Europe's Common Agricultural Policy

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Chapter 3

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Introduction

In April 1964, the United Kingdom (UK) secured the agreement of its four most significant suppliers of cereals — Argentina, Australia, Canada and the United States — that they would respect its new minimum import price regime for cereals. Tim Josling's PhD thesis at Michigan State University examined economic aspects of the 1964 Grains Agreement. Back in the UK, it was perhaps inevitable that he quickly became immersed in the country's agricultural trade policy concerns of the day.

Although Charles de Gaulle had rebuffed the UK's second bid for membership of the European Economic Community (EEC), with the resignation of de Gaulle in April 1969, and the election of Georges Pompidou to the Presidency of France, the UK's membership bid was again a live issue.[1] The Common Agricultural Policy (CAP) was a key concern; its adoption would challenge and force change to the UK's traditional food trade policies. Then, in the 1970 General Election, the Conservative Party pledged to switch the UK system of farm support from deficiency payments to CAP-like variable import levies: 'We will … introduce levies on

[1]Following several enlargements, and the UK's exit, the original EEC of six Member States evolved into today's European Union (EU) of 27 states. In these opening paragraphs the acronym EEC is used, but thereafter EU is deployed without regard to the evolving nature of the European Project or historical accuracy.

imports in order to enable us to eliminate the need for deficiency payments in their present form' (Conservative Party, 1970). Following the election, and led by Edward Heath, the new Conservative Government's intent was to reduce the level of government spending, although the planned policy change was also consistent with its aim of joining the EEC — 'If we can negotiate the right terms' — and the UK's acceptance of the CAP. In 1973, the UK joined and began to apply the CAP, but by the 2010s the UK's policy debate had come full circle, with the UK voting to leave the EU ('Brexit') and renationalising its agricultural policies.

After a brief history of the CAP, this chapter asks whether the reform process begun in the 1990s has been completed and whether or not there has been a paradigm change. It then poses the question: what are direct payments for? Pillar 2 is then briefly discussed. Finally two particular challenges for the post-2020 CAP are noted: that arising from the UK's exit from the EU, and the need for European farmers to adapt to climate change, whilst helping to mitigate its effects through carbon sequestration and a reduction in greenhouse gas (GHG) emissions. As I write, death rates rise and social and economic activities worldwide suffer from the coronavirus (COVID-19) pandemic. These circumstances are so unprecedented in modern times that it seems likely that the world economy will be rather different in years to come. One consequence is that the resilience of food supply systems, ensuring the availability of safe, nutritious and ethically sourced food for consumers, will be subject to greater scrutiny; but how this will impact the CAP is too soon to tell. Other on-going concerns that EU policy-makers face include providing ecosystem services and fostering productive, economically efficient and commercially viable farm and food-processing sectors: all this whilst respecting the EU's trade and climate change commitments, and the UN's sustainable development goals, in an interdependent world.

Scholars from a number of disciplines — including agricultural economics, political science, rural sociology, geography, law and, more recently, history — have created a substantial literature on the CAP, very few of whom can be acknowledged here. Fisheries have their own policy regime, and this is not discussed. The Renewable Energy Directive (RED), and its implementation by the Member States, does not fall under the rubric of the CAP, despite its implications for land use and commodity prices. Box 3.1 gives an introduction to EU governance and competencies.

A Brief Overview of the CAP's Rather Long History

The legal origins of the CAP lie in the 1957 Treaty of Rome, establishing the EEC. That treaty mandated that the common market would extend to

Box 3.1: EU Governance and Competencies

The EU is a unique and complex grouping of 27 sovereign states in Western and Central Europe, bound together by treaty. Nineteen share a common currency: the euro (€). Four main institutions formulate, decide and implement policies. The *European Commission* (previously known as the *Commission of the European Communities*) is the EU's civil service, headed by a College of Commissioners appointed for a 5-year term by the Member States. It makes policy proposals, which are then decided on by the *Council of Ministers* and the *European Parliament*, acting jointly. An overarching body is the *European Council* — the heads of government of the 27 Member States — that takes strategic decisions. The *European Court* oversees the administration of EU law.

The Member States have given the EU exclusive competence in some, but by no means all, policy domains. Of particular relevance to this chapter, the EU has exclusive competence over both agricultural policy and commercial policy. However, in implementing its policies the EU is reliant upon the national administrations of the Member States: making payments mandated by the CAP, collecting customs duties on imports as specified in its Common Customs Tariff (CCT), etc. Moreover, although the CAP lays down common rules and procedures, there are numerous instances in which Member States have discretion to tailor policy to reflect national circumstances and preferences. This has been particularly the case with the CAP's Rural Development policies.

Some important policy issues are not subject to EU control but remain the exclusive prerogative of the Member States. Those of particular relevance to agriculture and food include personal and business taxes, and law relating to land ownership, tenancy and planning. Although subject to overarching EU principles, Member States have the right to apply a reduced, or in some instances a zero, Value Added Tax (VAT) to food.

'agriculture and trade in agricultural products' and specified that one of the EEC's tasks would be the 'adoption of a common policy in the sphere of agriculture'.

