More for less:

Making the EU's farm policy work for growth and the environment

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EXECUTIVE SUMMARY

- On-going negotiations over the EU's long-term budget provide an opportunity for EU member states to reverse the serious poverty of vision for CAP reform that has characterised government and EU thinking for decades – but the window for doing so is closing quickly.

- The UK remains a big loser from the CAP. Between 2007 and 2013, the UK will contribute £33.7bn to the CAP and get back £26.6bn; a net contribution of £7.1bn. Per hectare, the UK receives £188, compared to for example France, Germany and the Netherlands which receive £236, £251 and £346 respectively.

- The CAP is irrational in how money is raised and how it is spent. There remains no clear link between the wealth of a country and how much it receives from the CAP. Latvia, for example, gets £115 per hectare from the EU's direct subsidies – the least of all member states – despite average farmers' income being only 35% of the EU average. Lithuania, whose farmers are the poorest in Europe in absolute terms, receives the third least from the scheme. In contrast, wealthier member states such as Ireland and France continue to do well out of the CAP.

- Despite a series of reforms, the main 'benefit' of the CAP is that on the whole, it is less damaging than it used to be. Owing to its arbitrary design and contradictory aims, the CAP fails to meet its own objectives of delivering bio-diversity, boosting farmers' competitiveness and promoting rural jobs and economic development.

- The share of the CAP spent on explicit environmental aims in the UK is only 13.6%, and could be even lower in the EU as a whole. By failing to differentiate between different types of land, direct CAP subsidies actively channel public resources away from where they could create the biggest environmental gain.

- At the same time, by providing income support irrespective of whether any meaningful economic activity takes place on a farm, direct CAP subsidies often act as an outright disincentive for farmers to modernise, in turn locking in unviable business models and hurting Europe's competitiveness.

- The cost of the EU's farm subsidies and tariffs to consumers and taxpayers in the EU now stands at €86.9bn, of which €52.5bn stems directly from CAP subsidies. The full liberalisation of the CAP and other EU measures to protect farming such as tariffs, and the reinvestment of the money into more productive areas of the economy, could be worth a boost in output equivalent to €139bn, or 1.1% of EU GDP. Britain would experience a boost in output of €14.2bn or the equivalent of 135,000 full-time and part-time jobs.

- Full liberalisation of the CAP would be economically viable. However, given the widely held belief that that there is still a role for the state to play in delivering objectives such as bio-diversity, land management, and R&D, such an option is not likely to gain political support.

- Therefore, we propose a pragmatic mix: a new, radically revamped EU farm policy, which would allow for resources to be effectively allocated to generate production and environment benefits, while better targeting jobs and growth. This would involve four steps:

  1) The current CAP structure would be replaced with a system of agri-environmental allowances. Funding for member states would be allocated according to environmental criteria, such as biodiversity, but would be administered nationally. Payments could then be transferred between farmers depending on where the environmental gain is the greatest.

  2) After complying with some minimum environmental standards, farmers would then be free to opt in or out of this scheme. Those farmers who wish to focus exclusively on production would be free to do so.

3) EU-level funding for rural economic development should be limited to the poorer member states only, and migrated over to the EU's structural funds. Farmers should also be able to qualify for time-limited support from a fund similar to the EU's Globalisation Adjustment Fund, targeted at making farmers more competitive and/or able to move into other parts of the economy.

4) A limited pot of money for agriculture-related R&D should remain at the EU level.

- By simultaneously streamlining the CAP budget, such a system would reduce the size of the CAP budget by around €122bn over seven years. This sum could either be invested back into the EU budget, in areas such as R&D, or returned to member states.

Box 1: What is the CAP?

The Common Agricultural Policy (CAP) is one of the EU's flagship policies, involving a series of objectives and subsidy programmes relating to agricultural production, rural development and the environment. It is the biggest single item in the EU budget, accounting for around €55bn a year,[1] or 40% over the current 2007 – 2013 EU budgetary framework period.[2] Since its establishment in 1962, it has been one of the most contentious areas of EU policy, in particular for the UK, which has always been a big loser in financial terms compared with other states.

At the time the CAP was set up, the EU's founding states had strongly protectionist and interventionist agricultural policies, and they decided that alongside having an open market between themselves, they would establish a common set of rules consisting of import tariffs, internal price support, export subsidies and direct income support to farmers. The rationale was that by guaranteeing farmers a certain level of income (usually above market prices), food security would be ensured.

Currently, the CAP is based on a two-pillar structure. Pillar 1 is mostly composed of direct payments to farmers and landowners in the form of the Single Payment Scheme (SPS), and accounts for around 80% of total CAP spending. Pillar 2, known as 'rural development', aims to promote economic, social and environmental development with rationale similar to the EU's Structural and Cohesion funds - but with a specific focus on rural areas - and accounts for 20% of total spending. Pillar 1 is delivered directly through the EU budget, while Pillar 2 is subject to co-financing from the EU and national governments.

The CAP's internal subsidies are complemented by external tariffs and quotas on imports from third-party countries. Though such tariffs are not part of the CAP per se, they form an integral part of shielding European farmers from the effects of global competition.

This report recognises that rural management and development policies play an important role in delivering 'public goods' such as biodiversity and clean water and air, and that there is a case for a common EU-level framework for agricultural markets. What we examine is whether the current CAP is the most effective way to provide the various objectives it claims to promote, or whether there are other, new, innovative ways to deliver biodiversity, a living countryside, rural jobs and a modern, competitive farming sector.

1 EU Commission, DG for Agriculture and Rural Development, 'How much the CAP costs' http://ec.europa.eu/agriculture/capexplained/cost/index_en.htm

2 The heading 'Preservation and Management of Natural Resources' takes up €413.1bn of the total €975.8bn (42.3%) allocated over the EU's 2007 – 2013 Multiannual Financial Framework (MFF). The CAP accounts for the overwhelming majority of this, but it also covers other aspects such as the Common Fisheries Policy.

1. THE COMMON AGRICULTURAL POLICY: WHAT IS THE STATUS QUO?

1.1. The UK's window for pushing for CAP reform is rapidly closing

Concerns over the cost and design of the CAP have been a long-standing feature of the UK's relationship with the EU. However, despite frequent complaints, UK politicians and civil servants suffer from a serious poverty of vision for CAP reform, focussing instead on the limitations involved in negotiations over the EU budget. This has led to blinkered policy-making driven not by the strength of alternative concepts of how the CAP could be designed, but by a lowest common denominator approach.

In 1984, Margaret Thatcher fought for and secured the UK's rebate from the EU budget because of the UK's substantial net contribution to this policy area relative to that of other member states. The previous Labour Government argued for fundamental CAP reform, and in 2005 then Prime Minister Tony Blair explicitly tied the future of the rebate to this objective, arguing that:

> "*We can't discuss the British rebate unless we discuss the whole of the financing of the EU, including that 40% of the budget goes on agriculture which employs only 5% of the people."*[3]

However, unlike in the case of the EU's Structural and Cohesion Funds where Labour had a clear and concise plan for reform (devolving the whole regional policy area back to richer member states)[4], the previous government failed to come up with thought-out plans for the CAP, and was heavily criticised by both domestic farmers and the EU. The then Commissioner for Agriculture and Rural Affairs, Mariann Fischer Boel, said she was "perplexed" by the UK's position, arguing that:

> *"Is it a gimmick or a game? For I've seen nothing concrete on what [the UK] wants... During the 2003 talks, there was a proposition to reduce direct aid to farmers and who voted against it?"*[5]

Ultimately, Blair was pressured to give up a substantial portion of the rebate, without securing anything more concrete than a vague commitment to further CAP reform in the future, resulting in the so-called 2008 Health Check, which generated only minor changes to the policy. However, the Coalition appears to have dropped Labour's ambiguous commitment to rationalising the CAP. Instead, its priorities ahead of negotiations on the EU's next long-term financial framework (2014 – 2020) focus on 'damage limitation', with three objectives stressed:

- Protecting the UK rebate from further reduction
- Freezing the overall size of the budget
- Achieving reform through 'downward pressure' – with less money available, the cash available must be better spent.

Given that the negotiations over the final shape of the framework are due to be completed in 2012 or 2013, and will see funding allocations broadly locked in for the next seven years, there is not much time for the UK to present a radical – but credible – alternative to the status quo. As this paper will argue, forgoing the opportunity to propose a fresh, innovative approach to farm and rural policy in these talks would mean passing on a range of significant financial, social and environmental benefits for the UK and Europe as a whole.

3 *The Guardian* 'Blair ties rebate talks to CAP reform' 13 June 2005 http://www.guardian.co.uk/world/2005/jun/13/eu.politics
4 To find out more about reforming the EU's Structural and Cohesion funds, read *Open Europe's* 2012 report: 'Off target: the case for bringing regional policy back home' http://www.openeurope.org.uk/Content/Documents/PDFs/2012EUstructuralfunds.pdf
5 *Forbes* 'EU's Fischer Boel perplexed about UK plans to revise farm [policy]' 30 June 2005

1.2. What are the objectives of the CAP?

The overarching objectives of the CAP, maintaining a reliable food supply and providing financial support for farmers, have remained unchanged since its inception. However, the Commission has since added a number of additional objectives, including:

- improving the quality of Europe's food
- guaranteeing food safety
- the well-being of rural society
- ensuring that the environment is protected for future generations
- providing better animal health and welfare conditions
- doing all this at minimal cost to the EU budget.[6]

Pillar 2 of the CAP, the 'rural development' component, is further broken down into three separate axes:

Axis 1: improving competitiveness through farm modernisation

Axis 2: improving the environment and countryside through agri-environmental schemes

Axis 3: diversification of rural economic activities, for example encouraging tourism

The CAP has multiple objectives which can sometimes clash with one another. For example, encouraging diversification in rural communities to reduce dependence on farming and promoting land stewardship can conflict with the objectives of maintaining a steady food supply and increasing farming efficiency. This is typified by the controversy over the Commission's proposal to only pay money to 'active farmers', which could leave part-time farmers with other revenue streams ineligible for continued support. The Commission also promotes the diversification of agricultural incomes.

It is nonetheless clear that collectively, alongside its traditional agricultural aspects, the CAP is at least in theory geared towards delivering a range of public goods which might not be entirely catered for by a purely free market system. In the UK for example, Axis 2 of rural development co-finances a range of pioneering environmental stewardship programmes such as the Entry Level Stewardship (ELS) and the Higher Level Stewardship (HLS) schemes. However, whether the CAP delivers these goods effectively is an entirely different matter (see section 2.2).

The UK has also moved further than other states in using a mechanism called Article 86 to divert funding from the SPS into the rural development fund (so-called modulation).[7] However the amount of funding over which the UK exercises some form of control is a small proportion of the whole, which means that there is scope for greater national control.

What is the Single Payment Scheme (SPS)?

The SPS (often referred to in the UK as the Single Farm Payment - SFP) is paid to farmers and landowners in the EU[8], replacing the original price support mechanisms which have now largely been phased out. Member states have some flexibility in allocating the funds, provided farms meet some basic eligibility criteria such as farm size and various phytosanitary and environmental standards. Although it is decoupled from production, the SFP still allows farmers to produce more than would otherwise be the case. The payments received by each member state are based either on historic receipts, such as how much land or how many animals a farmer used to possess, or on amounts negotiated on accession, meaning that there are considerable differences in the payments per hectare across the EU (see Graph 5).

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6 EU Commission, DG for Agriculture and Rural Development, 'The CAP – promoting sustainable agriculture in a global environment' http://ec.europa.eu/agriculture/capexplained/sustain/index_en.htm

7 Article 86 was agreed to allow more flexibility between the two pillars of the CAP. The UK has taken up this right to divert more payments towards Pillar 2.

8 The new member states are subject to transitory arrangements under which they receive payments from a similar but separate scheme called the Single Area Payment Scheme.

1.3. Recent attempts at CAP reform

The CAP remained relatively untouched until the 1990s, when significant political pressure forced through a series of reforms aimed at removing the market distortions caused by the subsidies, including a huge degree of over-production which resulted in the infamous 'wine lakes' and 'butter mountains'. There was also a need to bring EU farm policy closer into line with the international trading system, which was developing in a more liberal direction following a series of world trade talks.

- *The 1992 MacSharry reforms* marked a small step towards liberalisation by according market prices a greater role in setting production levels. They also included production limits and 'set aside' schemes in order to help reduce surpluses (which had given rise to the 'food mountains' in the1980s). This reform also saw the beginning of rural development and environmentally focused schemes.

