

## CAP budget negotiations: Make or break for the European Union\*



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"EU money for jobs, not cows". Who could forget Tony Blair's speech to the European Parliament in 2005, in which he claimed that "a modern budget is not one which continues to devote 40% of its spending to the common agricultural policy (CAP)"? The British prime minister was giving voice to the idea that a budget which spends significantly on agriculture is by definition archaic. Tony Blair's criticism, today widespread, would be valid if the European budget was one of a federation. But it is rather one of a heterogeneous integration process, in which the CAP plays an avant-garde role. The CAP is the EU's most integrated policy, and the only one to be financed mainly by the common budget. The level of CAP spending is therefore an indication of the weakness of integration in other areas rather than of the exorbitant cost of agriculture. Curiously, this error of reasoning has become dogma in the European debate. And yet to compare the costs of European public policies it is only necessary to add EU spending to member-state spending. Such a calculation shows that agriculture occupies 11th position in cumulated spending, with only 1.1% of the total, behind research and development (Bertoncini, 2009).

Since 1979 agricultural spending has been the recurring subject of budget negotiations, in spite of the constant shrinkage of its share

in the EU budget. In the run-up to negotiations over the post-2013 budget perspectives, and in a context of "new" emerging challenges and straitened public spending, the agricultural budget is an easy target for cuts – especially given the EU's low overall spending, at 1.03% of GDP (figure for 2008, DG Budget). In such a situation it seems almost inevitable that the agricultural project will suffer spending cuts without any debate beforehand. And yet the EU needs to think carefully about the future of agriculture and rural areas. They represent a powerful lever for action on the challenges facing Europeans – over food, the environment, the economy, social and territorial cohesion. In addition, the failings of agricultural markets make public regulation of the sector inevitable. The EU is therefore in a make-or-break situation over CAP budget negotiations. In deciding about its most integrated policy, it will either strengthen or sacrifice its capacity to meet the challenges of the future.

This policy brief explains why the debate has begun badly (1) even though a high-quality European decision on agriculture is necessary if solutions are to be found for global problems (2). It describes the desirable improvements to this reformed-but-imperfect policy (3), and makes several propositions to feed a debate which the EU and its farmers need.

\* This paper is the English translation of a Policy Brief originally published in French in September 2010.

## 1. A debate which has begun badly

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### An unfortunate separation of debates

The forthcoming budget choices are a source of worry for actors in agriculture, the food industry, consumer protection, forestry, environmental protection and rural development. Historically divided, this “community” is today brought together by shared concern over the fate of the CAP, to be decided by the budget negotiations and post-2013 reform. These actors are convinced of the need to make deep reforms to agricultural policy, and know that the specificities of farming and rural regions create a long-term dependence on public policy. The same is true for the correction of market failures (for example, the remuneration of rural public goods) and for regional economic and social cohesion. Opposite them is a stronger group which advocates (actively or passively) a budget cut, seen as legitimate because of the persistent imperfections of the CAP. Each side is convinced of its legitimacy, preventing a constructive dialogue over the services provided by agriculture and rural actors, and over their requirements to fulfil these missions.

### The cost of the CAP, a distorted debate

In 2008 the CAP's budget was € 52.3 bn. The critics of this fact are numerous, even though Eurobarometer surveys show that 58% of citizens estimate that the CAP budget should remain identical or increase (March 2008). The recurrent attacks on the agricultural budget are surprising to the extent that the policy is only the 11th in terms of European public spending, equal to cohesion policy and far behind the leading trio: social protection and active market policies (41.4%), health (14.2%), and education and training (11.3%). It is also worth noting that spending on research and development (1.5%), and energy and transport (2.2%) are higher than on agriculture. And a quick international comparison reveals that Europeans are about

average among developed countries in terms of GDP allocated to the sector, with 0.5% against 0.2% in the US, 0.4% in Canada and 2.4% in Japan (Bertoncini, 2008). For a better assessment of the CAP's effects on collective well-being, it is necessary to take account of its past and present successes, including security of food supply, food safety, and the diversity and quality of products at affordable prices for 500 million consumers. The upkeep of rural landscapes (which encourages tourism), the regional role of agricultural varieties favourable to nature, the boost to employment and economic activity in rural areas – these must all be taken into account too. More generally, the models used for assessing the effects of the CAP must take account of the complexity of the sector's economics (Gohin, 2010).