The treaty did not include a fully worked-out CAP, only suggestions as to the form it might take. Establishing the CAP's price support mechanisms, the level of price support given the divergent perceptions of the needs of German and French farmers in particular and how to fund the CAP, whilst coping with the Dillon and Kennedy Rounds of GATT (General Agreement on Tariffs and Trade) negotiations, and a virtual paralysis of decision making procedures until resolved by the 'Luxembourg Compromise' in January 1966, involved high drama, threats and marathon negotiating sessions. Agreement was nonetheless reached on the common price level that would apply to cereals (considered a key benchmark given cereals' predominant use of arable land and use as animal feed). Economists were not impressed. German farmers had won the day, and cereal prices had been fixed far too high.

Readers may need reminding that the CAP of the late 1960s was almost exclusively focussed on market price support, with prices kept well in excess of those prevailing on world markets. Although details varied from product to product, the basic scheme involved: (i) a variable import levy (an import tax) designed to bridge the gap between fluctuating world market prices and the EU's (usually) higher target (or threshold) price; (ii) an intervention (floor) price for the domestic market that led to the accumulation of butter and other produce 'mountains' in intervention stores and (iii) export refunds (subsidies) to enable the sale of 'surplus' produce onto world markets (Josling, 1970a, pp. 59–61). Currency movements, beginning with a devaluation of the French franc in 1969, shattered the CAP concept of 'common' support prices, resulting in a new system of border taxes and subsidies on intra-EEC trade, which became known as Monetary Compensatory Amounts (MCAs).[2] The World Food Crisis of the 1970s led many farmers, politicians (and some analysts) to conclude that CAP price levels were not inappropriate after all. But in the latter part of the 1970s, when world prices fell back to their pre-crisis levels, it again became apparent that CAP prices were excessively high.

The 'old' CAP was heavily criticised. Josling (1969) had shown how market-price interventions, of the sort deployed by the CAP, could be subject to rigorous economic appraisal. At a meeting in Wageningen in the Netherlands in May 1973, twenty-two distinguished agricultural economists from across Europe had signed the Wageningen memorandum on the reform of the CAP, with Josling one of their number. As he explained forty years later, the concerns of the memorandum's signatories were:

> 'that the CAP was failing to tackle the low-income problem in rural areas, it hampered structural change in agriculture, it allowed surpluses

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[2]MCAs were abolished when the Single Market came into force on 1 January 1993. With the introduction of the euro on 1 January 1999 the last remnants of the agri-monetary system disappeared.

> of farm products to accumulate and it posed problems for enlargement. The memorandum emphasized the need for new instruments to replace variable levies, for further trade talks to negotiate limits on export subsidies, for a curb on prices and for compensation payments to be considered when prices were cut' (Josling and Swinbank, 2013, p. 25).

In the 1980s, the prevailing view, shared by Moyer and Josling (1990), was that only a budget crisis could trigger a policy reform (see Chapter 1). The Uruguay Round (1986–1994), discussed by David Orden in Chapter 6, changed that. Although scholars still debate the extent to which budget concerns, a paradigm shift and pressure to conclude the Uruguay Round resulted in the MacSharry Reform of 1992, many analysts have concluded that GATT pressures played a pivotal role. Thus, in their sequel, Moyer and Josling (2002, p. 56) remarked that:

> 'one of the most interesting aspects of the Round was the extent to which domestic agricultural policy reforms were encouraged by the negotiations, and the extent to which these reforms are now effectively locked in by the terms of the Agreement.'

The MacSharry Reform began the process of decoupling farm income support. For example, the intervention price for cereals was reduced (but not eliminated), and farm businesses became entitled to a flat-rate area payment designed to compensate for revenue loss. In 1999, in *Agenda 2000*, these changes were extended to milk, and the price cuts deepened. *Agenda 2000* also saw the designation of a Second Pillar of the CAP — *Rural Development* — to complement its First Pillar devoted to market price and income support.

Agenda 2000's wider remit was to prepare the EU for a further enlargement, this time to the East. With the fall of the Berlin Wall in 1989, the incorporation of East Germany into the Federal Republic of (West) Germany, the loss of Soviet control over the Baltic and Central European states, and the break-up of Yugoslavia, the prospect of a substantial expansion of the EU's membership emerged. How would this affect the CAP? One particular question was whether area and headage payments, which had originally been seen as *compensation* for the cuts in support prices in the MacSharry — 1992 — and Agenda 2000 reforms, should be paid in the new Member States. By 2002, the matter was more-or-less settled. The Commission of the European Communities (2002, p. 4) reported:

> 'Direct payments are granted to farmers in EU-15 for a number of arable crops and cattle following the support price cuts of the 1992 and Agenda 2000 reform in these sectors. … Although direct payments were introduced initially to compensate for support price cuts, they have lost part of their compensatory character after 10 years of implementation and have instead become simple direct income payments. Therefore, the term 'direct aid' has replaced "compensation payment".'

Thus, when these states joined the EU their farmers became eligible for direct payments, although these were progressively phased in and — the new States argued — were less generous than those payable in the old Member States.

Whilst grappling with the challenges of enlargement, and defending the CAP in the opening phases of the Doha Round trade negotiations in the WTO, Franz Fischler developed a new reform proposal under the guise of a mid-term review of the Agenda 2000 provisions.

