The European Union's Common Agricultural Policy (CAP) post-2013

The coming months represent a unique opportunity for the European Union (EU) to build upon the considerable success of past reforms of the Common Agricultural Policy (CAP).

Through single payments, much of the EU farm support today is channelled to farmers in ways that are increasingly decoupled and income transfer efficient. As a result, there is less interference in farmers' production decisions and farmers retain a larger share of each euro transferred. But single payments are strongly skewed towards relatively large and wealthy recipients and benefits tend to be capitalised into land values, contributing over time to a higher farm cost structure.

Recent years have seen important developments in global agriculture markets, outpacing farm policy reforms. Growing demand and higher real prices for many agriculture commodities over the coming decade offer tremendous opportunities. At the same time, the sector faces major challenges: global food security, sustainable use of resources, climate change, and market volatility, amongst others. Now is the time for new policy approaches that would contribute to a more sustainable and competitive food and agriculture system across the European Union.

What policy approaches would contribute more to an EU food and agriculture system that is a competitive supplier of food, an efficient provider of public goods, an effective custodian of scarce natural resources, and a viable contributor to rural community well-being?

The broad suggestions outlined below derive from OECD analysis and, if adopted, would represent a further step in the CAP reform path that began two decades ago. ***The starting point is the desirability of shifting policy emphasis in the European Union from supporting farm incomes to investing in further improving farm productivity, profitability, and long-term competitiveness, in a sustainable way.*** Such a shift would have positive and enduring effects on farm and farm household incomes; but to the extent that income problems persist, a wide range of agricultural and non-agricultural policy responses can also be developed, addressing specific temporary or long term needs of farm households.

There is no obvious rationale for farm income support provided on the basis of current or historical production-related criteria and not specifically targeted to some income group. There is a much stronger economic case for public investment in services that benefit the sector overall, and allow potentially competitive suppliers to improve their productive performance, in an environmentally sustainable way and in response to growing world demand for feed, food and non-food uses.

Investing in a strong and competitive agricultural sector

No sector operates in a vacuum; fiscal, monetary and structural policies determine the wider environment in which the food and agriculture system operates and contribute to shaping its competitive potential. Ensuring coherence between the CAP post-2013 and EU-wide innovation, environment (including climate change), trade, and development policies is particularly important.

An effective system of intellectual property rights, that encourages both increased private investment in scientific research and development and timely dissemination of new technologies, offers significant benefits across the entire food supply chain – not least at the farm level. Environmental policies establish the regulatory context for sustainable resource use across competing demands – including for farming. Openness to trade offers significant economic benefits, and this potential will be more fully realised if complementary policies are in place that facilitate an efficient supply response and that provide adjustment support for vulnerable groups and individuals. Development assistance is responding to the very high reliance in many low income countries on agriculture for growth and employment; for the European Union this will mean both market opportunities abroad and new competitors at home.

Within this wider context, the CAP post-2013 agenda should begin by addressing remaining market deficiencies that constrain the competitiveness of the EU food and agriculture system; work to improve the functioning of markets across the EU and at its borders is not yet complete. Market access for some livestock products is still restricted by tariff rate quotas, with prohibitive over quota tariffs. While production quotas for milk are being phased out, they remain for sugar. Payment entitlements based on past references can increase costs for new entrants and slow structural adjustment. Rules regarding tradability of quota and payment entitlements differ by member states; similarly, land transactions (sales and leases) are governed by national legislation. There may be scope for EU-level rules that ensure a transparent functioning of sale and lease in these production factors, as well as for EU-wide tools to monitor the effects that the different policy instruments have on them.

Investing in innovation is particularly important. Agricultural research, technology transfer, and extension services have clearly demonstrated high returns, and greater efforts in this area, at EU and member state level, would improve agricultural productivity growth, profitability, and overall competitiveness. Organisational and process innovations may be as important as scientific ones, both to lower costs and to add value and differentiate products on the basis of various attributes important to consumers. Agricultural training, advisory services and market information systems help ensure that agricultural knowledge systems generate useful innovations that are spread widely and are effectively adopted. The availability of supporting infrastructure varies greatly across the European Union, and further attention might also be dedicated to ensuring appropriate information and communication technology (ICT) and transport facilities are in place.

Improving the management of risk

Recent years have provided clear reminders of how unpredictable and volatile commodity markets can be. It is not always possible to anticipate or to mitigate food market volatility. Globally, more open and transparent markets, increased trade, effective and transparent systems of stockholding, and less inward-looking policy responses to market disruptions would help. But there will inevitably be unexpected “shocks” that will need to be managed at the farm level.

An effective policy framework for producer risk management should be introduced, giving due consideration to the full range of policies that affect farm risk and to the distinction between risks that a farm household can efficiently manage and those that require public support. Farmers are well able to manage individual risks, such as “normal” fluctuations of prices and yields (for example, through choices of production methods, farm financial management, on and off farm income diversification). For these

risks government support should focus on the provision of information and training to help improve the ability of farmers to manage "high probability and low impact events".

