform of the CAP will not sufficiently meet all future challenges. A basic reform is necessary. It even seems more clear and efficient to abandon the CAP as such and replace it by a European Food and Rural Environment Policy (EFREP). But as the name is less important than the content, we will now describe principles, objectives and instruments of such policies.

6. Principles of a new European Policy for Food, Rural Environment and Transition

The new European policy should be based on the following principles:

1. It concentrates on **public goals and European common goods**, notably:
 - ensuring **food security, safety, quality and diversity**, facilitating healthy nutrition;
 - protecting rural **natural resources** for future generations;
 - protecting and development high quality rural **landscapes of European value**;
 - ensuring an acceptable level of **animal welfare**.
2. It leaves the achievement of these goals to the market where possible, but intervenes where necessary to **correct market failures**.
3. It endorses **subsidiarity** by leaving government intervention to the member states where possible and confining EU intervention to supranational interests.
4. It pursues **solidarity**, both between the EU and developing countries and between rich and poor regions within the EU.
5. It pursues **fair and sustainable global trade**, abandoning economic, ecological and social dumping while sustaining a level of border protection and internal support, required to ensure a reasonable amount of food security under calamities and to avoid competition from imports of cheap unsustainable products.
6. It facilitates farmers, rural communities and other parties involved to **adapt to drastic changes** required by the community at large.

In this way, future policy would consist of three interconnected domains (see figure below): (1) Sustainable Food, (2) Rural Environment and (3) Transition.



The three interrelated domains of the new policy

In the next section these domains are described in more detail. It should be noticed that the domains cannot be separated, simply because most primary food production is fully integrated in the rural environment. Most food will continue to be produced in rural areas and peri-urban areas. Conversely, many rural landscapes can only survive under a certain level of protection from the often low and unstable prices on the world market.

6.1 The Sustainable Food domain

The Sustainable Food component of the new policy focuses on food demand as well as supply. This can largely be left to the food market. However, the market does not (yet) sufficiently ensure:

- food security in times of crisis
- stable food prices
- healthy food at affordable prices
- animal welfare
- diversity of food
- food supply to the poor during a food crisis
- distortion of farming in poor countries.

Therefore government (including EU) intervention seems justified, also in the future.

A European Sustainable Food Policy would pursue the following **goals**:

1. to **secure the supply of safe, healthy and diverse food** for the European population, also in times of calamities;
2. **stable prices** of healthy food at a level that is affordable to low incomes;
3. fair marketing by securing full **transparency to the consumer**, not only on the nutritional quality of food itself but on the whole food chain, including sustainability aspects;
4. acceptable levels of **animal welfare** in the entire livestock production chain (incl. transports and slaughter);
5. to support **food security and food production (including processed foods) in developing countries** by avoiding dumping on their markets, allowing them market access, gradually abolishing tariff escalation and providing food aid when needed.

There are roles to be played by the EU on the supply side as well as the demand side. To mention a few:

Food security and stable prices require a **supply management** policy including set-aside, strategic stockpiles and quota systems. These instruments need to be used only if and when the market fails, for example by speculation in times of rising prices. Supply management can then be used as anti-cyclical instruments, discouraging speculation and stabilising prices. Conversely, in times of low prices production can be limited and stockpiles enlarged to keep prices at a stable level. This is somewhat comparable to the role of the Central European Bank.

Stable prices also require a certain level of border protection against cheap imports of foods produced in an unsustainable way.

The EU has an increasing responsibility to contribute to **global food security**. But does the EU have an increased responsibility to 'feed the world'? As food security is strongly related to poverty (the possibility to *buy* food) and the key to food security lies in poverty alleviation rather than agricultural policies, we have been defining the food security objective on European level. However, the EU can take its global responsibility in different ways:

- exports should be selective. Dumping with export subsidies must be entirely phased out, as is already foreseen;
- food aid should be given in times of hunger, but only on a temporary basis, combined with helping local farmers to restore production as soon as possible;
- developing countries would be allowed to protect their markets against cheap imports from Europe, enabling them to develop their domestic production and become competitive. In times of high prices, the EU should not rely on export levies to control domestic prices but rather stimulate domestic production.