### An untenable budget situation, and politically untenable too

For the first time in its history the EU will negotiate its budget as 27 member states, which should prove a reminder of the states' agricultural diversity. At this point the negotiating positions and possible alliances are uncertain. However, from member states having joined in 2004 and 2007 we can expect united opposition to the current distribution of payments. Following the Copenhagen European Council (2002), these member states benefit from market measures and second-pillar aid, but only qualify for direct assistance (the largest form of CAP spending) gradually and on condition of significant co-financing. This discrimination has allowed the CAP budget to remain stable but has created an unequal situation which the 12 states hope, legitimately, to see disappear after 2013. Their demand risks being all the stronger given that the economic crisis has since 2008 deprived certain states of the necessary co-financing resources. The context is therefore ripe for bitter negotiation over the agricultural budget.

## 2. A high-risk situation at a time of renewed relevance for agriculture

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As Europeans begin a negotiation which carries high risks for the CAP, three global phenomena are focusing attention on farming

and the policies which guide it: growth both in world agricultural demand and in market instability; climate change; and a new aware-

ness of the massive problem of pollution and the exhaustion of natural resources.

### **Increasingly unstable international agricultural markets**

The interconnection of international agricultural markets is causing growing price volatility, adding to the uncertainties for farmers who must already deal with natural fluctuations. Forecasts are difficult for the coming decades due to a combination of phenomena whose effects on Europe's markets are uncertain. First of all, as developing countries become richer their consumption habits change. Their increasing demand for meat means higher demand for agriculture: to produce one animal protein requires on average seven vegetable proteins. Next, world population is growing at the rate of 80 million people per year (the population of Germany), and should reach 9 billion in 2050. Lastly, a growing demand for energy-related production (biofuels) is linking farm produce prices to the volatile oil price. Faced with these future pressures, and in parallel to the food crises of 2008, the international institutions (World Bank, OECD) are calling for massive investment in developing country agriculture, having encouraged free-market policies in the sector for over 20 years. In rich countries these changes should be a reminder of the elemental role of agriculture. By extension they should encourage caution over any reform of market-regulating tools, necessary in times of serious crisis which threaten the existence of farm businesses.

### **The uncertain fight against climate change**

Global warming adds to the natural risks facing agriculture, but it remains unclear to what extent production systems can or should adapt. Different types of agriculture will face different problems (modification of vegetation rhythms, rainfall levels and ecosystems, etc.). The rise of climate change on the inter-

national and EU agendas has generated new demands on agriculture, which produces 13.5% of global greenhouse gas emissions. But beyond declarations about agriculture's participation in the fight against global warming, it is not yet possible to formulate clearly and precisely a response appropriate to the scale of the problem. This is because research has not yet produced credible options for creating carbon-neutral farming in the medium term. However, at the scale of the EU the CAP proposes several possibilities for limiting the effects of agriculture on global warming, and there is an understanding of the significance of soil management for the storage of carbon.

### **The environmental challenge**

Worries about natural resources and biodiversity accompany the accelerated degradations linked to global warming. Agriculture, which has a major effect on natural resources, could have a positive or negative impact on these degradations. The increasing agricultural demand in the medium term makes intensified production almost inevitable, and this could pollute and over-exploit ecosystems to the point of destruction. The situation is not helped by the fact that rich-country agricultural policies such as the CAP are still inspired by the principles of the green revolution, and encourage an intensive use of exhaustible natural resources – in particular water. CAP reform could correct these mechanisms and also encourage agricultural practices which contribute to the protection of biodiversity and natural areas, such as in fragile regions where the abandonment of farming can create serious environmental problems (for example, soil erosion and desertification in the Mediterranean). In addition, with regard to the environmental and climatic challenges faced by the EU, agriculture represents a major potential lever of action, affecting 14.6 million workers (FTE) in 27 member states and more than half of Europe's land surface.