- *The 1995 WTO Agreement on Agriculture* required the EU to further reduce protectionist measures such as import tariffs, internal subsidies, export subsidies and other programmes that artificially raised domestic agricultural prices and farmers' incomes. The export subsidies had become particularly controversial because they led to charges that the EU was engaged in 'food dumping' on global markets, which depressed global prices, and reduced farmers' income in developing countries.

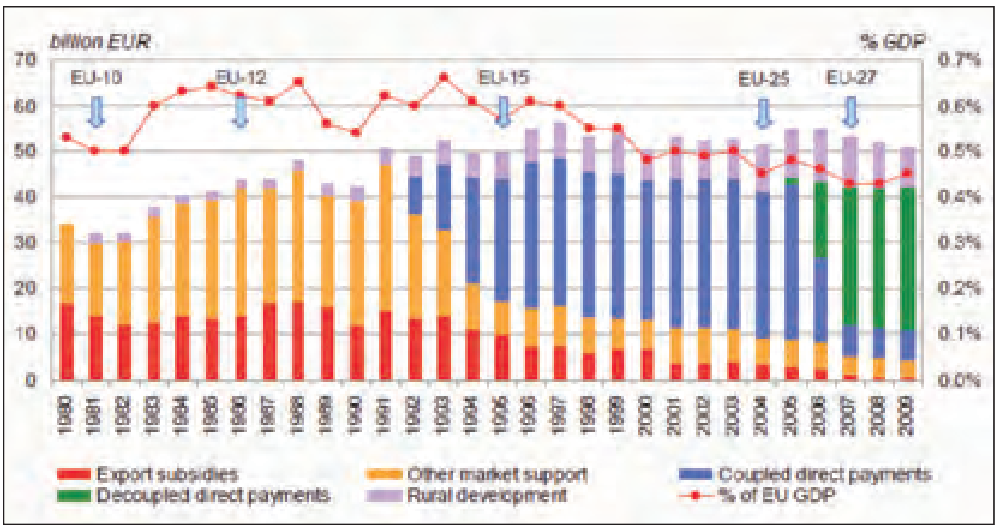
- *The Agenda 2000 reform* established the Two-Pillar structure with direct payments coming under Pillar 1, and the 'rural development' focus coming under Pillar 2. Agri-environmental schemes became compulsory in every member state, while efforts were also undertaken to promote the diversification of economic activity in rural areas.

- *The 2003 Fischler reform* led to a further shift away from intervention in agricultural markets, while strengthening the rural development aspect of the CAP. Significantly, this reform 'decoupled' direct payments from production via the SPS. It also allowed member states to shift funds (although only up to 5%) away from direct payments towards rural development (modulation).

- *The 2008 Health Check* was an initiative to check on the progress of the 2003 reforms, partly serving as quid pro quo for Tony Blair's decision to give up part of the UK's rebate. It included further incremental reforms to shift the CAP away from market interventions and direct payments to farmers and landowners, towards Pillar 2 objectives, by planning the withdrawal of milk production quotas by 2015, for example. It also reduced the amount of subsidies paid to large farms.

The above reforms have contributed to a shift in the CAP's emphasis and payments over time. Production-tied payments, market interventions and trade distorting export subsidies have been almost entirely phased out, as Graph 1 shows below:

Graph 1: The CAP's shifting focus 1980 - 2009



Source: ODI, based on data from DG Agriculture[9]

9 Cantore, N, Kennan J, Page, S (2011) 'CAP Reform and Development', Overseas Development Institute http://www.odi.org.uk/resources/docs/7245.pdf, page 6

Despite reforms and decades of criticism, the CAP's percentage share of overall EU GDP has remained fairly static. The graph above shows that despite the Commission's claims that the CAP has fallen from around 70% of the budget in the 1970s and 80s, to 40% today, this is not because of a fall in the absolute amount of subsidies paid out – which have remained largely constant - but because other areas of the budget have expanded more in comparison. Furthermore, direct aids (overwhelmingly the SPS) continue to represent a significant portion of the CAP budget. For instance, in 2010 the SPS represented:

- 90.8% of Pillar 1 of the CAP
- 71.8% of the CAP as a whole
- 35.4% of the whole EU budget

Meanwhile, the economic importance of agriculture in Europe has been in consistent decline, falling from 2.3% to 1.7% of overall EU Gross Value Added between 2000 and 2010. However, farming groups have managed to retain significant political influence, by far exceeding the economic importance of their sector, enabling them to act as a brake on more radical and comprehensive reforms than those outlined above.

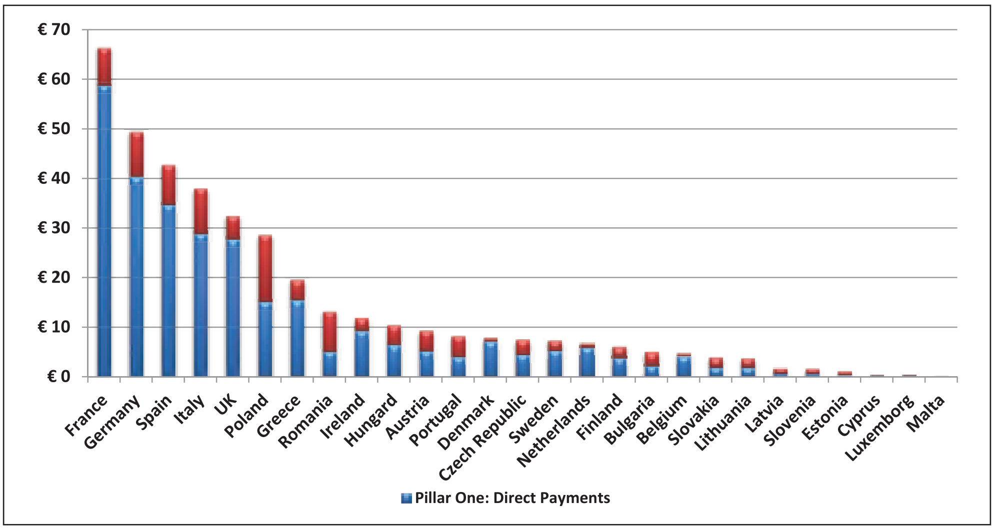
Box 2: Current Commission proposals for CAP reform

The Commission's most recent proposals announced in October 2012[10] follow a well-established pattern: the EU offers to tinker with the current CAP structure by introducing incremental reforms, in exchange for continued political support for the overall CAP scheme. Main points include 'greening' the SFP (by introducing more environmental conditionality), greater scope for states to transfer funding between the two pillars, an overall cap on the amount a farmer or landowner can receive through the SFP, and a limit on subsidies to 'active farmers', which contradicts other CAP objectives such as the diversification of rural economic activities and famers' income streams.

1.4. Winners and losers under the present system

Over the course of the current EU financial framework (2007-2013) just over €338.5bn of CAP funding has been allocated to member states, of which around €208bn had been paid out as of 2010. Graph 2 shows the allocation per member state broken down into Pillar 1 and Pillar 2, while Graph 3 shows member states' *net* receipts.[11]

Graph 2: CAP funding allocations per member state 2007-2013 (€bn)



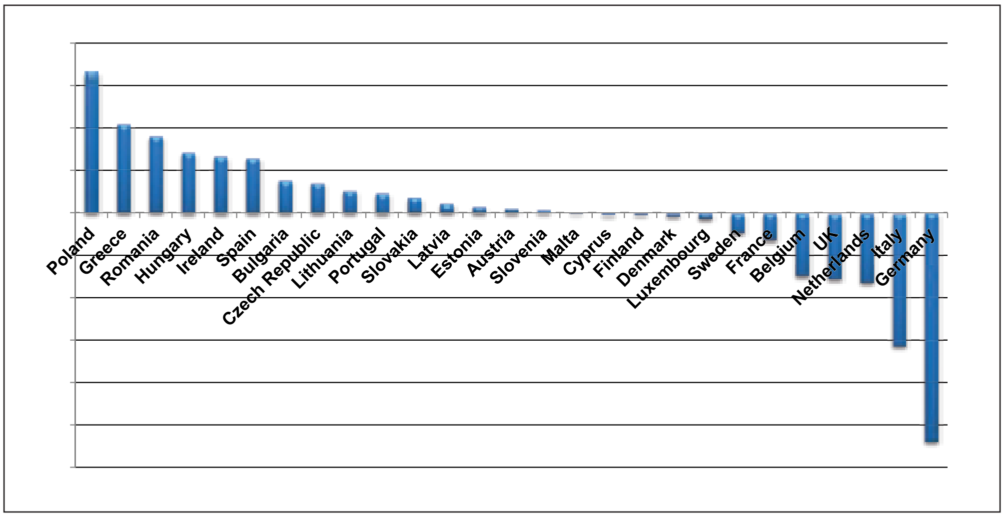
Source: EU Commission[12]

10 EU Commission, DG for Agriculture and Rural Development 'The Common Agricultural Policy after 2013' http://ec.europa.eu/agriculture/cap-post-2013/legal-proposals/index_en.htm

11 Calculated using an average of Member States' estimated direct contributions to the EU budget as a whole over this period.

12 Bulgaria and Romania joined the EU in 2007, but they were not eligible for CAP funding until 2008

Graph 3: Net CAP receipts per member state 2007-2013 (€)



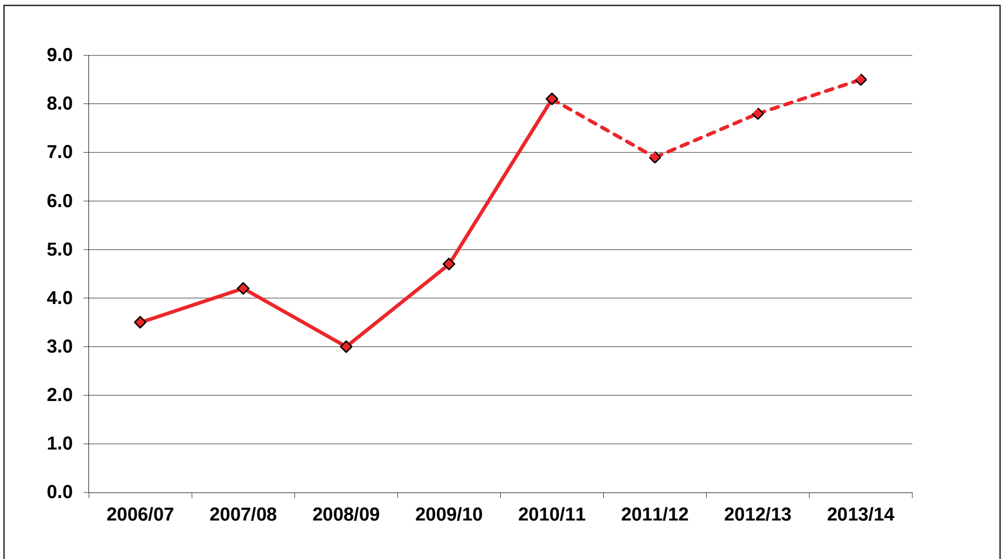
Sources: EU Commission, Open Europe calculations

The graphs show that there is no clear pattern of winners and losers from the CAP. Some old member states still do very well under the current framework, in particular France, Greece, Ireland and Spain- although France is now a marginal net contributor to the CAP. On the other hand, Germany is by far the biggest loser from the CAP, and perhaps somewhat surprisingly, so is Italy. The UK is also a net loser from the CAP, although it does not do as badly as some other net contributors to the budget. The picture is also mixed for the new member states. Poland, Hungary and Romania are among the biggest winners, but the Czech Republic, Slovakia, Slovenia and the Baltic states are not significant beneficiaries over the current framework.

1.5. How well (or badly) does the UK do out of the CAP?

Between 2007 and 2013, the UK has been allocated a total of €32.5bn (£26.6bn), broken down into €27.9bn (£22.9) from Pillar 1 and €4.6bn (£3.8bn) from Pillar 2. This has to be set against the UK's estimated contribution to the CAP of €41.1bn (£33.7bn), which means that overall, the UK has contributed a net total of €8.7bn (£7.1bn) over this period. As a consequence of giving up part of its rebate, the effects of which are being phased over the ongoing budget framework, the UK's net contribution to the CAP is increasing year on year, as Graph 4 demonstrates. The UK's contribution also has to be seen in the context of the UK's agricultural sector, which accounts for just 0.7% of the UK's GVA, less than half of the EU's average of 1.7%.