Fischler's core plan was to secure even more decoupling of the CAP's area and headage payments by bundling them into a new Single Payment Scheme (SPS). A farm business would continue to receive an unchanged level of support, regardless of crops actually produced or livestock kept, *provided* the land was still farmed by the recipient, that it was kept in a good agricultural and environmental condition, and that certain environmental, food safety, and animal welfare norms were respected ('cross compliance'). The outcome, however, allowed Member States some discretion. But with the inclusion of the dairy and sugar reforms, and the subsequent extension of the SPS to payment schemes for most other products, the bulk of the CAP's price and income support was now deemed by the EU to be 'decoupled' and was declared as such in the EU's periodic submissions to the WTO (see further discussion below).

Following another spike in world food prices, the so-called 'Health Check' of 2008 brought more products into the SPS, abolished set-aside and foresaw the end of milk quotas in 2015. Planning then began for a new package, to apply concurrently with the Multi-annual Financial Framework for 2014–2020. In this recalibration, the CAP's budget was more-or-less maintained in nominal terms, with no significant shift from Pillar 1 (price and income support) to Rural Development (Pillar 2). Direct payments were retained, with some switch of funds between and within Member States, narrowing the gap per hectare. However 30% of the direct payment budget was subject to 'greening', which meant that more stringent environmental criteria applied to the use of most farmland. The European Commission (2018b, p. 10) has reported that, in 2017, 41% of farms, and 79% of farmland, was subject to greening. However it also confessed: '5 years on, we can say without any real risk of contradiction that greening did not work. It did not deliver the results that our citizens want and our climate so desperately needs' (Hogan, 2018).

The CAP of 2020 is rather different from the CAP that was fashioned in the 1960s, although certain features endure. Throughout its life, it has probably been subject to more scrutiny and criticism than any other agricultural policy in history. At one time, it was seen as the EEC's core policy: the 'cement' that bound the Member States together in their quest for 'an ever closer union'. Internationally, it has led to trade conflicts, amid complaints about its detrimental impact on other nations. Within Europe, it has been accused of fuelling the growth of an industrial agriculture, leading to adverse environmental outcomes and a loss of biodiversity. Paradoxically, despite the CAP's attempts over 50-years to ensure 'a fair standard of living for the agricultural community', in its latest 'reform' proposal the European Commission (2017, p. 14) claimed that farmers' incomes are 'still lagging behind salaries in the whole economy'. Direct income support payments, it said, 'partially fill the gap between agricultural income and income in other economic sectors', and 'remain an essential part of the CAP.'

Completing the Reform of Farm Income Support?

So what has been achieved, and what remains of the 'old' CAP? Figure 3.1 shows how expenditure on the CAP has developed since 1980. If we were to adjust for inflation, expenditures in real terms would, of course, show a much flatter profile. Moreover, some of the growth in expenditure is due to the various enlargements of the EU. Expenditure on the CAP, which amounted to more than 0.6% of the EU12's GDP (Gross Domestic Product) in the mid-1980s, had fallen to about 0.35% of the EU28's GDP by 2018.

Export refunds (subsidies contingent on the export of the product) are no longer part of the CAP's lexicon. Reductions in intervention prices, beginning with the MacSharry Reform, combined with the fact that they were then fixed in nominal terms, which over time reduced their real value because of inflation, brought EU market prices closer to world levels, and meant that by the early 2010s export refunds were largely redundant. When WTO ministers met in Nairobi in 2015, they agreed to phase out export subsidies, and accordingly from December 2016 the EU's Schedule of GATT Tariff Concessions has made no allowance for their payment.

Similarly, intervention purchases and other market operations ('Other market support' in Figure 3.1) are largely a thing of the past. Instead, with the area and headage payments of the MacSharry Reform, 'Coupled direct payments' came to the fore, to be displaced by 'Decoupled direct payments' following the Fischler Reforms. Throughout, expenditure on Rural Development — rather a misnomer because the bulk of expenditure is devoted to environmental enhancement, support to farmers in disadvantaged regions, and farm and market chain modernization — has always been a small part of the whole. These changes have also been reflected in the EU's annual declarations of domestic support to the WTO. Thus, for 2016/17 it reported trade distorting support (its Current Total AMS) totalling €6.9 billion, accounting for a mere 9.6% of the maximum amount to which the EU claimed it was entitled under its WTO commitments (WTO, 2019) — and well within the revised limits that had been discussed during the Doha Round negotiations. From that perspective, no further reform was being demanded by its WTO partners. But the so-called Green

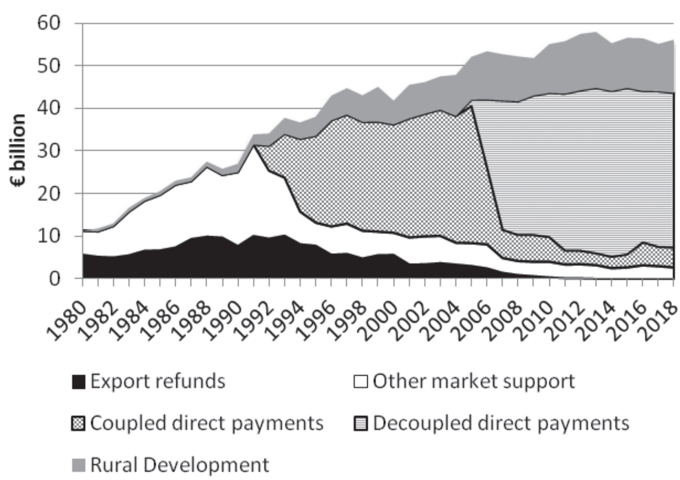

Figure 3.1. EU Budget Expenditure on the CAP, Annual Data, 1980–2018, € Billion Current Prices

Source: Data compiled and kindly supplied by the Directorate General for Agriculture and Rural Development of the European Commission.

