

## **WILL THE NEXT CAP REFORM MEET THE FOOD AND ENVIRONMENTAL CHALLENGE?**

**Address by Corrado Pirzio-Biroli  
before the  
LONDON AGRICULTURAL FORUM,  
9 May, 2012**

Current and projected growth in food needs is incompatible with current agricultural policies and western lifestyles.

To meet the food challenge three things are necessary:

1. Change the lifestyles that cause damage to nature.
2. Reduce food waste to increase food availability and reduce the overexploitation of nature.
3. Reorient agricultural systems to be more productive and more sustainable, decoupling, as it were, food production from resource use.

The first objective is unattainable unless significant taxation is applied to products with substantial GHG footprints, and/or rich in sugar and/or fat. As regards the second objective, food waste treatment is progressing and becoming good business, but more needs to be done to restore the nutrient cycle without returning to first-generation agriculture. The third objective - reorienting agricultural systems - is littered with obstacles to reform. It notably requires substantial changes in legislation, increased investment in targeted research and improved technology for greater resource-use efficiency, and better advice to farmers to increase both competitiveness and sustainability of production.

CAP reform should ideally respond to the main challenge of sustainable food production. To that effect, it should respond to farmer demands for opportunity, predictability, fairness, stable regulations, stable markets, and freedom to produce in an environmentally sustainable way. In exchange farmers are prepared to act as agents of change producing more value added with fewer resources. Their job is crucial for food and feed, as well as for healthy soils, clean water and air, and biodiversity. It is understood that land managers cannot contribute significantly to improve resource efficiency and nature without incentives and without a level playing field in managing resources helping them to stay in business.

The crucial question is whether the new reform proposal provides the right legal framework and sufficient incentives to reshape the CAP to that effect.

The most critical points for us land managers of the legislative proposal of 12 October 2011 are: payment redistribution, mandatory greening, greening criteria, active farmer, capping, R&D, food chain, flexibility and simplification. Time constraints lead me to skip the last four points, which you may wish to discuss later, before I draw some conclusions.

### **1. Payment Redistribution**

First, the stepwise redistribution of direct payments among countries (national ceilings) to at least 90% (for Rapporteur Luis Capoulas Santos, 100%) of the average per hectare, starting with a convergence of 40% of the Basic Payment from 2014. There are of course

other criteria that could be used for payment convergence, but none enjoys majority support.<sup>1</sup>

Nobody has contested the principle of the progressive rapprochement of the payments per hectare, whatever its weak logic. But several countries push for a speedier realignment of Basic Payments; whereas others, in particular the eight western members who have not yet adopted the regional model, want a slower one. In any event, the uneven distribution of payments will remain, because flat-rate payments which in the past depended on the distribution of production, will still depend on the distribution of land, which is equally uneven.

## 2. Mandatory Greening

Second, Mandatory Greening of 30% of the Basic Direct Payment based on common rules applicable to all farms over 3ha throughout the EU, except for organic production. This is a key element of the reform proposal. The mandatory nature of the greening provisions means that they must be met not to lose that 30% of the basic payment, let alone more than that for the most serious violations. This makes them super-cross-compliance measures.

It is unlikely this proposal can significantly be changed. However an attempt could be made by raising the contradiction between the Commission's two reform communications.

According to the Communication "The CAP towards 2020" of October 2010, the farmer had the guarantee of an "obligatory" Basic Income Support as long as he respected cross-compliance conditions; instead, if he failed to seriously respect mandatory greening measures, he did not risk to lose more than the 30% of the direct payments allocation.<sup>2</sup>

By contrast, the legislative proposal of November 2011 sanctions a failure to apply greening measures with undefined penalties (see: *Whereas* No. 26). This turns them into super-cross-compliance measures with the risk of losing also part of the Basic Payment in the worst cases.<sup>3</sup>

If it proved impossible to go back to the policy proposal of 2010, or the Greening talks get bogged down without an agreement, it may be worth asking whether there is a distinction between Cross-Compliance and Direct Payment Greening – both of which are

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<sup>1</sup> A more objective and fair distribution of the Single Payment national ceilings could be based on agricultural area weighted by some indicator of economic costs or living standards such as GDP/capita. But this would be cumbersome and equally controversial. One better option that may help reach compromise is a more balanced allocation of CAP support of the sum of Pillar 1 and Pillar 2 payments.