Graph 4: UK Net contribution to EU budget 2006 – 2014 (€bn)



Sources: HM Treasury

1.6 The role of tariffs

The impact of the EU's agricultural policies on the world market mostly results from external tariffs on non-EU goods, rather than direct subsidies. This is because production-linked and export subsidies, as well as intervention buying, have largely been phased out. The EU's high farm tariffs continue to come under massive criticism for distorting world markets, although the Commission has taken positive steps to enhance market access to the world's poorest countries in recent years.

Estimates of the average external tariff paid on imports from countries without special arrangements with the EU (most-favoured nation status) range between 18% and 28% of the value of the good imported, depending on the particular produce. This is much higher than the average 3% tariff paid on manufactured goods.[13] Any full programme of EU farm reform would still need to include a critical re-examination of tariffs and other barriers to global trade, such as SPS. However, tariffs and SPS fall under the EU's trade regime, the Common Commercial Policy, unlike CAP subsidies, which are negotiated through the EU budget. In this paper, we primarily deal with the subsidies element, although the tariff system is also considered in brief.

13 University College Dublin, Institute for International Integration Studies: 'EU agricultural protectionist measures' http://www.tcd.ie/iiis/policycoherence/eu-agricultural-policy/protection-measures.php

2. ARGUMENTS FOR AND AGAINST EU-LEVEL CAP SPENDING

2.1. Arguments in favour of EU-level CAP spending

A) Ensuring a level playing field for farmers in Europe

The UK National Farmers' Union (NFU) tends to be in favour of a common EU policy in farming, as it fears that British farmers would otherwise be disadvantaged. The reasoning is that without the CAP, other member states would subsidise their own farmers in various ways but the UK government would not. Likewise the House of Commons Environment, Food and Rural Affairs Select Committee has argued that the CAP maintains "fair competition for agricultural products within the EU"[14] as all farmers qualify for support.

There is some truth in this argument. However, even without the CAP, member states would still be subject to a common EU regulatory framework, including state aid rules, which would presumably prevent them from unfairly subsidising farmers. Equally, member states would still be subject to WTO-rules which prohibit the re-coupling of subsidies. Common EU tariffs on global produce would still provide a level playing field within the EU. Finally, as an overwhelming majority of all CAP subsidies are now de-linked from production, the impact of removing the subsidies should in theory be production-neutral vis-à-vis other member states, though there clearly are farms that currently operate at a loss which might go out of business (see section 2.2).

B) Enabling farmers to compete globally despite stricter standards

Another argument put forth by the NFU is that CAP subsidies serve to compensate farmers for the relatively strict environmental and welfare standards to which they have to adhere, unlike competitors in the global market place, who are free to produce at a lower cost due to more liberal standards.[15] Examples include animal welfare issues and limitations on the use of certain medications such as growth hormones and antibiotics. As Peter Kendall, the head of the NFU, has argued:

> *"I can have my market distorted by different welfare and different environmental schemes, [but] I need some sort of protection."*[16]

Again, while this argument contains some truth, and it is clear where the NFU and others are coming from, it is not unique to the farm sector. A whole of range of industries in the EU – for example the chemical, automotive and mineral refinement sectors – are all subject to tougher environmental standards than their global competitors and are required to cope without subsidies.

C) Securing farmers' incomes

As SPS comes in the form of direct income support, it is unsurprising that it contributes to the stabilisation of farmers' incomes. The Commission claims that the SPS helped stabilise volatile incomes in sectors such as crops (reduction of income variability between 15% and 65% in half the regions surveyed), beef, sheep and goats (18-51% in one third of regions) and mixed farms (10-40% in half the regions).[17] A study commissioned by Defra and conducted by LEI Wageningen University Research Institute in the Netherlands concluded that over 30% of UK farms would have a negative income without the CAP.[18] If the aim is to keep farmers artificially in business, this could be considered one way of achieving that objective. However, it does not explain why public funds should be used to keep farmers, rather than other economically struggling groups, in business.[19]

14 House of Commons Environment, Food and Rural Affairs Committee: 'Securing food supplies up to 2050: the challenges faced by the UK', Fourth Report of Session 2008–09, Volume I, June 2011
http://www.publications.parliament.uk/pa/cm201012/cmselect/cmenvfru/1356/1356.pd f page 1

15 Under WTO rules, imports can only be blocked on food safety grounds, not animal welfare or environmental grounds

16 House of Commons Environment, Food and Rural Affairs Committee (2011: 'Securing food supplies up to 2050: the challenges faced by the UK', Fourth Report of Session 2008-09, Volume I, June 2011

17 Agrosynergie EEIG, 'Evaluation of Income Effects of Direct Support: Executive Summary', May 2011
http://ec.europa.eu/agriculture/eval/reports/income/exec_sum_en.pdf, page 14

18 HCJ Vrolijk, CJAM de Bont, PW Blokland, RAME Soboh , 'Farm viability in the European Union: Assessment of the Impact of Changes in Farm Payments" Lei, Wageningen University, April 2010 www.lei.dlo.nl/publicaties/PDF/2010/2010-011.pdf

19 The Commission also claims that the CAP have a positive influence on reducing the disparity between regional farm revenues, though it does not provide any credible counterfactual or conclusive evidence to support the case, while also admitting that structural regional divergences have a tendency to increase.

D) Allowing farmers to 'opt in and out' of global markets

The Commission argues that direct payments allow farmers to react to changes in global prices and meet challenges with greater flexibility. The Commission notes that "through decoupled payments, we continue to give farmers a certain level of financial security…and we are liberating them to respond to market signals."[20] However, this argument confuses economic concepts. The Commission's argument is better expressed as giving farmers the flexibility to *decide whether or not* to respond to those changes. Remember, the very rationale behind virtually all farm subsidies is now to sever the link between global supply and demand, and farmers' production.[21] In other words, CAP subsidies allow farmers to opt in and out of global markets. As the NFU's Peter Kendall argued:

> *"I can probably crop the best half of my farm in difficult years, and when the price signals get better I have got resources in place to go and farm the whole of the land."*[22]

However, whether this should be considered a benefit or drawback very much depends on one's view of a number of other issues, including the most effective way to achieve food security (by encouraging supply diversity and the requirement that farmers respond to price signals, or through market interventions), the best comparative use of public funds, and the need to modernise the farming industry and keep food prices down.

E) Enhanced food security

The Commission argues that there is a "strategic interest for the EU to retain a significant degree of food self-sufficiency".[23] As EU Commissioner Michel Barnier argued during his time as French Minister for Agriculture,

> *"if Europe were to cut back on its agricultural production then the increase in its own food imports would contribute significantly to a worldwide increase in food prices…In other words, maintaining Europe's farm outputs at present levels also contributes to the stabilisation of global food markets".*[24]

However, it is not entirely straightforward to provide conclusive evidence as to whether the CAP, as it stands at the moment, helps or hinders food security in Europe (see 2.2).

F) Providing environmental benefits

The Coalition has said that it agrees that the CAP

> *"has a vital role in supporting the provision of environmental public goods; these public goods are unlikely to be supported by the normal functioning of the market…sustainable land management is best delivered through multi-annual, contractual, agri-environment schemes, which are currently enabled under Pillar 2 of the CAP."*[25]

The Coalition and Commission are right to argue that the CAP – or other government policies – can provide "basic levels of public goods."[26] Still, the share of CAP subsidies explicitly dedicated to environmental objectives is relatively small at present.[27]

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20 European Commission, http://ec.europa.eu/agriculture/faq/faq_en.pdf, p.9

21 A Commission reports on food prices notes that EU commodity markets between 1998 and 2010 were found to be less volatile than their global counterparts. Despite the spikes in food prices between 2007 and 2008, the coefficient of price variation in absolute terms is lower in EU markets than abroad. European Commission, DG for Agriculture and Rural Development, 'Commodity Price Volatility: International and EU perspective', 24 June 2010
http://ec.europa.eu/agriculture/analysis/tradepol/commodityprices/240610_en.pdf

22 House of Commons Environment, Food and Rural Affairs Committee, 'Securing food supplies up to 2050: the challenges faced by the UK', Fourth Report of Session 2008–09, Volume I, June 2011, page 40

23 House of Commons Environment, Food and Rural Affairs Committee, 'The Common Agricultural Policy after 2013: Government response to the Committee's Fifth Report of Session 2010-112, 24 June 2011
http://www.publications.parliament.uk/pa/cm201012/cmselect/cmenvfru/1356/1356.pdf

24 Michel Barnier writing in Europesworld, 'How Europe should tackle the global food crisis', Autumn 2008. Similar arguments have been made by the current agriculture commissioner
http://www.europesworld.org/EWSettings/Article/tabid/191/ArticleType/articleview/ArticleID/21209/Default.aspx;

25 House of Commons Environment, Food and Rural Affairs Committee, 'The Common Agricultural Policy after 2013: Government response to the Committee's Fifth Report of Session 2010-112, 24 June 2011

26 Under Pillar 1, the public good is limited to farmers fulfilling minimal EU requirements to preserve landscape and biodiversity. Pillar 2 has far more of an environmental focus, requiring each rural development programme to ensure that natural resources and the landscape are safeguarded. In addition, 25% of funds must be spent on improving the countryside and the environment.
Institute for European Environmental Policy, 'The Provision of Public Goods through Agriculture in the European Union: executive Summary', December 2009
http://ec.europa.eu/agriculture/analysis/external/public-goods/summary_en_fr.pdf

27 Between 2007 and 2013, €20.3bn of Pillar 2 funds have been allocated towards agri-environment measures, including measures which promote biodiversity, such as the Natura 2000 programme. EU funds spent on the promotion of biodiversity represent 48% of global aid to biodiversity. However, the Commission's interim report concluded there was "no evidence that biodiversity-related funding has increased since the adoption of the Biodiversity Action Plan".
European Commission, 'Communication from the Commission to the Council, the European Parliament, the European Economic and Social Committee and the Committee of the Regions: A Mid-Term Assessment of Implementing the EC Biodiversity Action Plan', December 2008
http://ec.europa.eu/environment/nature/biodiversity/comm2006/pdf/bap_2008_en.pdf

However it is clear that the 2003 reforms which introduced decoupled payments have moved the CAP away from the outright damaging environmental impact it has had in the past. In the UK, the CAP had contributed to negative externalities such as drainage of upland areas for agriculture with severe implications for river systems and habitats[28], heavy use of fertilisers to the detriment of naturally biodiverse grasslands, and the removal of hedgerows in order to increase land acreage, production, and therefore subsidies. A 2011 Commission report found that the environmental impact of market price support instruments in the early 1990s:

> *"strongly correlated with the extent to which they distort the market (giving rise to) intensified farming and the massive use of fertilisers, as well as a lack of diversification."*[29]

Other reports have also shown that decoupled payments are an environmental improvement on production-linked subsidies. However, advocating a policy on the grounds that it is better than it used to be is hardly a sufficient reason to continue to fund the policy.

G) A living countryside

The CAP can also deliver social benefits and public goods in two other ways. The CAP channels funds to so-called Least Favoured Areas (LFA), which are at greater risk of social and economic decay. As the Commission has argued,

> *"to the extent that LFA policy has contributed to continuing land use, and to the extent that the agricultural sector plays a role in the maintenance of rural communities, then it also underpins rural communities".*

The Commission nevertheless concedes that "although agricultural land use has generally continued in LFAs, the extent to which the causality for this can be assigned [to the CAP] is not clear".[31] The CAP's LFA scheme and other subsidy schemes contribute to a "living countryside", by encouraging active land management and the maintenance of open landscapes. This has an intrinsic value, and is beneficial for economic activities such as tourism.

2.2 Arguments against EU-level CAP spending

As with the EU's structural funds, it is not enough to ask whether the CAP generates a perceived absolute benefit, such as encouraging a 'living countryside' or boosting farmers' income. The relevant question is whether the CAP represents the best *comparative* use of scarce resources.

A) An ineffective tool for redistribution between rich and poor

i) The CAP as a whole

Just like the structural funds, the CAP is irrational with respect to where funding is raised relative to where it is spent. This is a critical flaw. One of the key arguments in favour of the CAP is that it produces 'European added value'. This means that EU-level spending on agricultural projects is a more effective use of funds and better redistributes resources to fulfil common European objectives than national policies could.

As the CAP is largely based on historic receipts rather than actual needs; the established member states benefit disproportionately, compared with the new member states, even though agriculture is more important to their economies. This is due to political considerations, which led to the new member states having to accept 'transitional arrangements'. This is evident when looking at CAP receipts per hectare of potentially eligible land throughout the EU, comparing it to average farmers' income, as measured by the Commission.