Box included total spending of €37.7 billion on direct payments to farmers. There is further discussion of direct payments below.

The third element of the 'old' CAP that lives on is the (often) excessively high import tariffs that can apply on an MFN (most-favoured-nation) basis, despite several rounds of GATT negotiations and the WTO's as-yet unfinished Doha Round. In 1970, outlining the creation of the CAP, Josling (1970b, p. 2) rather presciently remarked that: 'In the long run the most important questions will no doubt prove to be the external aspects of the Common Market's agricultural system rather than the internal tensions which it generates'.

The Uruguay Round resulted in the tariffication of border measures. In particular, variable import levies — a key policy provision of the 'old' CAP — were largely displaced by fixed, *specific* tariffs incorporated into the Common Customs Tariff (CCT). Subsequently, despite successive 'reforms' of the CAP (Agenda, 2000, the Fischler Reforms, etc.) that reduced intervention prices, there were no corresponding cuts in import tariffs (Swinbank, 2018).

A complex array of tariff rate quotas (TRQs), free trade area (FTA) agreements, the General System of Preferences (GSP) enjoyed by most developing countries and the Everything-but-Arms (EBA) concessions for the Least-developed Countries means that imports can penetrate the CAP's protective barriers. But these concessions are *not* available to all potential suppliers. Thus, there is a queue of countries eager to conclude FTAs with the EU that would allow their agri-food industries easier access to the European market. Europe's farmers, and existing beneficiaries of tariff concessions, are rather less enamoured by such moves. For example, in the summer of 2019, following the conclusion of a political agreement between the EU and the South American trade block Mercosur, Copa-Cogeca (2019) representing European agriculture expressed deep regret over 'the substantial concessions made in the agricultural chapter'. These concessions, it argued, included 'some of the EU's most sensitive sectors, such as beef, poultry, sugar, ethanol, rice and orange juice, for which … high tariff rate quotas have been proposed.' Similarly the African, Caribbean and Pacific Group of States deeply regretted 'that it was not consulted fully on the context and content of this Free Trade Agreement', and noted 'with great concern' that additional quantities of tariff-free sugar could gain access to the EU's markets. 'Further increasing supply through new Free Trade Agreements in an already over-supplied market can only have a detrimental effect on any residual preference afforded to developing countries', it stated (ACP, 2019).

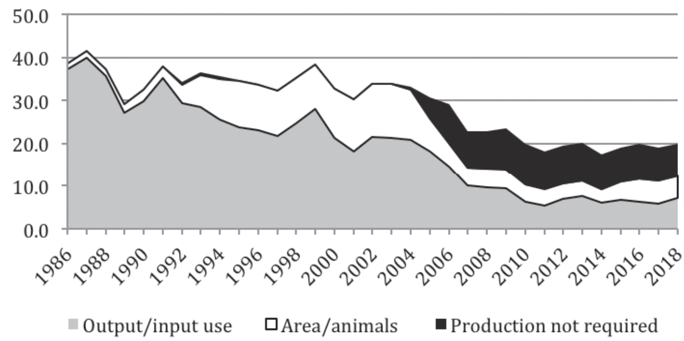

Figure 3.2. The OECD's PSE percentage, EU28, 1986–2018

Source: OECD's *2019 — Monitoring and evaluation: Reference Tables:* https://stats.oecd.org/Index.aspx?DataSetCode=MON2019_REFERENCE_TABLE, accessed 15 August 2019. — Support as classified by the author: (i) based on output or on input use; (ii) based on present or past area or animal numbers, but production still required, (iii) production no longer required.

There is a good deal of 'water' in many of the CAP's MFN tariffs, effectively blocking trade from those suppliers that do not enjoy preferential access, and meaning that the tariff is not a good measure of the extent to which EU farm-gate prices exceed those on world markets. The weakening of the CAP's domestic market price mechanisms through successive CAP reforms has been a major factor narrowing the price gap. Nevertheless, Copa-Cogeca's fear, that an expansion of the volume of preferential imports from the growing array of FTAs and TRQs impact on European farmers' returns, is relevant.

These various policy changes are reflected in the OECD's Producer Support Estimate (PSE), expressing the support received as a percentage of gross farm receipts, which show not only a reduction over time, but a switch from trade distorting measures to more decoupled forms of support (see Figure 3.2). Nonetheless, according to these calculations, market price support (which forms the bulk of the 'output/input use' shaded area in Figure 3.2) still accounted for a PSE of about 6% of EU farmers' gross receipts in the mid-2010s.

Paradigm Change?