<sup>2</sup> The 2010 Communication notably reads: "Basic Income support through the granting of a basic decoupled direct payment, providing a uniform level of obligatory support to all farmers in a Member State (or in a region) based on transferable entitlements...plus fulfillment of cross-compliance requirements." Incidentally this approach would allow to test to what extent the combined revenues obtained by farmers from the greening of Pillar 1 and from the markets are sufficiently attractive to claim the 30% payment top-up, and could possibly indicate the need for subsequent policy revision at mid-term for the sake of preserving the eco-system

<sup>3</sup> In an explanatory text the Commission specifies that "non compliance with the eligibility conditions gives rise to the withdrawal of the concerned share of the Greening payment...(and) may also be applicable by way of reductions or exclusions of the remaining Greening payment as well as, depending on the gravity of the non compliance, of other payments...a penalty may go beyond the level of the Greening Payment concerned."

effectively mandatory –, and considering whether the greening could therefore be incorporated into cross-compliance, and what would be the consequences for farming and the environment.

### 3. Greening Criteria

Third, the Commission has proposed the general respect of three greening criteria or agricultural practices – crop diversification, maintenance of permanent grassland, and a 7% Ecological Focus Areas (EFA). In addition it has proposed adding to cross-compliance the respect of NATURA 2000 rules, as well as the application of the Water Framework Directive of 2000 (WFD), of the Pesticide Framework Directive of 2009 - as soon as all MS implement each of them.

The three greening criteria are a pretty blunt instrument that apply to all farms over 3ha, although they are not equally appropriate to all countries. For example, crop diversification is unfeasible for Mediterranean countries, as the Commission admits (think of olive groves), and the EFA would be a disaster for Hungarian crop cultivators, slashing production.

There are disagreements between farm and green organizations about the 30% greening rate and the 7% EFA rate. Farmers are concerned about impacts on productivity and competitiveness of European agriculture. They want less greening, in particular lower EFA levels, and voluntary instead of compulsory application (which is not on the cards). Green NGOs want the opposite.

Requests for more options to choose from on greening measures raise worries about watering down and actual delivery of environment across the EU. Moreover, flexibility to better-fit implementation with different soils, climates, environments and farming systems would involve difficulties in judging the equivalence of greening actions, and create level-playing-field problems. It would also mean more complex regulations and require more controls of equivalence.<sup>4</sup>

A simpler and more acceptable approach than allowing the menus of greening options requested by some quarters is to accept the three greening measures proposed by the Commission, but devise a set of derogations as already envisaged for special cases like olive groves (where crop diversification is impossible).

While it therefore stands to reason to support the three proposed measures as the only practical approach to greening Pillar 1 without incurring into problems of environmental equivalence, more information is needed on the details of each before reaching agreement:

- **On Crop diversification** (Art. 30): how many crops, what is a crop, is the 5% threshold too small? Is the 70% threshold too big? Should the three-hectare threshold (Art. 30(1)) be increased (as the European CoA suggests) and/or should it be set at a different level for each MS? One could do this on the lines of Annex IV (for the Article 10 minimum payments), for example, with a schedule of the current

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<sup>4</sup> COPA has suggested three “Green Growth” measures: resource efficiency from nutrients and water, carbon sequestration in soils and biomass, and green house gas reduction. These are excellent concepts, but it is not clear how they can more precisely be defined and applied across the EU. This could possibly be achieved by establishing proper environmental targets and market instruments to reach them (e.g. Emission Trading Scheme for GHG), but it is difficult, involves the private sector, and takes time.

average arable area of each MS, take the threshold as x% of that statistical 2011 average.