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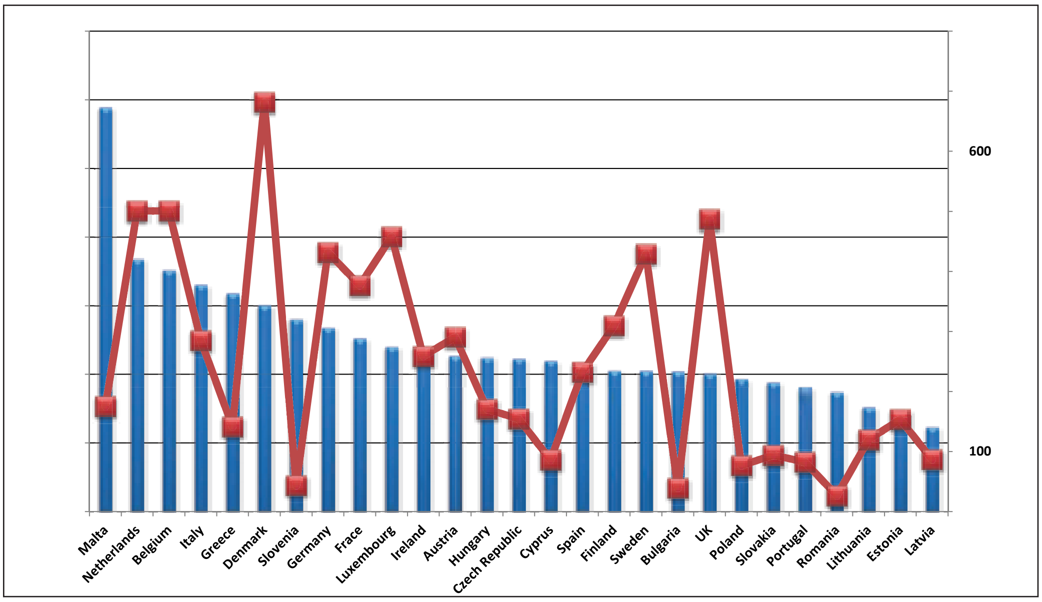
28 Posthumus H, Hewett CJM, Morris J, Quinn PF (2008) 'Agricultural Land Use and Flood Risk Management: engaging with stakeholders in North Yorkshire', Cranfield University www.ceg.ncl.ac.uk/theFARM/ripon.pdf

29 Alliance Environment, European Commission, DG Agriculture and Rural Development, 'Synthese des evaluations conduites sur les effects de l'environment de mesures de la PAC', November 2010
http://ec.europa.eu/agriculture/eval/reports/environment-summary/fulltext_fr.pdf

30 For instance a 2008 report by the OECD found that "nutrient balances, pesticide, energy and water use, ammonia and greenhouse gas emissions trends all decreased in the EU15."
OECD, 'Environmental Performance of Agriculture in OECD Countries since 1990: European Union Country Section'
http://www.oecd.org/dataoecd/35/28/40808769.pdf

31 Agra CEAS Consulting for European Commission, 'Synthesis of Rural Development Mid-Term Evaluations Lot 1 EAGGF Guarantee', November 2005
http://ec.europa.eu/agriculture/eval/reports/rdmidterm/lot1/chapter4.pdf

Graph 5: Average Farm income versus average direct payments per hectare



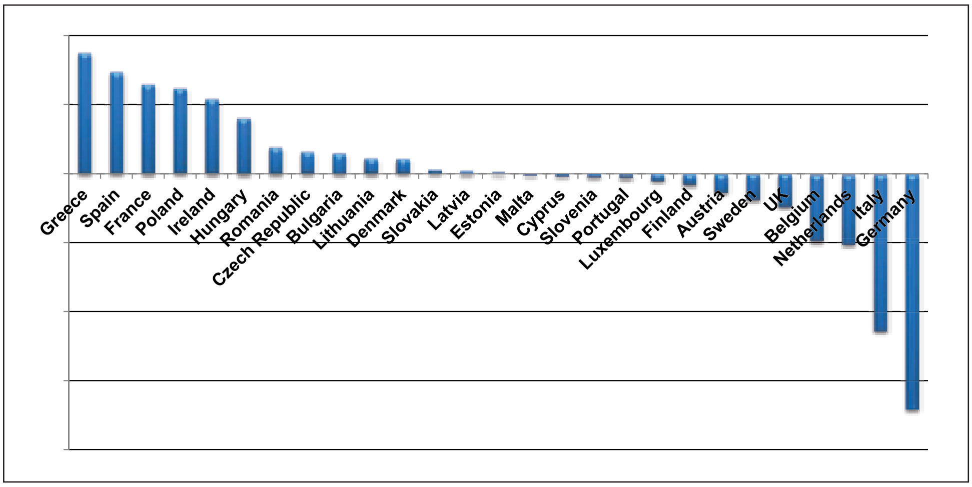
Source: European Commission, Open Europe calculations

ii) The SPS: the mother of all misallocations

Arbitrary redistribution across the EU

The CAP's badly targeted and unequal redistribution is particularly evident when looking at direct aid (i.e. the SPS). Perversely, many of the new member states, which are less developed and more dependent on agriculture, receive less than established, wealthier member states, as Graph 6 shows.

Graph 6: Net receipts of CAP direct payments per member state 2007 – 2013 (€bn)



Source: European Commission, Open Europe calculations

Arbitrary redistribution within member states

The shift from production-based payments to the decoupled SPS distributed on the basis on land area has also generated distortive and random redistributions. Land owners now receive a large share of the income support, irrespective of whether or not they are actual farmers. Landowners, as opposed to farmer households, now pick up over 40% of the subsidies, double the amount compared to a decade ago.

Because the distribution of the SPS is not linked to specific outcomes, but based on a mixture of historical receipts and the size of the farm, it has become a subsidy scheme for an arbitrarily determined group of people, rather than a serious redistribution policy.[32]

32 However, disparities between receipts in farms can be overcome to some extent. France's decision to adopt a historical model of the SPS combined with Health Check regulation (articles 63 and 68) enables it to transfer payments to areas with natural handicaps. Modelling the expected effect of this decision shows that it is likely to give rise to a redistribution of direct payments from regions specialising in the production of arable crops, to regions with natural handicaps, and a reduction of direct payments to large farms by 30%, in favour of smaller farms.
Chatellier V, Guyomard H (2008) 'Le bilan de santé de la PAC et le reequilibrage des soutiens a l'agriculture francaise', University of Rennes http://ideas.repec.org/p/rae/wpaper/201010.html

B) An ineffective tool to boost farmers' competitiveness or food security

The current structure of the CAP gives rise to opportunity costs with respect to production and competitiveness. This takes place in at least two ways. Firstly, due to its universal eligibility criteria, the CAP undermines the overall competitiveness of Europe's farming industry by channelling funds away from areas and business where funds can generate the biggest return. Contrary to what the Commission claims, this actually undermines food security.[33] Secondly, by acting as a form of income support, CAP subsidies, and the SPS in particular, can act as a brake on farm modernisation and adjustment by allowing inefficient farmers to stay in businesses. As Defra has noted:

> *"we also need to stimulate a change in behaviour rather than entrench continued reliance on subsidy which is increasingly difficult for the European taxpayer to afford."*[34]

This problem is unintentionally summed up by the Commission in studies looking at the "profitability" of farms. For example, a 2007 study revealed that without the subsidies, the percentage of "profitable" farms would fall from 35% to under 20%, while only a quarter of the large livestock and crop farms would be able to recoup their operating costs.[35] Of course, businesses that need subsidies to survive are by definition not "profitable" so the Commission's reasoning is circular. It follows that if the Commission really wanted to see improvement in these areas, it ought to target support at structural changes which would allow farms to adapt and become viable businesses.

C) An ineffective tool to encourage bio-diversity and best land management

While the CAP reforms of the last two decades have disincentivised over-production and intensive farming, and therefore removed some negative effects on the environment, the policy still marks a major and ongoing misallocation of resources with respect to delivering public and environmental goods.

As we highlight below, the actual share of CAP funding spent on delivering explicitly environmental benefits is small. Under Pillar 1, farmers are required to keep the land in good shape and abide by some environmental standards (cross-compliance) in return for direct payments via the SPS. However, in reality, the rules are minimal and largely covered by existing legislation. Defra estimates farmers only spend between 0.5% and 2.5% of the subsidy received on complying with the environmental obligations attached to it.

Pillar 2 has more of an environmental focus, requiring each rural development programme to ensure that natural resources and the landscape are safeguarded. In addition, 25% of funds must be spent on improving the countryside and the environment. But Pillar 2 accounts for a small share over the overall CAP budget.

Taken together, in the UK only 13.6% of CAP subsidies were tied to 'green' objectives in 2010.This is still above the EU average, however. An ECIPE paper estimated that over the 2007-2013 period, only 10% of the overall CAP budget was being invested in clearly 'green' subsidies.[36] Likewise environmental groups have consistently argued that the CAP delivers insufficient environmental benefits.[37] Given that this is one of the CAP's key objectives, this is clearly a problematic state of affairs.[38]

As with competitiveness and food security, the CAP – and the SPS in particular – channels resources away from where they could generate the biggest environmental gains, resulting in a missed opportunity to maximise 'green' benefits. This is because there is absolutely no distinction under Pillar 1 between different types of land. As some areas of the country and some habitats are more biologically important

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33 One study found that the efficiency of French dairy and crops farms fell following the introduction of the SFP compared to pre-MacSharry reform efficiency rates. Desjeux Y, Latruffe L, (2010) 'Influence of Agricultural Policy Support on Farmers' Technical Efficiency: An Application to France', University of Rennes http://www.prodinra.inra.fr/prodinra/pinra/data/2010/07/PROD20101325d65_20100707013903739.pdf

34 Department for Environment, Food and Rural Affairs, 'UK response to the Commission communication and consultation: "The CAP towards 2020: Meeting the food, natural resources and territorial challenges of the future"', January 2011 http://archive.defra.gov.uk/foodfarm/policy/capreform/documents/110128-uk-cap-response.pdf

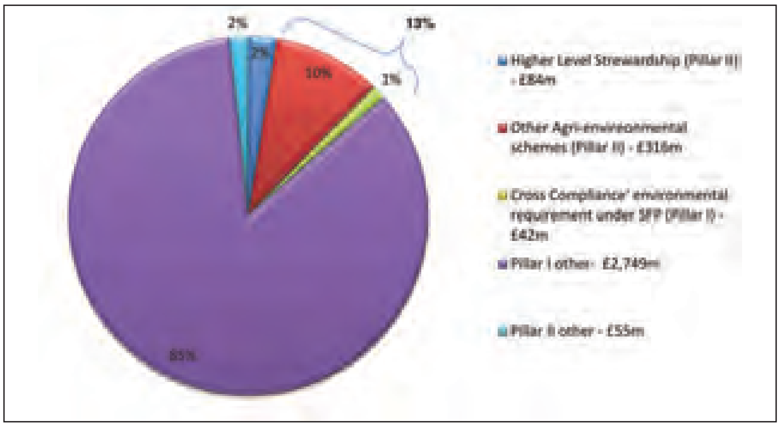
35 European Commission, DG Agriculture and Rural Development, 'CAP towards 2020 Impact Assessment: Direct Payments', 2011 http://ec.europa.eu/agriculture/rica/pdf/PO0202_direct_payments.pdf

36 Zahrnt V, 'A Guide to CAP Reform Politics: Issues, Positions and Dynamics', ECIPE Working Paper http://www.ecipe.org/publications/ecipe-working-papers/a-guide-to-cap-reform-politics-issues-positions-anddynamics

37 The Land Use Policy Group estimated in 2009 that up to £3bn would be required to meet agri-environmental targets in the UK stress that greater efforts must be made to fully integrate environmental policies into the CAP House of Commons, Environment, Food and Rural Affairs Select Committee, 'The Common Agricultural Policy after 2013', Fifth Report, April 2011 http://www.publications.parliament.uk/pa/cm201011/cmselect/cmenvfru/671/67109.htm#a22

38 The Land Use Policy Group argues that abolishing SPS would free up money to spend on the environment. Land Use Policy Group, 'Securing our Common Future through Environmentally Sustainable Land Management: the Land Use Policy Group Vision for the Future of the CAP post 2013' http://www.lupg.org.uk/pdf/LUPG_Vision_Final.pdf

Graph 7: Proportion of UK CAP receipts directed at environmental objectives in 2010



Sources: EU Commission, Defra[39]

than others, this means that resources are not effectively allocated in ways which could boost biodiversity.[40] As the RSPB has rightly pointed out, scientifically proven biodiverse habitats flourish on