Safe and healthy food requires **high EU food standards** as well as standards for communication including advertisement directed at children and health claims.

Diversity of food requires food safety standards that are not stricter than required, avoiding frustration of local and traditional production and processing methods. Claims referring to geographical origin and traditional methods would be strictly checked and defended in WTO negotiations.

The EU **Animal Welfare** policy aims at an acceptable basic level of welfare across the European livestock industry, whilst protecting European producers and consumers from livestock products that are produced at much lower welfare standards. In addition, transparency to the consumer is secured.

Transparency is vital for any market to function well. The EU would stimulate and set standards for this transparency to ensure that the consumer is well informed on the healthiness, quality, animal welfare aspects and environmental impact of food items. This would enhance healthy sustainable consumption and production.

Now that food supply is increasingly organised in international chains, the impact of transparency becomes far-reaching, even global. Multinational food industries and retailers will be increasingly accountable for the health, social, welfare and environmental impact of the food they sell. This illustrates the huge potential of integral food transparency.

Healthy nutrition can also be enhanced by additional **interventions** such as import levies on unhealthy food and subsidies for the promotion of healthy food. One example is the promotion of fruit and vegetables on schools, as is already being done in some member states.

In case production standards exceed legal requirements, trade measures or additional support are legitimate.

6.2 The Rural Environment domain

A European Rural Environmental Policy focuses on the preservation of natural resources and valuable landscapes by reducing negative impacts of farming on the natural environment and rewarding positive contributions exceeding legal obligations. Unlike the present CAP, payments would not be restricted to farmers, but are available to other land managers as well.

An **EU Natural Resources policy** would pursue two goals:

- to sustain and enhance **natural resources**, including soil, water, air, the climate and biodiversity;
- to sustain and improve **ecosystem services** by agriculture, including soil fertility, climate services (such as carbon sequestration), water purification, air purification, and a diversity of attractive landscapes and species.

Most of these policies can be implemented by the member states. The role of the EU would be to set standards for environmental quality that create a level playing field, while respecting ecological diversity. In addition, the EU can co-finance national programmes to restore and improve ecosystems and ecosystem services, at least where these services are deemed of European value.

In spite of the existence of a European Landscape Convention (of the Council of Europe), an **EU Landscape policy** has not been developed - except for payment for small-scale landscape elements under the agri-environment schemes. Landscape is also lacking in the EU's Sustainable Development Strategy. An EU Landscape policy would aim at sustaining, managing and developing a **diversity of landscapes of European value**: valuable cross-border landscapes and landscapes of international importance. A second

goal would be the **disclosure** of these landscapes to the public. This requires protective regulation as well as financial support.

In this way, the Rural Environment Policy will focus on the land management topics currently under Axis 2 of the rural development pillar of the CAP. The other elements of the present rural development policy will be transferred:

- investment support is targeted to future challenges and transferred to the transition part of the new policy - see § 6.3 for the further elaboration of this topic;
- socio-economic support and re-structuring of rural areas is transferred to the structural and cohesion funds under the *sustainable growth* part of the EU policy.

The Rural Environment Policy should fully include **peri-urban areas** (e.g. by including non-agricultural beneficiaries), as these play a key role in the relation between farming and citizens (diminishing alienation, recreational value), but adaptation to society's wishes is relatively complex and costly.

6.3 The Transition domain

In a humane society, it is no more than fair to facilitate drastic changes imposed by this society. The Treaty of Rome already mentions it, and in the 1997 'Buckwell report' *Towards a Common Agricultural and Rural Policy for Europe*, transition even is one of the four key elements.