Knudsen (2009, p. 61) reports that when Sicco Mansholt — then Minister of Agriculture in The Netherlands, later the EEC's first Commissioner for

Agriculture — participated in the negotiations that led to the agricultural chapter in the EEC Treaty, he:

> 'argued in favor of specialization of the agricultural production within the common market, the establishment of cost-effective production in the Community, and for a large degree of openness to the world economy so that farmers and the processing industries could purchase raw materials at optimal prices. It was a line of thinking that was so liberal and federalist that Mansholt could easily have scared … other ministers for agriculture'

The CAP that emerged in the 1960s, however, was quite different and had agricultural exceptionalism at its core, with its focus on 'closing the farm income gap' through market price support. The basic idea behind agricultural exceptionalism is that farming is quite unlike any other economic activity and that free market forces are unlikely to produce desirable outcomes in terms of farm incomes, food prices, food security and — in more recent times — environmental protection, let alone enhancement. Thus, it is thought governments have a critical role to play in protecting farmers from damaging market forces and managing the sector. This has led political scientists, and others, to talk about policy paradigms, and in particular to link agricultural exceptionalism to what might be called a *dependent* or *state-assistance* paradigm.

Not only was agricultural exceptionalism the prevailing accepted wisdom — although there were, of course, critics of this policy approach — it had been embedded internationally in the special treatment afforded the agriculture sector in the GATT (Josling, 2010). In the Uruguay Round, limits were placed on the exceptions afforded the farm sector (although the outcome was still a sector-specific *Agreement on Agriculture*) suggesting that a *competitive* paradigm was in the process of displacing internationally the dependent paradigm. The competitive paradigm 'emphasises agriculture as a sector that can hold its own against other sectors of the economy and that can thrive in an international trade system (at least, where markets are permitted to act freely of distorting, dependent paradigm style policies)' (Coleman *et al.*, 2004, p. 94).

Has there also been a paradigm change in the EU, towards a competitive model? Or rather, as some have suggested, to a *multifunctional* paradigm, which is 'clearly different from the 'dependent' one'? This multifunctional paradigm 'tries to reconcile through public regulations and incentives the needs of an open market economy … with society's demand for a high quality environment' (Garzon, 2006, p. 180). Daugbjerg and Swinbank (2009, p. 137), however, have contested this, in arguing that 'the multifunctional paradigm is no more than a newer evolved version of the state-assisted paradigm, or indeed the state-assisted paradigm in disguise.' Indeed, as noted earlier in this chapter, the perceived need for a continuation of 'income support' is still cited as a key challenge for the CAP. The European Court of Auditors' (2004, p. 3) earlier comment — that the objective of ensuring 'a fair standard of living for the agricultural community … has proved to be a real leitmotif running through the whole CAP' — surely remains valid?

The Role of 'Direct Payments'

Since their first appearance in the MacSharry Reform of 1992, as area and headage payments, analysts have asked: *what are direct payments for?* Initially area payments were characterised as 'compensation' for cuts in support prices experienced by cereal growers and were then criticised as overly generous when market prices proved more buoyant than expected. Direct payments *tend* to be capitalised into land and other asset prices, depending upon particular market circumstances. Whilst this benefited the original recipients, and lessened the competitive pressures they faced, it resulted in a barrier for new entrants who bought-in to a high-cost industry. Paradoxically, over the years, a recurring concern has been the ageing age-profile of farmers, and the difficulties 'young' farmers face entering the industry.

Although their value in real terms has been eroded through inflation, nearly three decades after their introduction there is no EU plan to phase out direct payments. Agricultural economists have suggested ways to do so — the 'bond scheme' advocated by Tangermann (1991), for example — but, aside from Brexit Britain, European policy-makers have shown little willingness to follow such advice.

Income Support

When they were introduced as compensation for policy change, direct payments reflected the production structures of the time. Thus, in more productive regions they were higher than elsewhere, and they were correlated with the scale of a farm's enterprises, be it the area of cereals grown or the farm's milk quota, for example. The new Member States, from the 2004 and subsequent enlargements, felt they were forced to accept an inferior level of funding for 'income support' than that enjoyed by farmers in the existing EU.

Thus, there was little to suggest that these 'income support' payments were objectively related to the income or revenue needs of any particular farm business. Efforts have been made to mitigate criticism by a limited massaging of the system. For example, there have been a number of attempts to target payments to particular recipients and to redistribute payments both within and between Member States. These efforts are long-standing and on-going. The 2013 recalibration of the CAP, for example, renewed attempts to limit the overall level of payment a farm business could claim ('degressivity' and 'capping'), to exclude 'non-active farmers' and to target more support to 'young' farmers and 'small' farms. So-called 'internal convergence' was a move towards flat-rate per hectare payments on a regional basis, rather than the past practice of some Member States that still retained an historical link to a farm's original entitlement determination. 'External convergence' was a limited shift of budget funds from countries with an above average per hectare payment rate to those below the average (Anania and Pupo D'Andrea, 2015).