Box 3: Why the Commission's proposal for 'greening' the SPS is misguided

As noted earlier, and partially in view of the issues identified above, in its recent proposals on CAP reform, the Commission has suggested 'greening' Pillar 1 as a way of addressing the weak link between the SPS and the delivery of public goods. It has proposed that 30% of payments will be dependent on farmers fulfilling three compulsory 'greening' actions:

- 7% of farmland to be set aside to provide 'ecological focus areas'
- Farms with more than three hectares of arable land should grow at least three different crops
- Areas classified as "permanent grassland" in 2014 to be maintained as such

While the intentions behind these proposals are sound, the Commission's proposed method of delivery is flawed, for the following reasons:

- ***Negative impact on production and consumer prices.*** The 7% set aside rule would remove 5.74m hectares from production across the EU, which is the equivalent of 31m tonnes of wheat production. This measure would reduce output and increase prices for consumers and producers.
- ***Environmental benefits unclear.*** The greening measures are passive, since they do not impose any requirements on farmers to upkeep the fallow land. Since the requirement to diversify crops does not apply to grassland, it is possible that farmers will choose grassland as their main source of livestock fodder, and rely on non-environmentally friendly protein supplements to replace crops previously grown on-farm. The link between the subsidy and the maximum amount of environmental benefit it can generate remains absent.
- **One-size-fits all measures.** The bio-diversity needs of Member States vary enormously, and a blanket requirement on crop diversity and fallow land will not be able to accommodate these differences. For instance, the Scottish Government has argued that the measures will upset re-seeding practices and encourage the abandonment of heather covered hills, which do not qualify as grassland.
- ***Cost to farmers.*** The Commission's Impact Assessment estimates that farmer's income will fall as a result of the greening measures. The cost of greening the EU as a whole would range between €33 and €41 per hectare of eligible farmland. Incomes of farmers in the pig and poultry section could fall by as much as 25%.
- ***Unfair for tenant farmers and small farms.*** The Tenant Farmers' Association has argued that the measures will impose unwarranted costs on tenants and small farms, who will have to pay rent on land which they cannot farm, due to the 7% requirement.
- ***EU farmers at a competitive disadvantage.*** Removing grassland from production permanently locks farms into one model of production and prevents farmers from diversifying their production, meaning that they will be less able to respond to market changes.

Source: "Greening the Common Agricultural Policy", House of Commons, Environment, Food and Rural Affairs Committee, Written Evidence, 2011[41]*.*

39 Defra states that "An appraisal of the likely costs of measures for a range of different farm types, the average compliance costs were estimated to be in the order of 0.5%, or 1.5% to 2.5% of the subsidy payment. In reality, these are lower as the figures assumed that farmers were not already meeting any of the standards." http://archive.Defra.gov.uk/foodfarm/farmmanage/singlepay/furtherinfo/crosscomply/index.htm

40 *Country Life*, 'RSPB criticises CAP reform', 1 September 2011 http://www.countrylife.co.uk/news/country/article/529126/RSPB-criticises-CAP-reform.html

41 House of Commons, Environment, Food and Rural Affairs Committee, 'Greening the Common Agricultural Policy: Written Evidence', 2011 http://www.publications.parliament.uk/pa/cm201012/cmselect/cmenvfru/writev/greening/greening.pdf

the least productive 10% of land. This is something that the CAP fails to capture: farmers in highly productive areas still receive a large chunk of subsidies despite generating fewer environmental gains.

The Commission justifies the CAP in part by arguing that taxpayers are funding environmental and other public goods which would not be catered for under a pure market system. But given the above, the Commission's defence does not stand up to scrutiny, especially regarding the SPS.

D) An ineffective tool to deliver rural jobs

Promoting "rural employment" is another CAP objective, and through Pillar 2, support can be given towards the "diversification of the rural economy", which is clearly a legitimate aim. But it is far from clear whether the CAP is the best vehicle to deliver rural *economic* development and job creation. There is an inherent tension between pursing job creation under Pillar 2, and trying to increase the competitiveness of the agricultural sector under Pillar 1. As an OECD report notes:

> *"Pillar 1 reforms create changes in the mindset of farmers who adopt a strategy of alterations in land use aiming to reach the maximum level of revenue. This has negative consequences for rural employment."*[42]

Equally, a number of studies have pointed out that the CAP has had a limited or outright negative impact on rural employment. The OECD analysis found that the 2003 reforms "have not increased jobs in the regions, at best they manage only to maintain the existing level [of employment]", while a 2010 report[43] on farms in Eastern Germany found that CAP support gave rise to "few desirable effects on job maintenance or job creation in agriculture." The effect of rural development aid was non-existent, while parallel CAP measures resulted in job losses; for every €1m spent on supporting processing and marketing for East German farms, seven jobs were lost in the short-term, and a further five in the long-term.[44] The study concluded that "the relevant decision makers should reconsider whether the CAP…is a useful policy to promote job creation in agriculture."[45]

E) The cost to taxpayers and consumers

The cost of the EU's farming policies to the wider economy comes in three guises: subsidies, tariffs, and EU regulations that farmers and others in the supply chain have to comply with. The OECD estimates that total support from consumers and taxpayers to farmers in the EU reached €105bn in 2008 (taking into account both the cost of subsidies and tariffs). Of this, the CAP subsidies represented a €52.5bn cost to taxpayers, while EU tariffs mostly accounted for the €25.3bn cost to consumers. The UK's share of this cost is €8.27bn: €4.6bn for taxpayers and €3.67bn for consumers.

The cost of CAP subsidies and tariffs does not equal the total level of support from consumers and taxpayers to producers as some is likely to come from national programmes, around €27.2bn in this case. Much of the consumer transfer is likely to have come from a mixture of CAP price support, the small amount of remaining production-linked subsidies, and the agricultural tariffs which the EU imposes. It is impossible to exactly trace where the consumer transfers come from, however, it is likely that nearly all result from CAP-related intervention in EU agricultural markets.

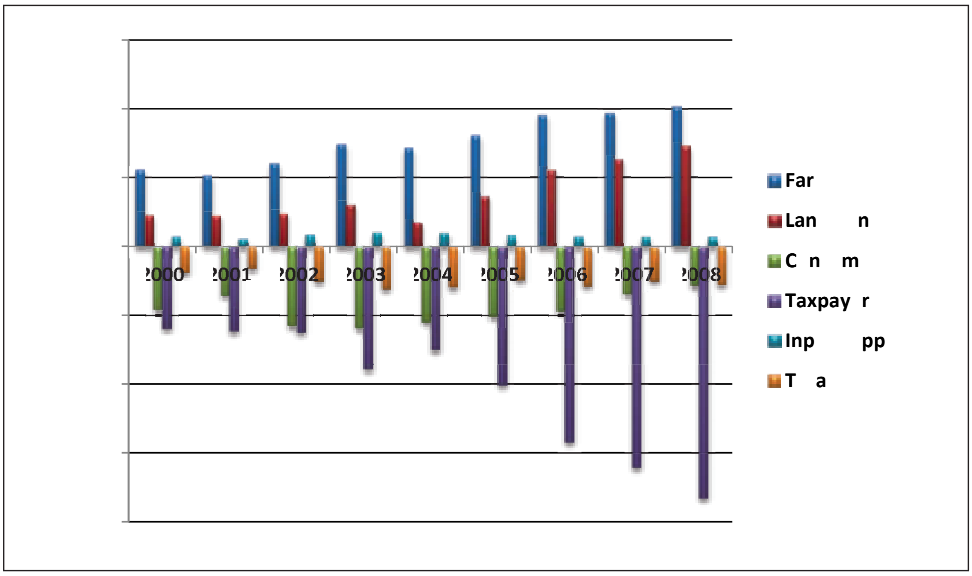
42 Mattas K, Arfini F, Midmore P, Schmitz M, Surry Y (2011) 'The impact of the CAP on regional employment: a multi-modelling cross-country approach', OECD Series 'Disaggregated Impacts of CAP Reforms: Proceedings of an OECD workshop' http://www.keepeek.com/Digital-Asset-Management/oecd/agriculture-and-food/disaggregated-impacts-of-capreforms/the-impact-of-the-cap-on-regional-employment-a-multi-modelling-cross-countryapproach_9789264097070-17-en

43 Petrick M, Zier P, (2010) 'Regional employment impacts of Common Agricultural Policy measures in Eastern Germany: A difference-in-differences approach', SiAG-Working Paper 9 http://ageconsearch.umn.edu/bitstream/93158/2/wp9.pdf

44 Defra has actively advised against turning Pillar 1 into a job creation scheme:. "UK response to the Commission communication and consultation on "The CAP towards 2020: Meeting the food, natural resources and territorial challenges of the future"", DEFRA, 2011.

45 The report also quoted 2008 findings which reveal that pre-accession aid to Slovakian farms increased farm employment at the expense of labour productivity. Petrick et al (2010)

Graph 8: Estimated distribution of the CAP's costs and benefits in EUR millions 2000 - 2008



Sources: OECD

F) Added bureaucracy

All funding schemes entail some administrative burden. However, the CAP's size and complexity, in particular its two pillar system, make it particularly costly to administer. An independent paper published by the Commission calculated that the administrative cost of the SPS under Pillar 1 was €4bn a year – 10% of total subsidies paid out.[46] The administrative cost of processing an individual claim under the SPS in the UK was estimated by the previous government at £742, which means that it cost more to administer thousands of SPS payments than it did to pay them out.[47] In 2007, 106,341 claims were made, bringing the total cost of processing SPS claims to over £78 million in the UK alone.

2.3. Conclusions

There is a fundamental misallocation of CAP resources. This is especially the case with the SPS. The CAP thus fails to:

- Redistribute funds from richer regions to poorer ones
- Invest capital where comparatively it can generate the most return with respect to productivity, economic development and jobs
- Invest capital where it can comparatively generate the most return with respect to environmental benefits

The main benefit of the CAP is that it is not as bad a policy as it was prior to a series of reforms – at least not in light of negative environmental externalities and trade distortions. However, it is hard to consider the CAP a good use of scarce public resources, given all its substantial drawbacks.

Nonetheless, some of the objectives behind the CAP, for instance biodiversity and rural economic development, are sound, and there is a role for public investment and intervention, as markets may not be able to deliver such objectives on its own. We look at how such objectives could be better delivered in the next section.

46 European Commission, 'Report on the Agriculture and Agricultural Subsidies Priority Are: EU Project on Baseline Measurement and Reduction of Administrative Costs', June 2009
http://ec.europa.eu/enterprise/policies/smart-regulation/files/abst09_agriculture_en.pdf

47 House of Commons, Hansard Written Answers, Environment, Food and Rural Affairs Committee, January 26 2009
http://www.publications.parliament.uk/pa/cm200809/cmhansrd/cm090126/text/90126w0009.htm

3. WHAT ARE THE OPTIONS FOR THE UK?

3.1 A fresh, innovative approach to supporting the countryside

In order to maximise the environmental and economic benefits resulting from CAP spending, resources need to be targeted in a far more effective way at areas where they can have the most effect. It follows that, unlike the current system, farmers with land that is best suited to agriculture must have incentives to continue to farm productively, and be properly rewarded by markets. At the same time, farmers with land of greater environmental potential and/or importance could farm in a less intensive manner, concentrating on the provision of public goods and be compensated accordingly. This is where spending public money is justified, as the markets are unlikely (but could potentially) sufficiently reward farmers for providing such environmental benefits.

We propose a four-pronged CAP reform programme to achieve this.

Step 1) Replacing the SPS with an agri-environment points system

For funding to generate the most environmental benefits, two measures should be put in place. The value of environmental goods must be evaluated and a mechanism for allocating the available funds to the best projects should be established. Defra and Natural England both have considerable expertise and have established metrics to classify land based on the benefits it generates, with respect to biodiversity and other aims.[48] In effect, these metrics attach a 'value' to every hectare of land through a points system, putting a clear price tag on the public good that needs to be delivered (in contrast to Pillar 1).

Farmers would then be compensated on the basis of the 'green' benefits they can deliver. The system would broadly be based on the idea of *environmental offsetting* - compensating for the damage done to the environment by one activity by pursing another activity elsewhere. However, unlike mere off-setting, the policy would strive to deliver a net benefit to the environment by incentivising farmers to actively deliver a public good regardless of whether or not harm had had occurred elsewhere.