We can discern a series of urgent transitions:

- **adaptation** of agriculture and ecological infrastructure to the **changing climate**, e.g. by reducing greenhouse gas emissions from agriculture, particularly livestock farming;
- to be continued: the **modernisation** of agriculture, among others the change of **supply-driven to demand-driven** production and the change to full production and market **transparency**;
- improving **social cohesion** and improving the **liveability** of the countryside;
- the preservation and creation of **ecological networks**. Climate change puts this transition in a new perspective, as species will need different distribution routes;
- adaptation of agriculture to the **Water Framework Directive** and the future **Soil Framework Directive** (although the latter has recently been cancelled or at least postponed);
- adaptation of the livestock industry to face **emerging veterinary and public health challenges** such as multi-drug resistant bacteria, bird flu and other new emerging diseases;
- adaptation of the livestock industry to higher standards of **animal welfare**.

Many of these transitions are the primary responsibility of the member states. The role of the EU would be to set European standards to creating a level playing field, to ensure that these standards are met, to co-finance transition in those cases where costs exceed the financial capacity of the member state, and to co-finance innovation.

7. Instrumentation of the new policies

7.1 The Sustainable Food domain

In the new Food Policy, three types of policy instruments are needed:

- to set and harmonise productions standards;

- to create a safety net for times of crisis, when the market fails. This is the case in times of food shortages, corresponding with high prices. Such crises are often reinforced by speculation. A safety net is also required in times of surpluses, corresponding with very low prices, which can cause a farm crisis;
- to supply long-term support to farming 'under pressure' in specific valuable landscapes.

The 'safety net' instruments to correct market failure are the most delicate. Compared to the current system of market and prices policy, the instruments should enable a more temporary, but - if needed - swift use. It should be emphasized, however, that in a globalising market, the EU has limited power to influence markets and prices. Instead, some form of 'global governance' will be needed to stabilise global markets and avoid farm or food crises, e.g. by agreements to prohibit large scale food speculation.

Looking at the policy instruments required, the following ones emerge:

- policy instruments to safeguard **food security**, such as strategic stockpiles, strategic production capacity (e.g. by schemes for set-aside and extensification) and export restrictions (levies or quota). In times of food shortages and high prices, set-aside land can be re-used and extensive land be re-intensified to boost production and reduce prices and speculation (anti-cyclical measures);
- guaranteeing **price stability** is effected along three ways:
 - generally speaking, price stability for producers can be taken over by the parties in the food chain;
 - on EU level, price stability for producers as well as consumers is mainly realised by supply management (measures under a.);
 - on global level, additional measures (trade and anti-speculation agreements) might be needed to stabilise markets;
- food and production standards (for quality, veterinary demands, animal welfare, environment etc.) and trade rules to guarantee a level playing field;
- long-term support (income support, higher agri-environment support or otherwise targeted support) for regions where farming is under serious pressure, but where continuation of farming is desired for food security reasons (and perhaps for environmental or landscape preservation reasons as well - see § 7.2).

EU Sustainable Food policy: objectives versus instruments

	strategic stock-piles	strategic production capacity	production standards	labeling	trade rules	import or export levies	support for specific farming types
food security	x	x			x	x	
safe and healthy food, sustainable production			x	x	x		
food diversity			x	x	x		
animal welfare			x	x			
price stability	x	x			x		
encourage farming in developing countries		x			x		
sustain production in 'marginal' regions		x		x			x

Compared to the current situation, **major changes** are:

- export subsidies are completely abolished (except for temporary food aid);
- price stability is no longer instrumented by traditional intervention measures, but by anti-cyclic supply management measures and (on a 'global governance' level) by trade agreements;

- an increased role of the EU in setting and harmonising production standards (including all aspects of sustainability) and guaranteeing transparency of production (standards, origin etc.) by labelling;
- a prolonged, but temporary (crisis management) role for supply management, mainly by set-aside;
- restriction of income support to (farms in) areas where farming is vital to the natural environment (biodiversity, landscape), but is threatened by abandonment;
- restriction of import levies to products produced in a non-sustainable way outside the EU.