- **On permanent grassland** (Art. 31): the CoA said that the obligation to maintain grassland post 2014 could be contrary to environmental aims, if farmers respond by converting to “more profitable” arable crops before that date. There are those that wish to drop the five year reference or extend it to up to 10 years or even more; this would remove the problem of the on rotation re-seeded grasslands necessary in some systems (including organic); it should also go somewhat towards focusing the protection on the really botanically valuable permanent grasslands (which tend to be those which have never in living memory been ploughed). To avoid that farms with certain grazed mountains/moorland find themselves with a liability for 7% EFA if their grazed pastures are not called ‘grassland’, one might also allow non herbaceous-ligneous grassland to be included in the definition.
- **On Ecological Focus Area** (Art. 32): there is insufficient information from the Commission as to what precisely EFAs are – except that “they are not set-aside” -, and what, if any, management will be prescribed for them. Are EFAs the best instrument to deal with the threats to soil structure and fertility, water shortage and pollution, wind erosion and biodiversity? Nobody knows. The regulation should be simple, with derogations for specific areas such as olive groves, vineyards and orchards. The Dutch idea to allow ‘group’ application of EFA is environmentally, agronomically and economically intelligent. The agreed EFA threshold would have to be respected (when not by each farm) at least on average within a given area. This will only work where the group accepts to divide up both the spoils and the penalties via an obligation exchange system. It therefore requires a degree of trust and cooperation. It must involve neighbouring farms with contiguous land, but might be applicable over wider land areas. It would allow taking soil fertility into account. Contiguous networks of EFA would allow creating ecological corridors and obtaining minimum conditions for biodiversity hotbeds. There is also the issue of **EFA trading**, which would allow farmers to trade their EFA obligations between zones where the opportunity costs of EFA are higher and those where they are lower. This would get the big arable plains off the hook and reduce foregone loss of food production. The Commission is unlikely to make a proposal allowing EFA trading, but the phenomenon cannot be stopped altogether, as farmers can rent at least some of their EFAs. EFA trading should actually be positively allowed, even between more productive and less productive regions, not only because it would help less productive regions and High Value Nature areas to be appreciated, but above all because EFA trading could become a first crude instrument to establish a market in public goods produced by farmers.

#### 4. Active Farmer

Fourth, the new definition of active farmer that notably excludes from funding recipients of €5,000 payments or more, whose payment receipts are less than 5% of total revenues from all non-agricultural activities.

There is general support for the principle of restricting payments to active farmers and avoiding the abuse denounced by the Court of auditors (CoA), who rightly questioned the allocation by certain Member States of direct payments to land around airports and public utilities; this is a misinterpretation of current law on minimum requirements for receiving direct payments. The real question is how one defines an active farmer in a way that is practically operable in relation to the scale of any abuses of the system.

The Commission's proposal is redundant and inapplicable. It would impose highly difficult determinations of "receipts from non-agricultural activities" (A9, 1.a), and would be also deeply discriminatory to certain highly diversified land managers. Its verification might require cross-referencing data held by payment agencies and tax authorities – which is incidentally impossible in some Member States, where tax controls go back several years and tax authorities therefore lack the database for the application of the <5% rule.<sup>5</sup>

The best way to correct it is, not by proposing a new definition of active farmer, different from the traditional one used by the CoA itself.<sup>6</sup> This would only risk opening a Pandora-box. Instead, the Commission should table a legal interpretation of the current definition satisfying the CoA's criticism and leaving the responsibility to identify the non-active farmers to the Member States. A fallback option is to make only a strictly limited amendment to current law<sup>7</sup> replacing the word "may" with "shall". All farmers providing agricultural products and/or environmental services should continue to be considered as active.

The Commission has already indicated in Recital no. 13 of the Direct Payment Draft Regulation that regarding support to beneficiaries whose business purpose is not, or only marginally targeted at an agricultural activity, such as airports, railway companies, and real estate companies managing sports grounds, Member States should refrain from granting direct payments to such natural and legal persons. But it is also specified that smaller part-time farmers should benefit from direct payments because they contribute directly to the vitality of rural areas.

## 5. Capping

Fifth, the introduction of progressive payments degressivity by tranche (capping) to individual farms on amounts beyond €150,000, with a maximum threshold of €300,000,<sup>8</sup> with deductions for the 30% greening and the labour costs (salaries paid).

There is a political logic regarding the main aspects of this proposal, but the Member States are divided over the issue in the light of the risks of administrative complexity, avoidance through property manipulation and additional costs for administrations and farmers.

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<sup>5</sup> Just one example of potential discrimination: A very large heritage organization (the National Trust) which has multi-million members and thus their subscriptions (for maintaining heritage property) and also owns and manages in its own name, tens of thousands of hectares of agricultural land would be excluded from claiming CAP payments under the 5% rule. Yet this land and its management is of the highest cultural landscape value, managed in an exemplary fashion. This is an extremely effective delivery mechanism for public environmental goods.