In practice, this could work as follows:

- Each farm would be entitled to apply for subsidies, which would be linked to an obligation to undertake environmental work, similar to the logic behind the UK's existing environmental stewardship schemes (ELS, HLS etc.). The work carried out would be valued according to a scale or point system, which would quantify how much each activity is worth economically, and pay out the subsidy accordingly. For example, growing crops suitable for birds, creating wetlands, achieving sustainable use of water resources, and a range of other activities would all be worth different points.[49]

- Each farm then has a choice. It can choose to spend the resources on providing the public good in return for the payment, or, if it considers that the cost of doing so outweighs the benefit of the subsidy, it can forego the subsidy, which can then be transferred to farms that could generate the same environmental benefit (i.e. achieve the same points) at a cheaper cost.

- The exact transfer mechanism would need to carefully explored and tested. However, there are several options:

    - Farmers could transfer the obligation and the subsidy between themselves, depending on who can deliver the environmental benefit the cheapest. The more productive farmers would have an incentive to take part in the system, as they would have the opportunity to keep part of the subsidy in return for providing a basic environmental good. The rest of the subsidy could be passed on to another farmer.

    - A single pot of money could be established centrally and any farmer would be eligible to apply. Subsidies would then be awarded by the government, possibly in cooperation with other bodies, based on which farmer could deliver the most environmental benefits the cheapest using the metrics or points system discussed above.

48 Defra is currently piloting a number of environmental offsetting schemes; http://www.defra.gov.uk/environment/natural/biodiversity/uk/offsetting/

49 Activities can include, sowing areas with crops suitable for birds, creating wetlands, sustainable use of water resources, habitat restoration such as fenland, marshland, hay meadows, broadleaf woodlands and orchards, allowing areas to be flooded for environmental and flood defensive purposes, improving public access, improving animal welfare. Some more specialist schemes are available on http://www.environmentbank.com/example.html

- The idea here is that since the most biodiverse habitats flourish on the least productive land, and vice-versa, there would be a fairly natural re-alignment between subsidies and farmers. Apart from abiding by some basic criteria and receiving a very limited payment (though this would be voluntary), the farmers sitting on productive land would likely forego the subsidy. For these farmers, there would be a real economic cost attached to the obligation, which would not be offset by the payment received. The reverse situation would be true for farmers who own less productive land, who could deliver environmental benefits more cheaply and use this as the main source of 'profit'. These farmers would enter the business of delivering a public good. A similar idea has been floated by Professor David Hill, the Deputy Chair of Natural England.[50]

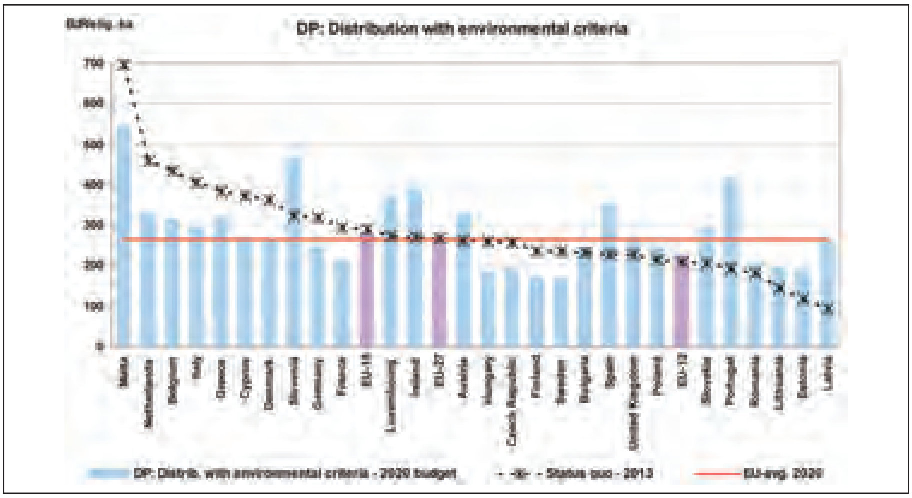
- Funding for this new environmental offsetting or allowance scheme would come from the complete abolition of Pillar 1. A majority of the money currently allocated under the SPS would be re-directed towards the new scheme.[51] The scheme would be administered nationally, and the EU would have a say in determining the total allocation of allowances per member state, and maintain a supervisory capacity to ensure individual member states do not attempt to re-couple the subsidy to production (which already is prohibited by WTO rules).

More detail on how this could work in practice is contained in Annex 1.

How would funding for the new scheme be determined?

To avoid the arbitrary allocations currently taking place under Pillar 1, the Commission has suggested a range of alternative criteria for allocated funds, including a model based on member states' environmental needs. The model is sensitive to varied habitats and the environmental make-up of different states, and would eliminate many of the current inequalities in the SPS allocations. Under this scenario, the UK would also see its payments per hectare increasing slightly, by around 10%.

Graph 9: Allocation of subsidies per hectare based on environmental criteria



Sources: European Commission[52]

Step 2) Devolving rural development for richer member states

While there is a case for continued EU support for rural economic development, there is no proven benefit of having this contained within the CAP, as opposed to other programmes, as the Commission admitted in a leaked 2009 report on the size and shape of the EU budget.[53] Therefore, we propose that Pillar 2 should be abolished in its current form, with funding migrated over to the EU's structural funds, which will be specially geared towards cohesion and growth in rural and disadvantaged areas. However, this funding would be focussed exclusively on poorer member states, and rural development policies would be devolved back to richer member states (see Annexes 6 and 7).[54]

50 Professor David Hill, House of Commons, Environment, Food and Rural Affairs Committee, Oral Evidence taken on the Natural Environment White Paper, 25 January 2012; http://www.publications.parliament.uk/pa/cm201012/cmselect/cmenvfru/uc1357-iv/uc135701.htm

51 The remaining legacy market intervention mechanisms under Pillar 1 would also be removed.

52 European Commission Staff Working Paper, 'Common Agricultural Policy towards 2020, Impact Assessment Annex 3', October 2011; http://ec.europa.eu/agriculture/analysis/perspec/cap-2020/impact-assessment/annex3ad_en.pdf

53 European Commission, (2009)' A reform agenda for a Global Europe [Reforming the budget changing Europe] 2008/9 budget review'.

54 Open Europe has proposed that a similar threshold should apply to the structural funds as well. See *Open Europe*, "Off target: the case for bringing regional policy back home" , 24 Jan 2012, http://www.openeurope.org.uk/Content/Documents/PDFs/2012EUstructuralfunds.pdf

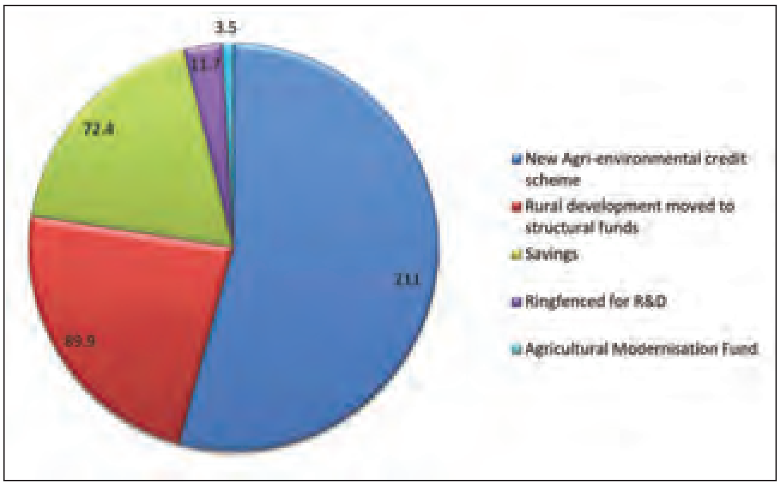
Step 3) Research & Development remain at the EU-level

Since the EU could benefit from economies of scale, we believe there is some merit in having EU-level spending on R&D, focusing on developing new crops and farming technologies (currently delivered through Pillar 2). Currently, 3% of the CAP budget could be ring-fenced for this purpose and merged with other R&D budget lines, mirroring targets entailed in the old Lisbon Agenda.[55]

Step 4) Funding targeted at transition and modernisation

The main long-term goal of EU agricultural policy should be to help agriculture move away from taxpayer support. Objectives relating to farm modernisation are currently delivered through Pillar 2, but there is a case for having a pot of money available at the EU level, which would help farmers adjust to structural changes in agriculture, diversify rural incomes and boost farm competitiveness. This could take the form of a separate fund under the auspices of the EU's existing Globalisation Adjustment Fund with a similar €3.5bn funding envelope.[56] This would be financed through current Pillar 2 funding before it is devolved back for richer member states. Indeed, the Commission has already proposed that farms should be eligible for support from the Globalisation Adjustment Fund over the upcoming 2014-2020 framework.[57]

Graph 10: New CAP structure as proposed by Open Europe (€bn)



Sources: European Commission, Open Europe calculations

How large would the overall budget for the new CAP budget be?

Given the need in the current financial climate to make savings at the EU-level to match those made by member states, the old Pillar 1 component of the CAP ought to be cut by at least 30%, the amount by which Defra's funding has been reduced.[58] The remainder would then go towards funding the proposed agri-environmental allowances scheme. The total saving from this measure would equal €72.4bn, which would allow the UK to reduce its net contribution to the EU budget by €7.7bn (£6.3 bn)[59] and save another £1bn by devolving rural development back to Britain, resulting in a net savings of £7.3bn over seven years.

3.2. The status quo or minor reforms

Even the European Commission has accepted that the status quo is not an option. Indeed a new reform package announced in October 2012 contained a number of incremental changes. However, this package is not intended to fundamentally re-examine the suitability of the CAP overall, but appears to be designed to update the justification of the CAP in these economically difficult times, where all public expenditure is coming under closer scrutiny. In addition to the absence of a central theme, the changes include a problematic definition of 'active farmer', which is in direct contradiction to the aim of promoting diversification of agricultural incomes. The cap on the amount an individual farmer can claim seems contradictory, as it would impose an artificial ceiling on farm sizes, in turn penalising competitive

55 European Commission, 'Lisbon Strategy for Growth and Jobs: frequently asked questions' http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/07/568&format=HTML&aged=0&language=EN&guiLanguage=en

56 Like the Globalisation Adjustment Fund, it will be off-budget, and only accessed if necessary.

57 European Commission, 'Proposal for a Regulation of the European Parliament and of the Council on the European Globalisation Adjustment Fund (2014-2020), 2011 http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2011:0608:FIN:EN:PDF

58 House of Commons, Ministerial Statement, 'Impact of the Comprehensive Spending Review', November 2011 http://www.publications.parliament.uk/pa/cm201011/cmselect/cmenvfru/writev/611/m01.htm ;

59 Assuming the 30% saved from the old Pillar 1 funding is re-allocated back to member states along the same lines as their average contribution to the EU budget over the framework period.

businesses.

Agreeing to the Commission's proposals would renew the EU's commitment to the CAP, without ensuring real changes. However, it would be politically 'cheaper' in Europe (but not necessarily domestically) than trying to secure comprehensive reforms, as the UK would avoid drawn-out and most likely bitter negotiations with the Commission and other member states.

Further incremental reforms

The UK could seek to continue the strategy of slow, incremental reform, albeit with alternative proposals to those put forward by the Commission. A whole host of groups, most of whom have a vested interest in maintaining the CAP in one form or another, have put forth proposals for reforms, including the removal of some of the worst aspects of the CAP, such as the remaining export subsidies (an idea suggested by the NFU)[60] or moving further on 'greening' (supported by organisations such as the RSPB).[61] From the point of view of the UK and other reform-minded member states, such reforms could include:

- *Continued modulation:* moving even more money (way above the 5% proposed by the Commission) from Pillar 1 to Pillar 2, where there is a clearer link to a public good delivered, and from which the UK is doing proportionally better in cash terms.

- *More flexibility:* pushing for greater national flexibility in deciding how the money that member states receive is spent within each Pillar.

- *Better allocation:* a move away from current historic allocations as part of an objectively designed future allocation key for both Pillars.

3.3. Reform through 'downward pressure'

As outlined in Section 1, the UK Government's current strategy is to achieve reform of the EU budget as a whole through 'downward pressure'. This involves placing a ceiling on spending, and trying to ensure that the available cash will be better spent. Net contributors and net recipients are forced to make tough choices on what to prioritise.

So far, this strategy has resulted in some success. The UK and several other countries have committed to freeze the EU's next long-term budget, which will, at the very least, prevent the CAP from increasing in *relative* terms.[62] The problem with this approach is that it still tends to allow vested interests to set the pace. For example, the CAP budget for the 2014-2020 period is likely to remain roughly the same, even if the UK and other member states manage to freeze the overall budget, while the structure of the subsidies – and most importantly the SPS – has not changed much.[63] This option would clearly be superior to 3.2, but it would still keep a flawed CAP in place.[64]

3.4. Liberalisation

The UK could seek to convince other member states to embark on a programme of liberalisation, similar to the one New Zealand has successfully undergone, or Sweden's reforms implemented in the 1990s before it joined the EU.