## **3. The need for a well-conducted debate, for the EU and for its agriculture**

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Given the challenges – food-related, economic and social, environmental and climatic – which face the EU, the CAP could serve as a means of collective response, by the intermediaries of farmers and other rural actors. But in the coming debate this policy risks dismantlement, a lack of reform, or even renationalisation.

### **A unique economic sector**

Studies on the agricultural economy all agree on a minimal conclusion: agricultural markets require public regulation because of the defects to which they are prey. The first reason is linked to the weak elasticity of demand for agricultural produce (once sated

the consumer buys no more, even if prices are low) whereas supply is variable and little connected to prices (due to a strong dependence on the climate). The second reason is linked to defects in the mechanisms of adjusting supply and demand, which are slow to enter into force (for example, for planting and maturation). The third reason is linked to the considerable “barriers” which prevent new producers from rapidly replacing those leaving the profession (for example, for retirement), due to the necessary amounts of investment, land, knowledge and time in order to be competitive in the market.

Lastly and above all, the temptation to end regulation of the agricultural sector should be reassessed in the light of one other particularity: agriculture guarantees the production of public goods (that is, positive externalities). Farmers, whose activity ensures positive external effects on the environment, landscape and rural heritage, would be forced to abandon their work and thus the provision of these amenities. We might ask the price of abandoning farming if it meant remunerating other actors to replace it.

## THE PILLARS OF THE CAP

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THE CAP COMPRISES TWO MAIN POLITICAL AXES. EACH OF THESE AXES IS CALLED A PILLAR AND DESIGNATED AS EITHER THE FIRST OR SECOND PILLAR OF THE CAP (...). EACH PILLAR COVERS A LIMITED BUNDLE OF POLICY ACTIONS.

**PILLAR 1 :** THE FIRST PILLAR INCLUDES THE MAIN AGRICULTURAL SUBSIDIES AND MEASURES OF MARKET SUPPORT IN THE FOOD SECTOR. MOST PAYMENTS EFFECTED UNDER THE FIRST PILLAR ARE COVERED BY THE CENTRAL COMMUNITY BUDGET.

**PILLAR 2 :** THE SECOND PILLAR IS LINKED TO THE EU’S RURAL DEVELOPMENT POLICY. IT COVERS ACTIONS AIMED AT IMPROVING THE COMPETITIVENESS OF RURAL AREAS, THE SUSTAINABILITY OF ENVIRONMENTAL RESOURCES, QUALITY OF LIFE AND THE DIVERSITY OF ECONOMIC FOUNDATIONS IN THE COUNTRYSIDE. THE SUMS ALLOCATED UNDER THE SECOND PILLAR ARE GENERALLY CO-FINANCED BY MEMBER STATES.

EXTRACT OF THE “REVUE RURALE DE L’UE”, EUROPEAN COMMISSION, NO. 1, OCTOBER 2009

### Changing a policy which remains imperfect despite reform

As the object of reform since 1992, the functioning of the CAP has been corrected and improved repeatedly. Aside from this, according to JC Bureau and LP Mahé (2008), it plays a role in absorbing price shocks – which can threaten the continued existence of farms – particularly by means of the single payment. Beyond markets, eco-conditionality has been a positive change in favour of protecting natural resources, and second-pillar spending has increased. Lastly, the reforms have allowed most of the conflicts with our trading partners to be settled. Alongside a respect for strict budgetary discipline, these various merits cannot be allowed to hide the limits of the current system. Concerning aid, the most important criticisms focus on the effectiveness of income support under the first pillar; on the cost of managing aid under the second pillar; on the leaking of aid towards non-intended beneficiaries; on the concentration

of payments; and on the unequal exposure of sub-sectors to price volatility. Concerning the environment and rural issues, criticisms focus on the incentive to pollute (water); and on the limited effects of aid from agri-environmental programmes and of eco-conditionality. In addition the CAP has not yet been made coherent with other EU policies; it remains a policy focused more on farming than on food; and competition policy sanctions certain groups of producers whereas it tolerates excessive concentrations in the food and farming industry, while first-pillar aids sometimes work against the principle of cohesion as a result of their unequal distribution.

