

## Prospects for agricultural reform in the EU<sup>1</sup>

The EU's Common Agricultural Policy (CAP) has been in effect from the early years of the European Community, with the straightforward intention to hold domestic prices of key agricultural commodities at sufficiently high and stable levels to encourage production and assure a "reasonable standard of living" for farmers.

The CAP is today the EU's most expensive policy, taking up almost half of the annual budget. It is also its most interventionist and complex policy. Multiple reforms have created a system of decoupled payments to farmers that protect and prolong the life of small-scale farms and constrain large-scale farming and the evolution towards a more efficient industry structure.

The rejection of modern, technologically enabled agriculture in favour of planning and control is misguided and concerning.

The CAP is constraining the productivity and competitiveness of European farming. It requires fundamental reform that puts an end to agricultural exceptionalism and allows the industry's structure and performance to be determined by market forces.

### **A brief history of the Common Agricultural Policy (CAP)**

The CAP is the EU's most expensive policy, amounting to €58 billion per year and about 40 per cent of the budget. The CAP was created under the Treaty of Rome in 1958 as a founding pillar of the European Community. While it has undergone many reforms, its five objectives remain unchanged to this day: to increase productivity, ensure "a fair standard of living" for farmers, stabilise markets, assure supplies and deliver reasonable prices for consumers.

At first, ensuring a fair standard of living for farmers – by implication protecting farm incomes and farm numbers – was the most important objective. This was based on 'price supports' involving varying levies, i.e. tariffs to raise import prices to domestic levels, and official intervention buying at predetermined prices. The CAP was extended from grains to other agricultural products in the 1960s. The Agricultural Council, operating under an implicit rule of consensus, set intervention prices. This ensured that as production responded to higher prices – a permanent state of excess supply – the Agricultural Council's reaction was to increase budgetary expenditure to cover cost.

Production controls were first introduced for sugar in 1968 and for milk in 1983, to be followed by the voluntary 'set-aside' of productive land for cereals in 1988. Surpluses continued to grow and the cost of export subsidies rose as the EU increasingly resorted to dumping its surplus agricultural commodities on world markets.

CAP expenditure rose to 70 per cent of the EU budget and, under growing pressures, reform became inevitable. With the 1992 MacSharry reform, the system of direct production subsidies and export subsidies was transformed into a system of decoupled payments, where farmers are given direct payments not tied to production. To justify the payments, they were defended as 'temporary compensation' for lower market prices. Protection of the environment and rural development were introduced as justifying continued support.

As a result of pressures from environmental groups, the 2000 CAP reform consolidated environmental objectives and separated CAP expenditure into two tranches: Pillar I and Pillar II. Pillar I accounts for more than 70 per cent of CAP expenditure and funds direct farm payments. Pillar II, co-financed by national funds, is aimed at improving agricultural competitiveness, the environment and the rural economy. National and regional authorities can decide, within limits, the objectives and content of rural policies for their regions. Therefore, co-financing marked the introduction of 'renationalisation' into agricultural policy.

The 2003 reform, prior to the EU's eastward enlargement, fully decoupled direct payments from production. The decoupled payments added to renationalisation by allowing member states to adjust modestly conditions attached to their receipt and reduce the payments for larger-scale farms. A side effect of this reform was that it was no longer necessary to grow anything in order to receive payments. This, in principle, increased the influence of markets in farmers' decisions. In 2008, set-aside was abolished. Milk quotas were phased out in 2015 and sugar quotas will be by 2017.

### **Global food production challenges and the CAP**

The CAP is not achieving its goals of sustainability and affordable food prices, but instead constrains highly productive and intensive systems below their potential.

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<sup>1</sup> Selected excerpts from Sean Rickard, "Prospects for a Reformed Agricultural Policy" (London: Institute of Economic Affairs, 2016) and Rickard, "Liberating Farming from the CAP" (London: Institute of Economic Affairs, 2012).

There is reason to believe that population growth and continued per capita income growth will vastly increase global demand for food over the long term. The challenge of global food production is to supply this rising demand at affordable prices. There are severe limits on the growth of the world's agricultural land and, due to urbanisation, cultivated land per capita has declined. Growing demands will need to be matched by greater output per hectare of land. As these higher yields are dependent on energy use, rising energy prices will push up production costs. Global demand is putting stress on the available fresh water supply, on which yields are also heavily dependent. Furthermore, climate change is affecting agricultural production, causing crop losses in recent years, and it will contribute to a more rapid spread of crop and animal disease. A major challenge will be to increase global food production while simultaneously reducing greenhouse gas emissions.

To meet the growing demand for agricultural commodities at affordable prices, the EU needs a more productive and sustainable agricultural system. To achieve this, it needs to bring structural change to an industry composed of fewer, larger-scale farms which deliver a superior performance in terms of productivity, unit costs and incomes. Farming exhibits economies of scale: unit costs decline as farm size increases. Yet, 70 per cent of EU farms have an area of 5 hectares or less and are constrained by their size, unlikely to earn a reasonable living from their land. Indeed, without the CAP's decoupled payments, 80 per cent of EU farms would not break even. Direct payments to farmers are prolonging the life of unprofitable farms, thereby frustrating the evolution towards a more efficient industry.