7.2 The Rural Environment domain

An EU rural environment policy would include the following instruments:

- Legislation, in two ways:
 - regulation and harmonisation of production standards to avoid negative impact of farming on the natural environment. This means continuation and further development of 'codes of good practice';
 - the obligation to designate nature areas and landscapes of European importance. For landscape, an EU Landscape Directive is added. But unlike the Birds and Habitats Directive, used to create the Natura 2000 network, a Landscape Directive seeks for stimulation and remuneration. It should be less informal than the Council of Europe's Landscape Convention, but less rigorous than the Birds and Habitats Directive and, as mentioned, only be aiming at landscapes of European importance.
- Financial disincentives (levies) for avoiding negative environmental effects of production, enhancing extensification (with possible biodiversity and landscapes benefits).
- Permanent payments for farming's positive contributions to the environment: ecosystem services. These include all services that are not supplied to markets and are left to the public domain: biodiversity, landscape and cultural heritage, but also farming's contributions to mitigate climate change (carbon sequestration) and a number of water and soil services exceeding legal obligations.

EU Rural Environment policy: objectives versus instruments

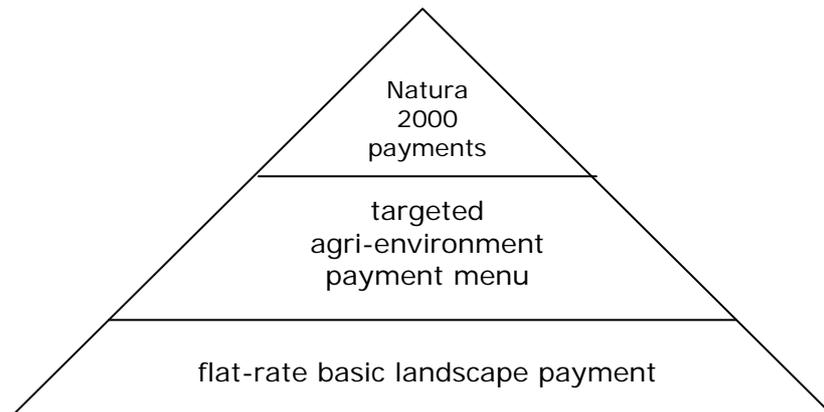
	codes of good practice	designa- tion of areas	perma- nent payment	incidental payments	nitrogen levy
avoiding negative impact on natural resources	x				x
rewarding ecosystem services: - biodiversity - landscape - cultural heritage - other services exceeding - legal obligations		x x	x x x x		
sustain production in valuable but vulnerable regions			x		

Permanent payments could be given in a three-tier pyramid or 'cappuccino model' (see the figure on the next page):

- a basic flat rate level for large areas, insofar as needed to protect public goods, including food security and natural resources against competition from the world market. For this reason, the current Less Favoured Areas scheme together with a re-styled Single Farm Payment could evolve into a basic landscape payment for regions where farming substantially contributes to an attractive landscape;

- a targeted menu-based payment, including high nature and landscape value farming systems, endangered species or vegetations;
- additional payments for Natura 2000 and areas where agriculture is in decline but deemed indispensable for landscape conservation.

Targeted payments for ecosystem services that are easily measured are de-coupled from primary production and directly linked to the service itself. If the service is strongly interrelated with land use and difficult to be independently measured, the payment for land use change should exceed the opportunity costs farmers face to make the change (also see the 2007 FAO report on paying farmers for environmental services). This requires policy changes up to WTO level.