<sup>6</sup> In its 2010 report, the Court of Auditors stuck to the current definition of *active farmer* taken from the Regulation 1782/2003: a person "who carries out an agricultural activity", which includes "maintaining the land in good agricultural and environmental condition." In a speech presenting its report in November 2010, its President Vitor Caldeira stated with regard to agriculture: "The Court recommends reducing the risk of error by improving the quality of information in the databases used for establishing entitlements and calculating payments and by clarifying and enforcing rules on land usage and maintenance."

<sup>7</sup> Article 28(2) of Council Regulation (EC) No. 73/2009 on minimum requirements for receiving direct payments says: "'From 2010, Member States may establish appropriate objective and non-discriminatory criteria to ensure that no direct payments are granted to a natural or legal person...'"

<sup>8</sup> PAYMENTS (EXCEPT 30% GREEN PAYMENTS) ABOVE €150,000 ARE CUT BY 20% UP TO €200,000, BY 40% FROM 200K TO 250K, BY 70% FROM €250K TO 300K AND BY 100% BEYOND THAT. A €300,000 PAYMENT CORRESPONDS TO A FARM OF 1,200 HECTARES.

There is little interest in entering into a discussion on payment degressivity figures, which will occupy the Member States. Instead, it is worth reflecting on risks of discrimination and on deductions of measures that are environmentally comparable to greening. One should for instance ask to avoid discriminating between farmers (and cooperatives) with hired labour and those who have chosen business models such as *partnerships* and/or use *contractors* for specific farming operations by covering these and similar cases in the regulation. One could also seek to extend the deduction of greening measures from payment degressivity to environmentally comparable measures such as agri-environmental schemes.

## 6. Food Chain

Sixth, a strengthened position of producer organizations within the **food chain** via interbranch agreements allowing also to steer quantities. This can be of great benefit to producers enhancing their share of income from the food chain. The ELO has subscribed to the view that across a range of products farmers get an unfairly low share of total consumer expenditure on food as too much is retained by the processors and retailers who have the market power. We have therefore supported the new measures proposed in the Bové Report to improve the role and benefits to the farmer within the functioning of the food chain, notably through greater market transparency, a strengthening of the bargaining position of land managers and limitation of dominant positions in the food business, the creation of a European futures market for commodities, and codes of good commercial practices. Farmers can also autonomously use Pillar 2 support to shorten the supply chain via downstream processing and marketing, without or within producer organizations.

Although not a part of the CAP, the creation of a big European Commodities Futures Market is an essential point, that is being addressed by another Commissioner. More generally, the effects of new market-risk management measures hinted at by the Commission are difficult to predict. The latter are so vague that one wonders what concept the Commission, who has asked for the competence to manage the “toolkit”, has as to how to apply risk management (only ex-post) in specific circumstances.

## 7. R&D

Seventh, a doubling of the R&D budget devoted to agriculture with focus on applied research, and encouraging **innovation partnerships**. R&D is of great importance for enhancing productivity as well as sustainability. The innovation partnerships are a useful tool to move from the laboratory research to farm implementation.

## 8. Flexibility

Eighth, flexibility. There are two forms of flexibility: policy flexibility between Pillars and flexibility through subsidiarity in implementation. **On policy**, the addition of new tools, new Pillar 1 payments, risk insurance in the second pillar, the crisis reserve (the greatest innovation) and trade assistance fund outside the Multiannual Financial Framework (MFF), undermine the basic concept of the two-pillar structure adding to complexity. **On implementation**, the diversity of the enlarged Union leads its MS to call for more flexibility/subsidiarity to take account of distinctive national/regional specificities in many parts of these regulations. We must beware that each such step takes us away from a common policy (to which MS are generally attached), allows potential distortions to competition, and almost certainly introduces complexities that require additional controls.

## 9. Simplification

Ninth and last point, simplification. The proposal contains some simplifications, foremost among them are the simplified flat-rate support for small farmers, and the

streamlining of cross-compliance controls, particularly for farmers using certification systems. But the simplifications are outshined by the complications, and several critical points lack the necessary detail before they can be assessed. That the reform means more red tape is the biggest criticism.