### **The likely future of agricultural policy**

Although we no longer live in the post-war era of depressed agriculture and deprivations, the European Commission continues to defend the CAP by arguing that financial support for farming is necessary to deliver viable food production, the sustainable management of natural resources and balanced development across the EU. According to the Commission, decoupled payments improve competitiveness by encouraging farmers to tailor production decisions to market requirements, but the evidence for this is lacking. The Commission holds the view that phasing out decoupled payments will lead to the failure of many agricultural holdings and put additional pressure on the viability of rural areas with higher unemployment and migration.

The CAP's objective of protecting farm incomes has endured. The political and wider populations of Europe view this as legitimate, if no longer open-ended. The fact that in each Member State the average agricultural earnings are lower than the national average, and that around half of the EU's farms are defined as semi-subsistent, is stressed by the farming lobby as the justification for continued income support. Now that the Lisbon Treaty has given the European Parliament greater oversight of the CAP, there is little prospect of a significant reduction in funding for farm payments in the foreseeable future. Due to strong political support for 'family farms' and very powerful farmers' lobbies, it has been impossible to undertake any reform of the CAP without the assurance that funding would continue at prevailing nominal levels. The next twenty years or more will see periodic reforms of the CAP, but they will be unlikely to disturb the course set. Future reforms will continue the shift to a greater influence for market forces, the encouragement of sustainable farming and partial renationalisation.

### **The need for reform**

To effectively overcome current problems of demand and sustainability, farmers must achieve the maximum feasible efficiency. Currently, the average farm yield is consistently below the attainable yield, the yield that could be achieved under efficient market conditions. Attainable yield increases over time with new knowledge, such as technologies and genetic advances. The fruits of science and technology must be directed to raising productivity to higher levels and in a sustainable manner. However, the benefits of new scientific advances can only take root in farms that have the skills, access to capital and incentive to invest in new technologies. CAP policies not only discourage public and private research into highly productive farm systems, but direct farm payments are designed to maintain farm numbers, regardless of average levels of efficiency. They are also not conducive to bringing forth the levels of investment and entrepreneurial flair needed to convert science-based advances into commercial opportunities.

For farm businesses to be able to achieve higher levels of productivity and efficiency and generate the funds necessary to invest in business development, a CAP that will allow market forces much greater influence over the behaviour and rewards for farm businesses is needed. This means the removal of direct payments as an automatic right based solely on precedent rather than any objective assessment of needs, albeit subject to providing minimum maintenance of the land.

This will lead to a more competitive and less diverse industry, with economically viable farms that are larger and more open to innovation. As a result, European agriculture will be more productive and less labour-intensive. This will not cause a fall in total EU agricultural output because the contribution of smaller-scale farms, those most vulnerable to the removal of support payments, is proportionally less than their number.

Budgetary savings from removing decoupled payments to farmers under CAP would create better-targeted and more efficiently funded environmental and rural policies. Higher efficiency and productivity would lower overall greenhouse gas emissions and reduce soil erosion. Furthermore, the release of land from less efficient, smaller-scale farms would provide space for ecosystem services (woodlands, habitat conservation, recreation and carbon sequestration).

### **Agricultural reform and technological innovation**

Biological science-based technologies, including genetic modification, offer high potential to sustainably improve food crop production. New technologies, such as GM to enhance traits such as drought, heat and pest tolerance would seem to offer great potential in meeting the challenges of climate change and water shortages outlined above. Genetic engineering offers the prospect of increased productivity while reducing the impact of farming on the environment. EU strategy commonly names biotechnology as key in fighting hunger and malnutrition and feeding an increasing human population with reduced environmental impact. However, EU policy is restricting and regulating GM products, constraining research and reducing take-up. In order to achieve its goals, the EU needs to deregulate agricultural technology and stop holding back changes in farm productivity growth and competitiveness.

The much needed increases in productivity can be delivered by technological advances. These advances through precision technologies – the fusing of agricultural engineering and information technologies – need to be adopted at farm level, which requires expensive investment. Even with decoupled payments, smaller farms will not generate sufficient surplus to fund performance-improving investment. It is large-scale farms that can better invest in productivity and sustainability-enhancing technological advances which will make a more efficient and sustainable use of resources possible. The adoption of new technologies is also influenced by the farmer's level of education, technical sophistication and management acumen – all of which also appear to correlate positively with farm size.

CAP regulations on new technologies and GMOs constitute an almost de facto moratorium on growing genetically-altered crops, but meanwhile these products can be imported from non-EU countries. The TTIP deal, on the other hand, is attempting to remove or reduce trade barriers arising from regulations and standards, which will help food producers seeking to sell in both the EU and US to avoid additional challenges.

### **Further reading**

Rickard, Séan. "Liberating farming from the CAP." IEA Discussion Paper 37. London: Institute of Economic Affairs, 2012.

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