Compared to the current situation, the **main shifts** are:

- payment of targeted ecosystem services is embedded as a permanent instead of a semi-temporary measure. At the same time, the range of payments is substantially extended to all ecosystem services exceeding legal obligations: from biodiversity and landscape to water, climate, soil, air etc.;
- payments for ecosystem services are (where possible) de-coupled from primary production and based on a newly developed market for public goods. If this is not possible, payments should exceed opportunity costs of land use change in order to really generate income capacity;
- landscapes of European importance are included more prominently on the EU agenda, however - in contrast to the Natura 2000 approach - in a stimulating way;
- the other elements of the present rural development policy are divided into a sustainable growth part, shifted to another section of the EU budget (competitiveness and cohesion), and a transition part (temporary incentives for change) under the transition domain of the new policy (see § 7.3).

7.3 The Transition domain

The transition policy exists of temporary and one-time financial incentives, merely consistent with the traditional instruments, including:

- investment support;
- temporary income support;
- support for early retirement;
- support for relocation of farms;
- support for training and education.

In addition, other instruments enhancing structural changes can be included, such as 'land banks' or 'mitigation banks'.

7.4 Design and implementation level

Future of the current 'Pillars'

As stated before, the three parts of the future policy are strongly inter-related. However, the current financial instrumentation of the CAP (income support in Pillar 1, rural development support in Pillar 2) is no longer viable in the context of our ideas - that is why we speak of domains instead of pillars:

- 'plain' income support would be strongly restricted;
- sustainable land management, i.e. rewarding ecosystem services would be strongly extended and receive a permanent basis, but would mainly be implemented on national level;
- the socio-economic part remains, but will be better targeted and divided in two sections: a transition policy and a 'sustainable growth' part, the latter shifted to the (substantial) part of the EU budget of the same name.

This would imply a strong shift in expenditure: the Food policy will have modest 'safety net' expenditure, the sustainable land management part will have substantial expenditure, with the transition policy in between.

As the current Pillar 2 contains a well-elaborated system of implementation and monitoring, conversion of this pillar to a more comprehensive payment system would seem logical. However, the nationalisation of parts of the policy implementation and the broadly criticised bureaucracy of the current rural development regulation urge for a serious re-modelling of its character.

Implementation level

A serious reconsideration of adequate policy levels is needed. In the previous paragraphs, we have been introducing new goals at EU level, but have been nationalising important parts of the actual implementation. Beforehand, it should be considered:

- that defining the targets and implementing the measures do not automatically require the same policy level;
- that shifts in policy level can have serious budgetary consequences, but that (at the same time) budget shifts can be organised relatively easy, e.g. by an alternative way of modulation (from EU to national funds).

Recapitulating, the new policy could include the following distinction.

- a. The EU level seems most appropriate for:
 - food security (including a global element: anticipating scarcity);
 - production standards and trade rules ('level playing field');
 - climate change;
 - landscapes and biodiversity of European importance (cross-border areas and areas of outstanding international importance).As pointed out before, these targets and policy measures require relatively modest budgets on EU level.
- b. All other targets and measures (rural development, biodiversity and landscapes of national importance, all other ecosystem services) could be implemented on national level. This would justify a drastic shift in budgets from EU to national levels. Thinking in 'old' policy terms, the rural development (Pillar 2) budget and a large part of the direct payments (Pillar 1) could be nationalised. This would require new financial agreements on EU level, and/or framework directives on EU level to guarantee the nationalised money is spent well.

8. Relevance for short-term reforms

In the light of the longer term reform of the CAP, fine-tuning of 'old CAP instruments' like the Single Farm Payment, cross-compliance and modulation seems of secondary importance. Nevertheless, the EU and a number national governments have been pointing out that short-term adjustments should be in line (or at least not be conflicting

with) with long-term goals. We will now discuss some existing ideas on short-term reforms in the light of the long-term goals described in earlier paragraphs.