The structure of the **multy-layered targeting** measures of the first pillar is pretty complex: 30% of national envelope of D.P. green payments, up to 10% for Small Farmer Scheme, 5-10% for coupled support by MS, 5% for areas with natural constraints, up to 2% for young farmers < 40yrs. It is so complex that it cannot be implemented and controlled without heavier monitoring and bureaucracy.

Several of these mandatory and optional targets are questionable. For instance, the scope of devoting up to 5% of the national ceiling to areas with national constraints is unclear. It adds nothing to Pillar-2 Least Favoured Areas schemes. The same result could be achieved without top-ups by simply regionalizing payment systems. Moreover, it is difficult to see how, even if the EU spent €800m (2% of €40billion) on encouraging less-than-forty-years-old new entrants into farming for 5 years from the start, this would help much to boost the number of young farmers and deal with the problems of agricultural restructuring. The greening provisions and the different optional transfers (not to mention the programming of rural development) increase the complexity of the CAP. The distinction between markets (P.1) and rural public goods (P.2) is disappearing, as direct payments target ecological goods and areas with natural constraints, whereas P.2 includes tools regarding market failures some of which (the two crisis reserves) are even outside the Multiannual Financial Framework 2014-2020(MFF). In particular, the splitting of environmental measures between the greening of P.1 and the agro-environmental measures in P.2 blurs the functions of the two pillars complicating administration and causing more red tape.<sup>9</sup> There is actually a new problem of coherence, as certain issues would in future be handled in both pillars: greening, organic farming, Areas of Natural Constraint, young farmers, small farmers, risk management. We must be clear what each pillar is seeking for each such issue, and ensure there is no overlap or duplication. We will have to avoid the risk that farmers, who have already gone farthest in delivering environmental public goods are undermined.

The record of simplification efforts of previous CAP reforms is poor: every CAP reform involves more bureaucracy as measures become more targeted and control requirements increase. Simplification efforts have better prospects between reforms. So it will probably also be this time. Nevertheless, we should continue to insist that every policy proposal show proportionality between benefits sought and administrative effort/costs involved.

## **Conclusion**

The main driver of reform this time is the budget crisis, the risk of budget cuts and the need to better justify the CAP. The fear of cuts is acting in favour of a reform, but at the same time budget austerity is an obstacle to the reform's success. As this discussion takes place in the wake of the worst financial crisis Europe has experienced since WWII,

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<sup>9</sup> Current proposals suggest four elements of help to areas with specific natural constraints disadvantaged: Member States could redistribute more resources to Least Favoured Areas (LFAs) by the way they choose their regionalization of Direct Payments; then there is a new, per hectare, top-up proposed within the Direct Payments, plus the use of some continued coupled specific supports, and all this is in addition to existing LFA payments in Pillar 2. This is cumbersome and incoherent.

there will be the biggest fight for money we have seen in years, both among member states and between beneficiary sectors.

The reform proposal has produced, both in Council and Parliament, as well as in the Court of Auditors, let alone within farm and green organizations, substantial, general dissatisfaction, objections to excessive delegation of powers to the Commission, and grievances for failure by the Commission so far to provide details considered important before the EP can take position.

On 24 April, the CoA reported to the COCOBU Committee of the EP that the Commission proposal focuses too much on controlling expenditure, notably the continuing complexity of cross-compliance, and not enough on promoting and measuring farm performance, and that it would impose an excessive burden of red tape and increases in management costs without any indication as to whether these would be compensated by increased efficiency. It considered the redistribution effect to be minor (0.5% of planned DP). It expressed concerns about the proposed definition of “active farmer”, the risk that payments may be made to beneficiaries that do not exercise any agricultural activity, and the corresponding major administrative burden. It criticized the administration of Pillar 2 for relying on six levels of norms between the EU and the Regions with a number of implementation acts. It concluded that the CAP would remain too complex, making it difficult for paying agencies and beneficiaries to administer.

The impact of the proposed reform on farm incomes and operations will be substantial. For instance:

- the proposed redistribution of payments favours lower-sized farms, and grazing-livestock (beef and sheep), wine and horticultural farmers to the detriment of the largest farms and dairy and crop farmers.
- In principle capping will hit hardest the largest, supplying most environmental services and most commercially astute farms in Europe and incentivise them to fragment – reducing agricultural competitiveness (but fragmentation for DP reasons will be monitored).
- The greening of Pillar 1 guaranteeing payment eligibility affects every farmer in Europe expanding CAP resources for the environment sixfold, and causing additional production costs.
- The effects of a more balanced functioning of the food chain should help increase the farmers’ share of the agro-industrial cake.