At the other end of the spectrum, catastrophic risks that are beyond the capacity of a farmer to anticipate or manage require attention from governments. The "terms and conditions" of emergency support and protocols for government response are often possible to define in advance (for example, by clearly defining catastrophic risks, when governments would intervene, and how support would be cost-shared). Doing so contributes to improve the certainty around the consequences of "low probability but high impact events" and can contribute to better informed farm decision making, while still respecting the capacity of national or local governments to make decisions in light of national or local needs.

In between these two extremes is a category of risks that might be managed through specific markets (with or without government support), such as cooperative arrangements, production contracts, insurance, and futures contracting. Cooperative schemes, production contracts and futures contracting can be highly effective, with government involvement limited to ensuring effective regulation that allows these markets to function as intended, without information asymmetries and without opportunity for manipulation by special interests. Insurance schemes in agriculture are seldom both viable over time and attractive to farmers, unless some form of assistance is provided. Government support should be temporary in nature and aim to create incentives for private provision of insurance programmes, for example by providing incentives to create databases and share information on individual risks. As risk exposure and insurance schemes vary considerably across the EU, common rules could be developed to make sure support is temporary, minimally distorting, and does not crowd out the development of private insurance systems.

There is no single risk management policy for all farmers – a better option may be to ensure a wide variety of management tools is available, leaving individual decisions to farm households themselves.

Ensuring sustainable resource use…and contributing to rural community well-being

The long run sustainability of agriculture in the EU depends on maintaining the underlying natural resource base – soil, water and biodiversity. At present, few policy measures are directly and specifically targeted at helping ensure sustainable resource use or helping the sector adapt to climate change impacts, mitigate greenhouse gases, or enhance carbon sequestration. Encouraging wider use of established farm practises, such as improved manure management to reduce run-off into water courses, low and no-till systems that reduce soil erosion, and flood/drought control systems for conserving biodiversity, could have significant benefits. Increased research and development of new technologies and processes for crop breeding, animal genetics and feeding systems offer further benefits, especially if efforts are coordinated internationally.

There is a keen interest in ensuring an adequate provision of the public goods desired by society, while avoiding "public bads" (i.e. the negative externalities associated with food and agriculture production). While actual policy experience with targeted policies is limited, a range of policy instruments could be employed. Education, training and information initiatives, tailored to the specificities of local situations, could be helpful in many cases. Regulations and taxes should be systematically employed to preclude, or strongly discourage, negative environmental impacts (the "polluter pays principle"). Creating markets, such as is being widely discussed for carbon emissions and sequestration schemes, should be introduced where practical to do so. Direct payments by governments should be introduced where there

is a clear demand for a good or service that is not remunerated by the market and where market creation is not feasible. In designing such payments it is important to target explicitly the desired outcome, to the extent feasible, and not to limit, *a priori*, the origin of supply (in other words, in some cases non-agricultural providers may be appropriate).

Farmers are the custodians of much of the land and water resources across the EU, and agriculture plays an important role in contributing to healthy and vibrant rural and remote areas. But rural community well-being is also about much more than agriculture. Across the EU, agriculture provides a modest and a declining share of economic activity in most rural areas. The diversity of rural and remote areas in the enlarged European Union requires, more than ever, approaches that are targeted to specific local conditions. As such, a place-based rather than a sector-based approach to rural development is much more likely to be successful, in economic, environmental, and socially sustainable terms. Support should be guided by EU-wide aims and aspirations, but then targeted to local conditions; pre-supposing that agriculture is the appropriate focus in all cases would not be appropriate. Whether EU funding is provided via the CAP or cohesion funds, guidelines for support should be harmonised.

Supporting farm income: which farm households, and why?

But what about farm income levels and the overall economic well-being of farm households? Are there problems that need to be addressed? Given the diversity of individual financial situations within the sector (depending on farm type, size, location, etc.), this question cannot be answered using aggregate sector level information.

Available data across EU member states are surprisingly sparse, particularly given the vast sums spent annually to contribute to supporting farm incomes. But even with the limited available data it is clear that the largest farms that produce most agricultural output have both high farm income levels and high levels of wealth, relative to average income and wealth levels of the rest of the population. Farm household incomes (which also include off-farm income sources that are often particularly important to smaller farms) are, in countries that collect the information, comparable to that of non-farm households.

In the absence of complete and up-to-date information, these conclusions are often challenged. For this precise reason the European Union should ***invest, on a priority basis, in the creation of a database to measure farm household income and farm household wealth on a comparable basis across the EU***. A better understanding of the financial situation in farm households, of the nature, causes and duration of any income problems, and of how farm household well-being compares to the situation in non-farm rural and urban households would ensure well informed policy formulation.

Further reading:

- *Evaluation of Agricultural Policy Reforms in the European Union* (OECD, 2011)
- *Agricultural Policy Monitoring and Evaluation 2011: OECD Countries and Emerging Economies* (OECD, 2011)
- *OECD-FAO Agricultural Outlook 2011* (OECD, 2011)
- *Disaggregated Impacts of CAP Reforms: Proceedings of an OECD Workshop* (OECD, 2011)