### Avoiding the slide towards renationalisation

The mechanism for modulating aid – which transfers a part of it from the first to the second pillar – restores some margin for manoeuvre to states, relative to the initial centralisation of the CAP. States co-finance second-pillar spending, composing their own rural develop-

ment policy from a choice of around forty measures. This additional flexibility is welcome in that it allows adaptation to national and regional specificities, but it remains insufficient in the eyes of observers and actors and will probably be extended. There is concern, however, about recent changes which allowed states to increase the ceilings for national aid

during the milk crisis. Given the pressures on the EU budget, there is a strong temptation to renationalise agricultural policy. Any slide towards a renationalisation of the CAP would exacerbate competition between national policies and cause distortions of competition within the internal market.

## 4. Proposals for a methodical debate on the CAP budget

Medium-term challenges are encouraging people to rediscover the role of agriculture. But to meet these challenges, agricultural policy seems obsolete and the likelihood of a reduced agricultural budget inevitable. In this context, what kind of debate would help to build a sustainable Europe with the help of a reformed CAP after 2013?

### Debating in the right order

The excesses of the system of regulation by price in the 1980s left the CAP with a pitiful public image. Various reforms have corrected these problematic mechanisms but have never been accompanied by a revision of fundamental principles. Today this complicated policy suffers from a lack of clarity which erodes its legitimacy and prevents a debate on the underlying issues. The first step towards a reform is therefore to adopt a new method for discussion, including within the Council. As JC Bureau and LP Mahé (2008) remind us: “Any serious effort to look at the long-term objectives of the CAP for the 21st century must start with two questions. What types of market failings require an agricultural policy? What policies must be a matter for EU competence and finance?” The budget being a means to finance policy, it is important to answer these questions before choosing the tools necessary to achieve the objectives and, lastly, their level of financing.

### For a remaking of Europe’s public support for agriculture

Leaving aside the normative dimension of the CAP, which shows positive results (food safety, for example), and focusing on measures with budgetary impact, three objectives can be fixed after 2013: the environment (protection of natural resources and the fight against climate change); regulation of agricultural markets (by their nature unstable); rural public goods (that is, landscapes, recreation areas) and regional cohesion, a principle at the heart of European integration. Notre Europe believes that the correct path to follow will involve creating instruments targeted at these objectives. European public funds should finance European public goods, and payments should be conceived as incentives rather than rights. The CAP should support the competitiveness of agriculture rather than the income of farmers, but it must also provide safety nets and guarantees which allow agricultural markets to resist price instability. Payments should be allocated according to a contractual principle which commits the collectivity to remunerate the farmer who provides a service (maintaining farming land in rural regions according to strict environmental standards; compensation linked to natural handicaps; services in regions of environmental sensitivity or special natural value). Such tools will help to meet Europe’s challenges of instability, of natural-resource management, and of agricultural market failure.

## Conclusion

Precisely because agricultural policy takes place at EU level, budget negotiations will be make-or-break for the EU. If it were to seize the opportunity of these negotiations to rethink objectives, tools and budget – in short the political project for agriculture and rurality – the EU would have at its disposal a powerful tool with which to attack multiple challenges (economic, social, environmental, food-

related and regional) between now and 2020. Conversely, if it prunes the agricultural budget in contempt of political reform, it will deprive itself of a means of acting directly on these challenges. The outcome of this “game” will depend on the capacity of member states to move beyond the juste retour logic, and instead to create a new agricultural project in line with the EU’s economic and political aims.

*A first version of this Policy Brief has been published in the Report:*

### **Think Global – Act European: The contribution of 14 European think tanks to the Spanish, Belgian and Hungarian trio of EU presidencies.**



*Think Global-Act European*, ss. dir. Elvire Fabry and Gaëtane Ricard-Nihoul, *Notre Europe* (March 2010).

This new edition devoted to the trio of Spanish, Belgian and Hungarian presidencies focuses in particular on the changing role of rotating presidencies and presidency trios following the arrival of a permanent President of the European Council and a Union High Representative for foreign affairs and security policy. Experts from 14 European think tanks review the agenda of the trio (structural reform, economic governance, energy, climate change, migration, justice and internal affairs, world governance, common foreign and security policy, CFSP/CSDP, enlargement, neighbourhood, European institutions, European political space and budget), analysing for each issue the changing global context and the current challenges, before addressing concrete propositions to the trio.