The most pertinent question is whether the Commission proposals are sufficiently ambitious to increase farm productivity as well as its economic and environmental sustainability. The devil is of course in the details, many of which – too many - will only be known in the implementing regulations.

There are a number of good ideas in the Commission’s Communication of November 2011, but few real policy innovations: regarding greening, including water saving, perhaps the functioning of the food chain and price volatility, and hopefully some additional tools to promote the production of ecosystems. And yet, too little attention is devoted to the key relationship between climate change, energy policy, agricultural policy, and soil preservation. The impact of animal husbandry on emissions is being ignored.

There is still too much retrofitting of proposals to the present system in order to better justify the direct payments to farmers rather than risking to face the political difficulties

of ambitiously addressing new goals, if not a new vision, for the agriculture of the 21<sup>st</sup> Century as outlined in the Lyon and Dess reports.

I have doubts that the next CAP reform will give a boost to productivity and that the proposed greening measures will be cost-effective and lead to a significant increase in environmental benefits. Greening is likely to increase the cost of farming – which may well be higher than the current Commission estimate of €33-40 per hectare -, reduce food supply and increase market prices, accompanying increased farming costs. The greening measures could thus prevent farmers from responding to high food prices by planting more arable crops. Moreover, reallocation of farm support towards a unified rate shifts it from more productive to less productive areas. Reduced food supply would mean reduced exports. As development aid tends to weaken as well, Europe's contribution to feed the world would dwindle. The reformed CAP would then damage food availability to the world while reduced development cooperation would damage, not just income, but also access to food by the less-developed-net-importing developing countries. This might be a price to pay if the reform increased the production of environmental and other public goods in Europe. But this is unlikely to be the case.

I expect both sustainability and competitiveness to fall short without a massive increase in financial incentives and advice. Public support needs to be complemented by finance from parastatal and private sources – something the Commission has failed to advocate - and a massive improvement is needed in the scope, training and quality of the advisers and extension services available to farmers to help them adapt. This will not happen without additional incentives. If green targeting hits the farmer unprepared and penalizes farmer income, it will fail. If so, one should not be surprised to see even more farmers leaving the land, and further environmental degradation.

It would seem that the European Parliament shares most of my fears. It feels that the Commission ignored the sense of Parliament as reflected in the Lyon and Dess Reports reports, and considers that the public incentives proposed for the production of ecosystems and other public goods by farmers are insufficient for the task. There will be much talk about public goods, but little incentives to produce them. Nevertheless, if the public goods rationale gets into the minds of the people, whatever is done with the next reform in that regard, it will mark an important step in the psychology and the politics of sustainable agriculture.

We cannot hope that we will have an overall EU budget commensurate with EU 2020 policy objectives without the creation of an Own Resources system for the EU budget in accordance with the Lisbon Treaty. This would allow to decouple EU revenues from national budget contributions. The EP is well aware of this.

EP leaders, most notably the Chairmen of the agriculture, environment and budget Committees have no intention of taking position on CAP reform before the EP knows the size of the EU MFF 2014-2020, and the financial resources available for the CAP. This points to the likelihood that agreement on CAP reform will not be reached in time to allow farmers to apply it at the beginning of 2014. and that the present system of direct payments may have to be prolonged by six months or more.

The EP is playing a key role intervening early in the debate, undertaking hearings and launching own initiative reports. But its strongest weapon is to refuse to agree. In such an event the EU could not apply the cut in agricultural expenditure envisaged by the Council as from 2014. Without agreement by end 2013, the EU budget would have to work on a provisional-twelfth basis, which means one twelfth a month based on the currently higher budget.

Past experience shows that the diversity of often-contradictory objections by MS and the failure even of the Green organizations, dissatisfied about the greening aspects, to produce a concerted report will make it quite difficult to change the structure of the reform proposal, which would therefore be largely accepted, as it were, by default. The position of the EP becomes therefore essential if the Commission proposals are to be substantially amended and if the EP is to play the role in agricultural affairs that the Lisbon Treaty stipulates.

Thank you.