This option would involve liberalising the farming industry, allowing for a 'single market in farming' akin to the ones existing for other sectors such as pharmaceuticals, chemicals, services or cars. The market would be subject to a common set of EU and WTO rules including guidelines on state aid, but would not receive EU-level subsidies. Removing subsidies should not be confused with removing external agricultural trade tariffs – as noted above, these are covered by trade policy, not the EU budget. As long as the tariffs remained in place, farmers would remain shielded against proper

60 NFU Policy, 'The CAP after 2013' http://www.nfuonline.com/article.aspx?id=2147485501&terms=cap+after+2013

61 RSPB, 'Farming reforms must deliver for wildlife: RSPB Cymru raises concerns over CAP proposals', 13 October 2011 http://www.rspb.org.uk/news/292379-farming-reforms-must-deliver-for-wildlife-rspb-cymru-raises-concerns-overcap-proposals

62 BBC News, 'Cameron announces EU budget free pact', 17 December 2010 http://www.bbc.co.uk/news/uk-politics-12017053

63 Budget sees a small reduction from Eur 57bn to Eur 51 bn European Commission, 'Proposal for the 2014 – 2020 Multiannual Financial Framework', 6 December 2011 http://www.eubusiness.com/topics/finance/fin-framework.2014-2020

64 It is also worth bearing in mind that the UK rebate is only applicable on funding to 'old' Europe meaning that transferring funding to the new states under the existing arrangements could lead the UK's rebate to dwindle.

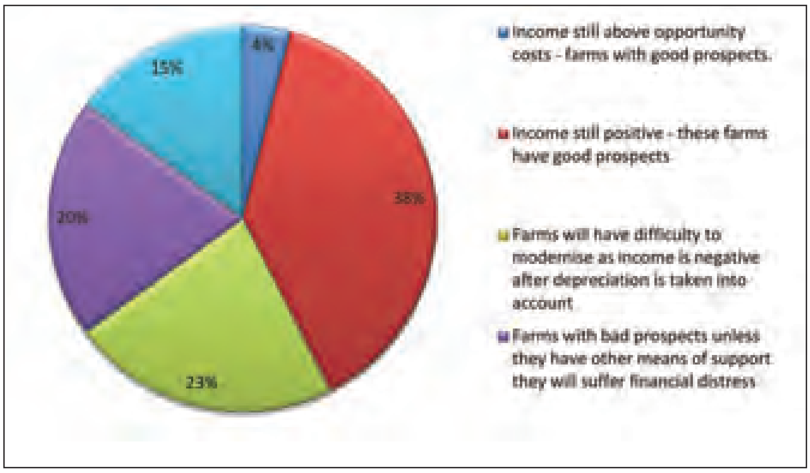
competition from farmers around the globe. However, the removal or lowering of subsidy and tariff levels are both usually involved in discussions about agricultural liberalisation. We briefly consider the effects of reform to the two policies below.

What would happen to farmers if CAP subsidies were scrapped?

As the experiences in Sweden, which liberalised its agricultural sector shortly before joining the EU, and New Zealand, which abolished all subsidies after 1986 show, liberalisation is possible and can be economically beneficial, while allowing the vast majority of farmers to stay in business. Annex 4 details how the agricultural sectors in these two countries coped with large-scale liberalisation. There have been a number of studies on the impact of the hypothetical removal of EU subsidies on the regions' farmers, and a range of studies looking at the impact of removing the tariffs as well. Most studies point to a decline in the number of farmers and a more or less detrimental impact on the economy. However, almost all studies use static models that fail to take into account a range of adjustments which could take place if the subsidy were removed. For example, farm gate prices could rise, efficiencies could be made, incomes diversified, and land adapted to more profitable crops.[65]

One Dutch study looking specifically at the removal of the Single Farm Payment concluded that around 15% of UK farms would not survive without these subsidies, and many others would suffer financial distress.[66]

Graph 11: Even without CAP 85% of UK farms could still be viable



Sources: Vrolijk, H.C.J. et al (2010)

The 2009 Scenar 2020-II study for the European Commission concluded that land use would fall by 6% over the 2007-2020 period, and agricultural wages would rise by half the rate they would otherwise.[67] Interestingly, the 6% reduction in farm use is less than the 7% that the Commission has proposed should be set aside under 'greening' of Pillar 1 (see section 2.2).[68] Other studies have highlighted the negative impact on employment in the farming sector.[69] Crucially, the SCENAR 2020-II report concluded that the removal of tariffs would have only a very small impact on land use, resulting in a 1% contraction of farmland in use. In fact, the removal of subsidies was found to have a greater impact (see graph 12).

65 This scenario also fails to explain how a non-production linked payment such as the SFP should have such a dramatic effect on production. In theory at least the removal of a decoupled payment shouldn't effect farm incomes as the cost of land (or rent) decreases to fill the gap.

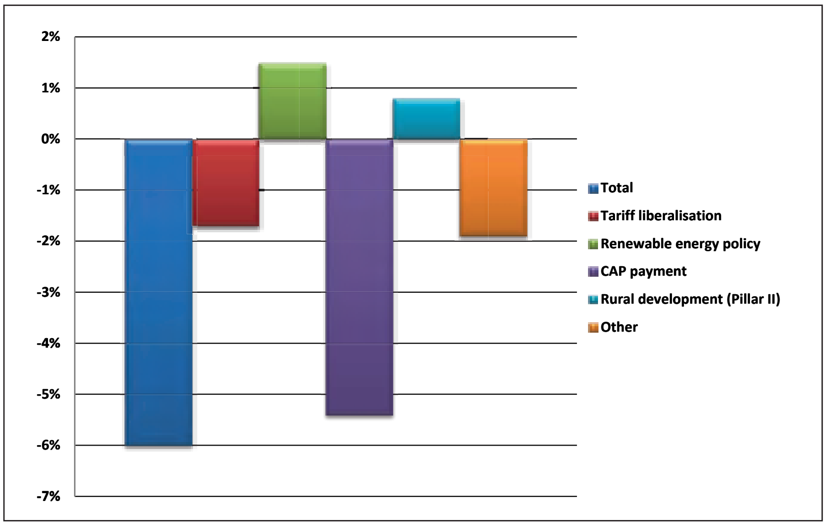
66 In this study all but up to 15% of farms could continue farming in the immediate aftermath of the subsidy being withdrawn. However, they point out that in many cases this is due to ignoring depreciation on plant and machinery, meaning that these farms would find it hard to replace these items and so in the long rum become unviable. Vrolijk HCJ et al (2010)

67 European Commission, 'Scenar 2020 II- Update of scenario study on agriculture and the rural world', December 2009 http://ec.europa.eu/agriculture/analysis/external/scenar2020ii/index_en.htm

68 European Commission, 'Update of Analysis of Prospects in the Scenar 2020 Study: Preparing for Change', December 2009 http://ec.europa.eu/agriculture/analysis/external/scenar2020ii/report_en.pdf

69 This scenario also fails to explain how a non-production linked payment such as the SPS should have such a dramatic effect on production. In theory at least the removal of a decoupled payment shouldn't effect farm incomes as the cost of land (or rent) decreases to fill the gap.

Graph 12: The effects on agricultural land use of the abolition of Tarrifs and CAP payments 2007-2020



Sources: OECD, LEITAP[70]

Impact on the wider economy

However, as we note above, the impact on farmers is only one of many considerations that need to be taken into account when considering whether the CAP is the best use of public resources. The liberalisation of the farm sector can generate much wider economic benefits. According to widely cited figures from the OECD, in 2008 – the last year for which the organisation undertook the exercise – the cost of supporting farmers to EU taxpayers and consumers stood at €105bn. We expect this figure to be roughly similar today.[71] Of this cost, €86.9bn stemmed from either CAP subsidies or EU tariffs, while the rest (€27.2bn) resulted from the various support mechanisms put into place by the EU member states themselves (which we have excluded from our calculations since they are not locked in at the EU-level).[72] This cost is broken down as follows:

- €52.5bn: the direct cost to taxpayers of subsidising farmers through CAP subsidies, simply mirroring the amount of subsidies that farmers get through the CAP every year (which, on average, is now actually €55bn, as we set out in section 1)

- €25.5bn from consumers, stemming from EU tariffs on farm produce, which creates artificially high prices in the EU compared to the prices on global markets

Therefore, removing the EU's various support measures for farmers could save EU consumers and taxpayers €86.9bn annually.[73] Of this, 13% (€9.1bn) would go to consumers and the rest (€77.8bn) to taxpayers.

However, there could also be substantial positive knock-on effects from liberalisation, which could allow the money freed up to be invested in more productive parts of the economy. The actual benefit would therefore be higher than the total money saved. The figures below give an illustrative example of how much the EU economy could gain, should the funds currently spent through EU farm policy be invested elsewhere.[74] (see Annex 5 for full explanation of these figures).

70 OECD (2011) 'Disaggregated Impacts of CAP Reforms: Proceedings of an OECD Workshop' http://books.google.co.uk/books?id=aAGeW__5fOMC&printsec=frontcover#v=onepage&q&f=false

71 Given that the structure of the CAP has not changed, and the difference between prices on the global market and EU market remains relatively narrow (a determining factor).

72 Some aspects of these costs are naturally transfers between different actors in the economy (such as taxpayers, consumers and producers) since these represent only the cost of support to EU farmers. For simplicity we assume here that any transfer from consumers or taxpayers to producers would likely be crowding out already productive investment, as such we see the entire cost to consumers and taxpayers here as a dead weight loss to the economy, which would be returned with liberalisation of the support mechanisms. For example the subsidies could be obtained through borrowing from the private market (since they are not directly linked to production). There may be some additional incremental cost to this which is missed out here, but it is likely to be small and difficult to estimate under our scenarios.

73 We assume here that any transfer from consumers or taxpayers to producers would likely involve crowding out already productive investment. As such we see the entire cost to consumers and taxpayers here as a deadweight loss to the economy, which would be reversed if the support mechanisms were liberalised. For example the subsidies could be obtained through borrowing from the private market (since they are not directly linked to production).

74 To calculate the hypothetical saving to the economy we treat this saving as a direct injection into the economy, assuming that the support mechanisms and regulations use up resources and assets that could have been deployed productively in other ways, and that those other uses would have produced a direct value equivalent to the regulatory or subsidy cost.

Hypothetical benefits to the EU economy

Cuts to support	Direct boost to output (€ bn)	All economy output multiplier	Indirect boost to output (€ bn)	Total boost to output (€ bn)
100%	86.9	1.6	52.14	139.04
50%	43.45	1.6	26.07	69.52
25%	21.725	1.6	13.035	34.76

Source: Open Europe calculations[75]

In other words, the potential benefit of large-scale liberalisation of the CAP to the EU as a whole could be the equivalent of adding €139bn to the EU's annual economic output. We can also do similar calculations for the UK. The initial savings would be €8.27bn, €4.6bn for taxpayers and €3.67bn for consumers. Full liberalisation would generate the equivalent of a €14.2bn boost to the country's annual output.

Hypothetical benefits to the UK economy

Cuts to support	Direct boost to output (€ bn)	All economy output multiplier	Indirect boost to output (€ bn)	Total boost to output (€ bn)
100%	8.27	1.72	5.95	14.22
50%	4.14	1.72	2.97	7.11
25%	2.07	1.72	1.49	3.55

Source: Open Europe calculations

Translated into full time job equivalents (FTE) – the indicative impact on employment – a 100% liberalisation is equal to 135,000 jobs in the UK.

Hypothetical benefits to the UK economy, FTE

Cuts to support	Direct boost to GDP (€ bn)	Percentage increase in GDP (%)	Total increase in employment ('000)
100%	8.27	0.0005	135.21
50%	4.14 0.	0003	78.84
25%	2.07	0.0001	39.42

Source: Open Europe calculations

Although such reforms would clearly expose farmers to tougher global competition, the wider impact on the EU and UK economy from the liberalisation of agricultural support in the EU could be overwhelmingly positive.[76] However, it is worth noting that it is questionable whether it would be politically possible to introduce such radical reforms.