In 2015, roughly 20% of farmers received 80% of the total payments made (European Commission, 2018a). Some of the larger payments are made to business organisations or charities that support a number of farm and farm-workers' families. Thus in the UK, in 2018, the largest sum (£4.6 million) was paid to the National Trust, with the Royal Society for the Protection of Birds in second place at £1.4 million.[3] Nonetheless, what appear to be large family trusts appear highly placed in the UK's list; and it is difficult to believe that many of the recipients have household incomes so low that they warrant 'income support', particularly when payments are often well in excess of the welfare payments to which the EU's non-farm citizens are entitled.

The lack of clarity about the extent of the farm income 'problem' is a systemic concern that, as Knudsen (2009) documents, goes back to the origins of the CAP. She suggests that the claim in the 1960s that farm incomes were 'considerably lower than those in other sectors … was not

[3]Data extracted from Defra CAP Payments Search, http://cap-payments.defra.gov.uk, accessed 8 November 2019. The University of Reading received £184,282.

generalizable for the sector' as a whole; that the claim was not subject to serious scrutiny and that 'a Sunday trip to the countryside … would surely have given ministers and their advisors a clue as to the diverse socioeconomic realities' (*op cit.*, p. 143). Rather than 'farmers on welfare', the CAP's 'income support' might be better characterised as the outcome of six decades of successful rent-seeking behaviour.

Hill (e.g. 2019, p. 49) has been a persistent critic of the need for income support. He comments:

> 'Quite what the underlying problem is has never been well-articulated …. Despite the view of the European Court of Auditors … that there is need for information on the incomes of agricultural households if this objective is to be adequately monitored, the *[European]* Commission seems quite content to operate without it. Worse, it appears hostile to filling this information gap. … Instead, the Commission has devised a methodology involving average factor rewards (rather than household income) that gives the sort of answer (depressed incomes) that is compatible with continuing CAP direct payments; even though there is independent evidence that farm families as a group are relatively well-off in many Member States in terms of the incomes households can use to support their standard of living.'

Cross Compliance

In parallel with their role as an income support, direct payments could also be seen as payment from society for the *multifunctional* role played by European agriculture. For this, business size, income and wealth are probably not relevant criteria in determining the level of direct payments. Farming, it is said, supplies a number of 'public goods'.

In the policy debate, the term 'public goods' is often loosely applied, to the chagrin of many economists, but the basic premise advanced is that European farmers — who it is said face higher costs than their competitors elsewhere — deliver a number of positive externalities associated with agriculture: landscapes, biodiversity, animal welfare, flood management, carbon sequestration, cultural traditions, etc., and even food safety and food security. In this discourse, rather less attention is paid to the negative externalities associated with agriculture: pollution of watercourses, species loss, greenhouse gas (GHG) emissions, etc.

The EU deploys three policy mechanisms in its attempts to deliver these 'public goods'. First, farmers and landowners can receive payments for specified actions under the Second Pillar of the CAP, which is explored more fully below.

Second, legislative provisions are in place to enforce a minimum level of environmental protection: the Birds and Nitrates Directives, for example. Third, many of these provisions are reinforced by *cross-compliance*, under which direct payments ('income support') can be reduced if a number of statutory management requirements (SMRs), including the Birds and Nitrates Directives, are not met, and farmers fail to achieve good agricultural and environmental conditions (GAECs). The financial penalties associated with non-compliance are, however, low, and in 2016 the European Court of Auditors (2016, paragraph 79), found 'that the application of penalties varied significantly between Member States'.

In the post-2013 CAP, *greening* augmented these provisions by conditioning 30% of direct income support payments on the pursuit of additional farming practices deemed beneficial for the environment — a two crops rule for example under which farmers with between 10 and 30 hectares of arable land had to grow at least two different crops, and the 'area taken up by the main crop must not cover more than 75% of the arable land' (Rural Payments Agency, 2019, p. 38).

Some readers might baulk at the thought that farmers are rewarded for obeying the law — complying with the SMRs — but defenders of the practice would counter that the risk of financial penalties for non-compliance can act as a powerful policing tool. But payments are neither calibrated to the farm's cost of compliance nor to the value of the public good benefits generated. Indeed, anecdotal evidence suggests that the costs incurred by the farm in complying with cross-compliance and greening are frequently trivial in comparison to payments received.

Food Security

The subheading to a European Commission webpage currently reads: 'The common agricultural policy supports farmers and ensures Europe's food security'.[4] Readers of this, and similar statements, are left to infer that without the CAP, and in particular direct income support, the food

[4] The common agricultural policy at a glance: https://ec.europa.eu/info/food-farming-fisheries/key-policies/common-agricultural-policy/cap-glance_en, accessed 9 January 2020.

security of Europe's citizens could be imperilled. Food security is a complex and multifaceted concept, with an individual citizen's food security perhaps more dependent upon their command of adequate financial resources, and ready access to a functioning supply chain, than the actual provenance of the agricultural raw material (see Chapter 5). The 'old' CAP of the 1970s undoubtedly impacted on the volumes of produce leaving Europe's farms but, following successive CAP 'reforms', the EU claims in international *fora* that CAP support now has minimal impact on production and trade.