Single Farm Payment, cross-compliance and modulation

There is rather broad consensus that the Single Farm Payment should be regarded as a transitional step on the route to a system of CAP payments based on the purchase of public benefits. Cross-compliance and modulation are the main instruments in this transition. In the light of the long-term goals, interesting questions are:

- a. Which public goods are to be purchased: ecosystem services only or food security as well? In our view, public services include food security, but this service may require other policy measures rather than substantial budgets.
- b. How should the Single Farm Payment best be implemented: on the basis of a historic reference, as a flat-rate payment, with or without a regional approach? For the Netherlands, for instance, a flat-rate payment (which would be around € 450,- per ha) will cause severe inequity among farmers and regions (especially to the disadvantage of dairy farms), and will not secure an adequate coupling to public services. In our view, a flat-rate approach anticipates the future much better than a historic reference, on condition that at least part of the payment is targeted to valuable regions and/or coupled to ecosystem services. The latter is risky, however, as the current payment system (income foregone) still limits the income capacity from ecosystem services. This route requires reform (decoupling) of the payment system as well (also see § 7.2).
- c. What should be the destination of modulated budgets? Green NGOs advocate targeting at agri-environment schemes only, farmers' organisations advocate a broader range or are even against further modulation as (in their view) Pillar 2 does not sufficiently guarantee that the money returns to farmers. In our view, modulation budgets might be dedicated to different kinds of public services, including direct support (via Pillar 1) to specific farms and areas as meant in Article 69 of EU regulation 1782/2003 (see § 4). Using this article might even enable parties involved to reach agreement of further modulation;

Set-aside and energy crops

Now that the European Commission has lifted the set-aside obligation for 2007/2008 (and discussion on final abolishment is to follow), NGOs plead for retaining the environmental benefits of set-aside, for instance by:

- integration of set-aside measures in the agri-environment schemes;
- introduction of additional cross-compliance obligations;
- introduction of a separate environmental set-aside scheme.

In a broader perspective, there is much concern on the rapid upscaling of biofuel production as a result of the recent Commission target. NGOs and the European Parliament have proposed *environmental certification* of energy crops and introduction of *environmental energy crops schemes*. Also in the light of the food security objective to anticipate scarcity, retaining some form of set-aside seems a wise option.

Less Favoured Areas scheme

The current evaluation and reform of the Less favoured Areas (LFA) scheme, is not included in the Health Check, but takes another route. This could turn out to be a missed opportunity, as a re-styling of the LFA scheme in relation to the future (flat-rate) Single Farm Payment provides excellent chances to design a scheme to support areas where farming substantially contributes to an attractive landscape.

Part C: Concluding summary

Need for drastic CAP reform

European rural policies face urgent problems to be solved, some of them new, some existing but increasing. Important global developments need European answers: increasing food scarcity, depletion of natural resources and valuable landscapes, climate change, water availability, biofuel production, etc. In addition, the EU faces serious governance problems relating to budget and communication problems, over-centralisation and bureaucracy, and enlargement.

The European Commission has announced further reforms, but these remain largely within the current CAP context and do not sufficiently anticipate the problems mentioned before. Therefore, a more radical change is needed.

From two pillars to three domains

This radical change could be achieved by putting EU rural policies into a new framework of objectives and instruments, where a reformed (sustainable) food policy is - on an equal basis - accompanied by an environment and a transition policy. In this way, the new policy will consist of three domains:

1. a **Sustainable Food Policy**, ensuring food security, safety, quality and diversity, stable prices, transparency to the consumer, adequate levels of animal welfare, European solidarity and fair global trade;
2. a **Rural Environment Policy**, ensuring preservation of natural resources (air, water, soil, biodiversity) and valuable landscapes by reducing the adverse impacts of farming on the natural environment and enhancing (rewarding) farming's ecosystem services;
3. a **Transition Policy**, facilitating adaptation of farms and rural communities to drastic changes imposed by climate change and society.

These 'domains' are strongly inter-related, but pursue different goals and use different instruments. The remaining, more general socio-economic objectives and instruments of the current CAP (regional development, social cohesion etc.) are transferred to the 'sustainable growth' part of the EU policy and budget.