The CAP's 2nd Pillar: Rural Development

For the 2014–2020 funding period, Member States planned to devote 25% of CAP expenditure to Pillar 2, and 75% on market price and income support (European Commission, 2019, p. 2). The split does, however, vary from one Member State to another. Unlike Pillar 1, Pillar 2 policies are in part funded by the Member States ('co-financing'), increasing overall taxpayer spending. Member States (and regions within Member States) have considerable discretion in devising their own Rural Development Plans, subject to the approval of the European Commission, according to a common set of criteria. Under the current Rural Development Regulation (now extended to 2021), support should:
'contribute to achieving the following objectives:

(a) fostering the competitiveness of agriculture;
(b) ensuring the sustainable management of natural resources, and climate action;
(c) achieving a balanced territorial development of rural economies and communities including the creation and maintenance of employment' (Regulation 1305/2013, Article 4, *Official Journal of the European Union*, L347).

Member States had 17 Rural Development Measures from which to fashion their Rural Development Plans, ranging from advisory services through to animal welfare payments. All Rural Development Plans had to include provisions for agri-environment-climate payments, and all had to devote at least 30% of EU funding 'on climate change mitigation and adaptation as well as environmental issues', drawing on 8 of these 17 measures.

Given the heterogeneous nature of this list of measures, with their different financial needs, it is somewhat insidious to contrast spending on one measure compared to another; how to judge the planned spending of 0.3% of the overall 2014–2020 EU budget allocation on 'setting-up producer groups and organisations', for example, against the 6.8% on 'basic services and village renewal in rural areas'. Nonetheless, it is striking that three measures accounted for over 55% of the planned 2014–2020 spending: 22.7% on the cryptically named 'investments in physical assets', 16.5% on 'agri-environment-climate' and a further 16.5% on 'payments to areas facing natural or other specific constraints' (European Commission, 2019, p. 13). Moreover, an examination of the individual Rural Development Plans reveals Member States expressing quite different priorities for these three measures: some favouring 'investments' and others 'agri-environment-climate' schemes.

All three measures reflect long-standing activities. Investments in physical assets, for example, refers to a range of investment projects that help farms and the processing and marketing chain to increase 'performance and sustainability', a continuation of policies that date back to the 1960s.

Agri-environmental schemes were introduced into the CAP by the MacSharry Reform of 1992, and form an important part of Pillar 2. They do, of course, insist on the delivery of benefits additional to cross-compliance and greening (discussed above), but unlike Pillar 1 support they are multi-annual in scope. Both in the EU and in Brexit Britain there has been considerable debate about the compatibility of schemes with international trade commitments. Some commentators (e.g. Hasund and Johansson, 2016) fear that the EU's schemes have paid too much deference to WTO rules. To qualify as a decoupled, green-boxed, scheme, environmental payments must be 'limited to the extra costs or loss of income involved' in complying with a 'clearly-defined government environmental or conservation programme and be dependent on the fulfilment of specific conditions under the government programme' (paragraph 12 of Annex 2 of the Agreement on Agriculture). A strict reading of this wording seems to suggest that payment schemes based on the social value of the public goods produced would be difficult to defend, and this has resulted in management-based programmes with payments linked to the cost of compliance. Any 'domestic support measures in favour of agricultural producers' that do not meet the green box criteria should, by default, be considered as amber box payments.

A Challenge for the Post-2020 CAP: Climate Change

The post-2013 CAP, agreed during the tenure of Dacian Cioloş as Commissioner for Agriculture and Rural Development, was to apply for the period 2014–2020. It was his successor, Phil Hogan, who tabled the initial proposals for the post-2020 CAP. Elections to the European Parliament in May 2019, and the installation of a new College of Commissioners, meant that it was Janusz Wojciechowski, as Commissioner for Agriculture, and a reconstituted European Parliament, that would interact with the Council of Ministers to determine the new CAP (although its implementation had slipped to January 2022).

Commissioner Hogan's proposals for a 'strong, modern, simplified and well-funded CAP beyond 2020' did not differ fundamentally from the policy already in place. Direct income support payments would retain their key role, although funding would decline in real terms. Funds from the EU budget for the Second Pillar would be reduced, with Member States expected to make up the shortfall by increasing national contributions. Cross-compliance and greening would be revamped under 'a new system of 'conditionality' *[which would]* link all farmers' income support (and other area- and animal-based payments) to the application of environment- and climate-friendly farming practices', embodying a 'higher environmental ambition'. And there would be a 'new delivery model' under which Member States would acquire more autonomy (and responsibility) for designing and implementing policy subject to the European Commission's approval (Hogan, 2018).

The new College of Commissioners left these proposals in place, but added their own priorities. Thus, one of the Commission President's six 'Political Guidelines' is a 'European Green Deal' which will enshrine a '2050 climate-neutrality target into law' (von der Leyen, 2019, p. 5). Whether this will be acceptable to the Member States and whether the 'target' will be achieved are open questions.

A number of Western governments have committed to net-zero greenhouse gas (GHG) emissions by 2050, with consequent implications for agriculture, land-use and farm policy. Agriculture will be expected to reduce its emissions (notably methane and nitrous oxide, more so than carbon dioxide) and engage in carbon sequestration. Legislation, public funding of R&D and investment schemes (Pillar 2), could nudge the farm sector to adopt appropriate practices; but whether European governments are yet ready to apply carbon pricing — paying farmers and land owners for the carbon they capture and store, and charging them for the GHGs they release — is yet to be seen.