Food policy: stable food supply and prices, transparency for consumers

There are still strong reasons for an EU Food Policy. But compared to the current policy, it should focus on strategic supply management (in times of crisis), provide a safety net for producers and provide optimal food safety and transparency to consumers. In terms of instruments:

- there is a prolonged, but more temporary (crisis management) role for supply control by strategic stockpiles and strategic production capacity (set-aside and extensification schemes);
- export subsidies are completely abolished;
- import levies are restricted to products produced in a non-sustainable way outside the EU;
- the EU has an increased role in setting and harmonising production standards (incl. all aspects of sustainability and animal welfare) and transparency of production (including labelling).

Rural Environment: permanent payment for landscape and ecosystem services

While the adverse impact of agriculture is reduced by EU and national legislation and taxes, the Rural Environment Policy focuses on rewarding positive contributions to the natural environment exceeding legal obligations: ecosystem services. Important elements include:

- permanent (instead of semi-temporary) payment of a broad range of targeted ecosystem services: biodiversity and landscape, but also water, climate, soil, air etc.;

- payments for measurable ecosystem services are de-coupled from primary production and based on a newly developed market for public goods. Payments for services strongly related to land use change should exceed opportunity costs the changes required in order to really generate income capacity;
- landscapes of European importance are included more prominently on the EU agenda, however - in contrast to the Natura 2000 approach - in a stimulating way;
- income support is restricted to (farms in) areas where farming is crucial to the natural environment (biodiversity, landscape), but is threatened by abandonment. The Less Favoured Areas scheme and the new, flat-rate Single Farm Payment are re-styled to a payment system for regions where farming substantially contributes to an attractive landscape.

The other (socio-economic) parts of the current rural development policy are shifted to the Transition Policy and to the 'sustainable growth' part of the EU budget.

Transition policy: facilitating change

Agriculture and rural communities are facing important and drastic changes imposed by society: the ongoing need for modernisation, adaptation to major environmental (climate, water) and market changes (e.g. from supply- to demand-driven, animal welfare), for improving social cohesion etc. The Transition Policy is meant to facilitate these challenges. It is instrumented by temporary payments (such as investment subsidies and capital payments) and by 'agricultural land banks' (including mitigation banks).

Financing: one fund and major shifts in expenditure

The current two-pillar system of financing is replaced by one EU fund for food and rural environment. As direct support will merely be replaced by targeted support and the range of rewarded ecosystem services will be expanded, the current pillar 2 model of implementation and monitoring could be used, on the condition of major changes in the implementation:

- bureaucracy should be strongly reduced;
- the payment system needs drastic change ('de-coupling');
- it should enable a shift from EU to national implementation.

Compared to the current budgets, the Food policy will require a modest (merely 'safety net') expenditure and the Rural Environment policy will require substantial expenditure, especially for permanently rewarding ecosystem services (including landscape preservation). The Transition policy will have an intermediate budget.

Implementation shift from EU to national level

Important parts of the new policies are implemented on national level rather than EU level. The EU level seems appropriate for food security, production standards ('level playing field'), climate change and landscapes and biodiversity of European importance. All other policy instruments can (although complying to EU objectives) be implemented on national level. This would imply:

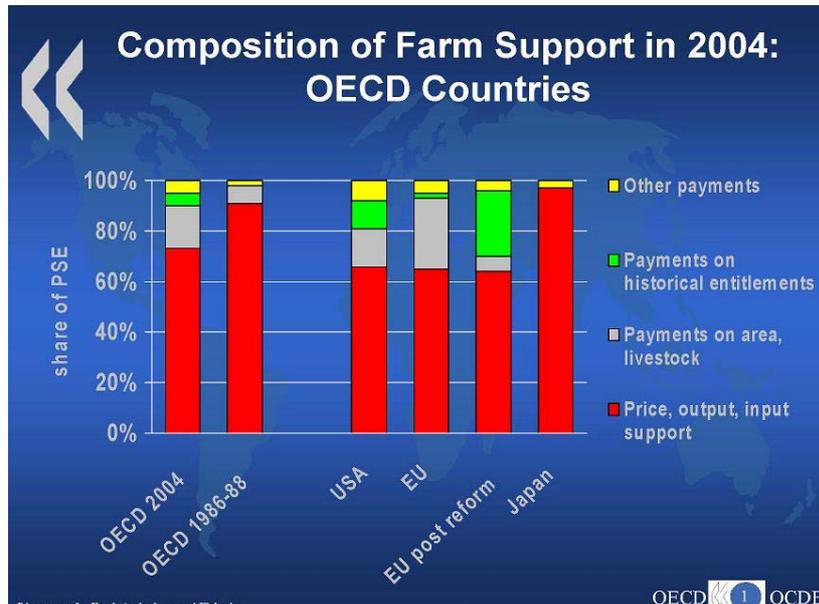
- new, much more globally formulated implementation criteria at EU level;
- more room for tailored implementation by member states;
- a major budget shift from the EU to the member states (or a new financial arrangement between the EU and its constituents).

Consequences for short-term reforms

In view of the long-term changes of the current policy, 'no regret' revisions on the short term (Health Check, Budget Review, Less Favoured Areas scheme) may include:

- an EU-wide transition to flat-rate income support, partly specifically targeted to public goods such as valuable landscapes, combined with the reform of the LFA scheme;
- using additional modulation budgets for public services, including direct ('Article 69') support to farms beneficial to the environment;
- retaining set-aside (although in a somewhat different form) for food policy as well as environmental reasons (ecosystem services).

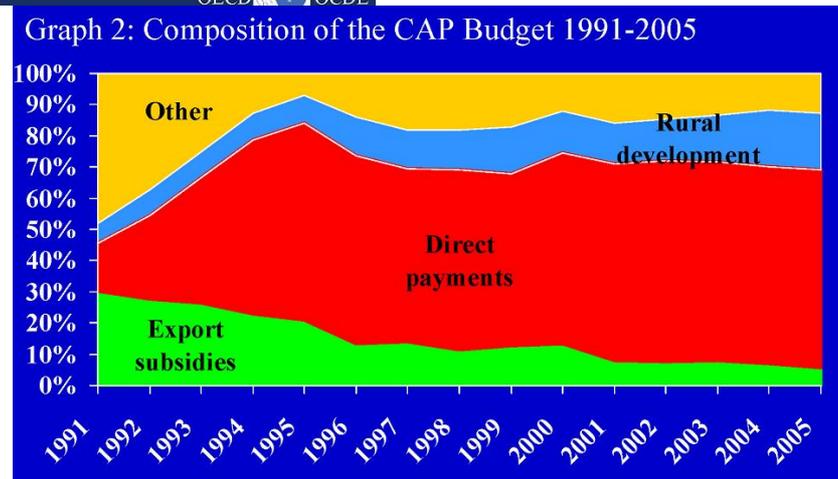
Annex: some illustrative facts and figures



Graph 1. Composition of EU farm support compared to other (OECD) countries
Source: OECD

Graph 2. Composition of the CAP budget between 1991 and 2005.

Source: H. Grethe (Humboldt University, Berlin)



Composition of the 2007 EU budget

	billion €	share
Sustainable growth, including:	54.9	43.4%
- competitiveness	9.4	7.4%
- cohesion	45.5	36.0%
Natural resources, including:	56.3	44.5%
- environment	0.2	0.2%
- agricultural expenditure and direct aid	42.7	33.8%
- rural development	12.4	9.8%
Other expenditure, including:	15.3	12.2%
- freedom, security and justice	0.6	0.5%
- citizenship	0.6	0.5%
- EU as a global player	6.8	5.4%
- administration	6.9	5.5%
- compensations to new member states	0.4	0.3%
Total	126.5	100%

Source: IEEP (Towards the CAP Health Check and the European Budget Review, 2007)