But even if net-zero GHG emissions can be achieved by 2050, not just in Europe but elsewhere, farmers will still need to *adapt* to the climate change that is already in train. It could be argued that this should involve private investment decisions by the entrepreneurs affected; but the history of the CAP suggests that Pillar 2-like taxpayer funds will be made available to help farmers adapt.

Brexit Britain

Following a referendum in June 2016, on whether the country should remain in, or leave the EU, and after some delay, the UK finally quit on 31 January 2020. At the time of writing, the UK is still, *de facto*, applying the CAP, the EU's customs union and single market, and the CCT. During this implementation period, which is scheduled to last until the end of 2020, the UK hopes that an ambitious FTA can be negotiated with the remaining member states (EU27). Whether this can be achieved, or what form the FTA will take, is unclear at the time of writing; although the firm intent of the British Government is that the CAP will no longer apply.

Brexit raises a number of issues that the EU27 will have to face as they take the CAP forward. First, Brexit challenges the core premise on which the CAP is built. As Josling (2016, p. 22) remarked, it offered the UK 'a huge opportunity to rewrite the rules'; and the UK seems intent on doing so. Direct payments will be phased out (in England at least, if not other parts of the UK), with some of the budget savings channelled into new 'public money for public goods schemes'; the UK seems set on slashing its border tariffs on most goods (Swinbank, 2019). If a major European economy can make such a fundamental break from the state-assistance paradigm, what is to stop the idea catching on, particularly if it is successful, driving a fundamental review of the CAP at some future date?

Second, Brexit could potentially change the dynamics of CAP decision making. UK ministers and MEPs have often appeared quite hawkish with regard to the CAP — although how successful they have been in shaping the policy is an open question — and, conceivably, the loss of the

British vote might play out in strengthening CAP support for EU27 farmers.

This might then be a factor conditioning the EU27's response to a third potential impact of Brexit. If the UK does embark on a liberal trade regime, existing EU27 suppliers of agri-food products to the British market might suffer from the loss of their preferential access, notwithstanding the historical ties and physical proximity that has driven past trade flows. Ireland is often cited as a potential casualty. If Irish beef exports to the UK market were displaced by Brazilian product, what would the EU27's response be?

Fourth, the EU27's trade regime within the WTO could become more vulnerable. As a result of Brexit, the UK needs to define its own Schedule of Commitments in the WTO, in particular its agricultural tariffs, tariff rate quotas (TRQs) and support for the farm sector. The apportionment of the EU28's TRQ obligations between the EU27 and the UK has proved particularly problematic with the EU's critics arguing that what had been proposed 'amounts to a reduction in the quality and level of access provided by the EU to WTO Members for a large number of agricultural and *[non-agricultural]* products' (Third World Network, 2019). The EU27 and the UK suggested a simple arithmetical split, in which the sum of the two parts equalled the EU28's prior commitment. This caused some concern, expressed in the WTO's Council for Trade in Goods where it was argued that splitting a TRQ between two distinct customs territories rendered the concession less valuable to traders, as it reduced their ability to switch exports between the two markets. Moreover, some of the resulting TRQs might then be too small to allow commercial shipments.

In addition, it was argued that, if the EU27 and the UK fail to negotiate an FTA allowing reciprocal tariff and quota free trade, British product could now compete with other third-country suppliers to fill the EU27's TRQs offered on a MFN (*erga omnes*) basis, thus displacing imports from other WTO members that had previously made use of these TRQs. This could lead to a claim for compensation, involving, for example, a further opening of the CAP's protected market.

A fifth consideration is the budget. Despite a complicated system of rebates, the UK had consistently been a sizeable net contributor. Member states quibble about the overall size of the EU's budget and its spending priorities, as well as the financial transfers between countries it generates, and the CAP figures large in these discussions.

Concluding Comments

It is doubtful that when delegates gathered in Stresa in 1968, to advise on the design of the future CAP, they had any conception of how the world would look in 2020 or what would become of the common agricultural policy foreseen by the Treaty of Rome. That there is still a policy called the CAP, over 50 years later, despite vastly changed political, economic and technological circumstances, strikes this author as quite remarkable. The CAP has changed, as briefly chronicled in the preceding pages, but its commitment to farm income support has been unwavering. Have we misread the data, misunderstood the economic processes involved or is there something 'exceptional' about farming that economists fail to grasp, warranting continued and extensive state intervention?

New technologies (for example food production less reliant on land, traditional crops, and animals?) changes in diet (fewer livestock products perhaps?) and the need to adapt to climate change will challenge Europe's farmers into the foreseeable future, and politicians will react to some, if not all, of these challenges with policy measures, some of which may fall under the broad rubric of the CAP. But, aside from the (hopefully short-term) challenge of a global recession arising from the shutdowns occasioned by attempts to dampen-down the outbreak of the coronavirus, and indeed its threat to the unity of the EU itself, the most pressing issues of the day, in this author's judgement, are the need to equip Europe's farmers with the flexibility to cope with climate change and to deploy their skills, and their use of rural land, in helping Europe achieve net-zero GHG emissions, preferably long before 2050; and to reverse biodiversity loss.

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