75 There is a wide range of literature on the topic of all economy multipliers but the basis for our estimate were figures produced by the European Commission in their 2009 assessment of the EU industrial structure, see here: http://ec.europa.eu/enterprise/newsroom/cf/_getdocument.cfm?doc_id=5580 Supported by similar evidence here: http://www.voxeu.org/index.php?q=node/6314

76 See also OECD (2011) 'Liberalising trade in food and agriculture: what is the best way forward?' http://www.oecd.org/document/18/0,3746,en_21571361_43893445_44365330_1_1_1_1,00.html

3.5. Opting out

If reform of the CAP does indeed prove to be impossible as has often been argued, the UK could seek to opt out of this policy area completely. This could happen in a number of ways:

- *An opt-out:* Though it has never been tried before, the UK could seek an opt-out from the CAP, similar to what it has from other EU policy areas such as the Schengen area, or the euro. The exact nature of such an opt-out would need to be explored, but the basic principle would be that UK contributions and receipts are both taken out of the CAP redistribution, leaving the UK free to run its own farm policy. However, due to the UK rebate from the EU budget, it is not entirely clear whether this option would actually reduce Britain's net contribution to the EU, as this may fall by less than the rebate does (under a scenario in which the UK remains part of all other EU budget policies).

- *Semi-detachment:* The UK could also withdraw from the CAP as part of a wider effort to fundamentally restructure its relationship with the EU. There would be a huge number of issues associated with such an option with far-reaching impact on UK farmers. It is questionable whether Britain could seek to regain control over its own tariff regime (i.e. withdrawing from the Common Commercial Policy).

- *Contributing to rural development outside the EU budget:* Under the above two options, the UK could still seek to contribute to rural development and bio-diversity in poorer countries that cannot afford it themselves, through its own subsidy scheme. For example, Norway runs its own regional development scheme outside the EU's structural funds.

ANNEX I: HOW WOULD AN AGRI-ENVIRONMENT POINTS SYSTEM WORK?

An illustrative example:
Under our proposed agri-environment scheme, farmers could transfer their obligation to undertake environmental work to farm which could have greater scope for cheaper environmental improvement (i.e. a farm on marginal land). For example:

- *Farm A. An efficient grain farm situated on top quality agricultural soil.* This farm receives the UK average of, say, £77 per acre (the level of SPS under Pillar 1). The subsidy will now come with a requirement to achieve 77 environmental points. But crucially (unlike the current 'greening' proposals), the points can be achieved by another farm. Therefore if the cost to farm A of achieving one credit or point is 70p, as a result of taking prime land out of production, the benefits of it being a part of the scheme are low.

- *Farm B. A grassland farm on marginal land.* This farm also receives £77 per acre. However this farm's cost of achieving an environmental point is only 20p.

Farm A could transfer the obligation for achieving the environmental points to farm B. In this case, farm A currently makes a 'profit' of 30p on each point. If Farm A pays Farm B 50p to achieve the environmental point, both farms will profit. Farm B will make 30p (50p less the 20p cost of the work) and Farm A will make 50p (£1 less the cost of paying Farm B) which is more than either currently earn. The example below shows how farmers and the environment can benefit from a transfer scheme:

	Farm A (prime land)	**Farm B (marginal land)**
SFP £ per acre	£77.0	£77.0
Environmental points to be achieved per acre	77	77
Cost per point of environmental work	-£0.7	-£0.2
	-£53.90	-£15.40
Profit per point	£0.3	£0.8
Profit from points per acre without transfer mechanism	£23.1	£61.6
	With transfer across farm boundaries	
Payment between farms per point	-£0.50	
Total payment from Farm A to B per acre	-£38.50	£38.50
Cost of environmental work	-	-£15.40
Profit after transfer	£38.50	£84.70

ANNEX 2: EXISTING AND POTENTIAL ENVIRONMENTAL POINTS SCHEMES

Existing Entry Level Scheme:

Entry Level stewardship Scheme points (one point = £1)	
Option description	**Points available**
Enhanced hedgerow management	42 per 100m
Permanent grassland with low inputs	85 per ha
Ditch management	24 per 100m
Management of field corners	400 per ha
Wild bird seed mixture	450 per ha
12m buffer strips for water courses on cultivated land	400 per ha
Skylark plots	5 per plot[77]

Potential new extension:

More Ambitious Open Europe Scheme	
Option description	**Points available** (for illustrative purposes)
Recreation of traditional hay and water meadow	150 per ha
Management of restored Chalk down land	100 per ha
Management of restored traditional Orchards	100 per ha
Recreation of fenland, saltmarsh or broadleaved woodland or sites for the establishment of metapopulations of reptiles and amphibians.	300 per ha
Recreation of low intensity farmland with public access	150 per ha
Restored heather moorland	80 per ha
Land used for the reintroduction or maintenance of rare species	100 per ha

77 Natural England, 'Entry Level Stewardship' http://www.naturalengland.gov.uk/ourwork/farming/funding/es/els/default.aspx

ANNEX 3: LARGE VERSUS SMALL CONSERVATION AREAS

One of the potential consequences of an environmental offsetting or points system is that environmental restoration and improvement work would be clustered in areas where the benefits to the environment are maximised, potentially creating large contiguous areas of environmentally rich landscape. There is a debate in conservation circles as to whether the benefits of conservation are best accomplished in large contiguous pieces of environmentally rich landscape, or on landscapes where environmental benefits are more widely dispersed. Although there is a need to protect smaller specific areas required for specific species (already covered for instance by SSSI legislation) we believe there are significant benefits to be had from the creation of larger areas, including:

- *Wildlife corridors:* The survival of certain species depends on the creation of larger areas to maintain species population and prevent atomisation. If conservation land is split into smaller areas, the viability and adaptability of species is adversely affected.

- *Areas able to accommodate mobile species*: Some species, primarily birds and large mammals require large territories in order to create viable populations. The fragmentation of surviving natural habitats in the UK has made a number of these unviable.[78] [79]

78 See here for a discussion of the relative merits of these two schools of thought. Boyd C et al, (2008) 'Spatial scale and the conservation of threatened species', Conservation Letters Volume 1, Issue 1
http://onlinelibrary.wiley.com/doi/10.1111/j.1755-263X.2008.00002.x/abstract;jsessionid=FC9DD514E2F303FCC3ABED219EA02360.d02t04 pages 37–43

79 For instance the reintroduction of the Giant Bustard has required a contiguous managed area of grassland on Salisbury Palin, RSPB, 'Reintroducing the great bustard to southern England'
http://www.rspb.org.uk/ourwork/projects/details/282720-reintroducing-the-great-bustard-to-southern-england

ANNEX 4: THE EFFECTS OF LIBERALISATION IN SWEDEN AND NEW ZEALAND

Sweden

Sweden, prior to joining the EU, had embarked on a full scale program of agricultural liberalisation. Starting with a system broadly similar to the current EU set-up, Sweden chose to remove market support mechanisms, export subsidies and quotas. In helping to achieve a political consensus for reform, it was argued that the distortions present in agriculture skewed support away from its intended recipients (smaller farmers and the North) and towards larger farmers in the South, hurting the environment and increasing inflation.[80] The reforms were never fully implemented, and were eventually reversed when Sweden joined the EU in 1995. However, in their short lifetime, the reforms had a positive effect on the Swedish economy in terms of inflation food prices, and reduced the deadweight of support. Crucially, the negative results to farmers of these measures were limited:

- *Prices of agricultural products declined:* Between 1989 and 1993 producer prices fell in nominal terms by almost 10% - a real decline by 30.2%. Food prices also declined.

- *Mixed impact on production:* Milk production declined by 8% from 1989 to 1992 before rising again. Lower pork prices contributed to increased consumption and the number of sheep and suckling cows also increased considerably.

- *380,000 hectares of arable land were initially taken out of production.* However, it is estimated that just 80,000 hectares were permanently removed from production and transferred to alternative activities.

- *Farm numbers declined.* Between 1989 and 1993, the number of farms declined from 98,600 to 91,500, as some farms naturally restructured and were required to modernise.[81 82]

New Zealand

Britain's membership to the EEC in 1973 caused a major realignment of New Zealand's trade outlook, dramatically affecting its agricultural exports.[83] New Zealand at first responded to the withdrawal of a major market by increasing subsidies and incentives to produce. However in a small agricultural economy these swiftly became unsustainable, and in 1984, the government decided to push through a full liberalisation programme of the sector, combined with a currency devaluation. This strengthened the competitiveness of the country's farming sector, though this was helped by a simultaneous depreciation of the New Zealand currency (giving an advantage to its exports). The New Zealand reforms show that agricultural markets and farms do adjust to liberalisation. The wider benefits were also apparent in the removal of costs to the state and lower inflation.[84]

As in Sweden, the negative effects were limited. Only 800 farmers, or 1% of the total number of commercial farmers in operation, ceased production. Sheep farmers, the group most heavily subsidised, were hardest hit. It took six years for land values, commodity prices, and farm profitability indices to stabilise.

80 Mats Hellström, Former Minister of Foreign Trade, European Affairs and Agriculture of Sweden, Ambassador and Governor of the Province of Stockholm, Geneva 15 October 2010
http://www.iisd.org/gsi/sites/default/files/ffs_gsiunepconf_sess4_mhellstrom.pdf

81 Rabinowicz E (2003) 'Swedish Agricultural Policy Reforms', Imperial College London
http://ageconsearch.umn.edu/handle/15740 82Blandford D, Hill B, (2006) 'Policy Reform and Adjustment in the Agricultural Sectors of Developed Countries' CAB International http://bookshop.cabi.org/Uploads/Books/PDF/9781845930332/9781845930332.pdf

83 As late as 1964, New Zealand sent 61% of its total meat exports (lamb, mutton, beef and veal), 94% of its butter, and 87% of its cheese to the UK.
Sayre L, 'Farming without subsidies? Some lessons from New Zealand', Rodale Institute
http://newfarm.rodaleinstitute.org/features/0303/newzealand_subsidies.shtml

84 New Zealand's Agricultural Reforms and their International Implications R.W.M. JOHNSON; www.staff.ncl.ac.uk/david.harvey/AEF873/NZReformsJohnson.pdf

ANNEX 5: METHODOLOGY

To calculate the impact of liberalising the CAP on the wider economy, we started with the OECD figures on agricultural support. These figures outline the transfers within the EU from consumers and taxpayers to producers. The OECD estimates that total support from consumers and taxpayers to farmers in the EU reached €105bn in 2008 (taking into account both the cost of subsidies and tariffs). Of this, €52.5bn represented the cost of CAP subsidies to taxpayers, while €25.3bn was a cost to consumers (mostly from EU tariffs). The UK's share of this cost is €8.27bn, €4.6bn for taxpayers, and €3.67bn for consumers.

We used 2008, as this is the latest year where data for the transfers is available along with the deadweight loss (DWL), also taken from the OECD. We assume that all the subsidies from the CAP constitute transfers from taxpayers to producers, hence the €52.5bn figure. We assume that the remaining transfers come from national related schemes, and therefore we do not include this remaining €27.2bn in our estimates. We also assume that all the consumer support comes from EU related agricultural schemes since EU member states cannot set these nationally for the most part.

If EU agricultural support were fully liberalised, the savings would be equivalent to the value of these existing support mechanisms – in 2008, this was €86.9bn. This is the initial static benefit. To give an illustrative estimate of the dynamic effects, we apply a multiplier to these figures. First, it is assumed that these savings are taken as a direct boost to the output of the economy. In treating the cost as an injection, we are assuming that the support mechanisms and regulations use resources and assets which could have been deployed productively in other ways, and that those other uses would have produced a direct value equivalent to the regulatory or subsidy cost.

Some aspects of these costs are naturally transfers between different actors in the economy (such as taxpayers, consumers and producers) since these represent only the cost of support to EU farmers. For simplicity, we assume here that any transfer from consumers or taxpayers to producers would likely crowd out already productive investment. As such we see the entire cost to consumers and taxpayers here as a deadweight loss to the economy, which would be avoided if support mechanisms were liberalised. For example, the subsidies could be obtained through borrowing from the private market (since they are not directly linked to production). There may be some additional incremental cost to this which is missed out here, but it is likely to be small and difficult to estimate under our scenarios.

Finding an output multiplier for the EU economy as a whole is challenging and the figures should therefore only be taken as a broad estimate.[85] Our estimate is taken from a broad range of literature, but is mostly based on recent assessments by the European Commission on the multiplier effect of investment in various areas of the economy (which we then aggregated up). We then multiply the direct initial effects to calculate the indirect benefit to the economy and the overall boost to output.

The impact on the UK is calculated in a similar way. The UK's share of the initial impact is calculated by using UK shares of CAP spending financed by taxpayers' support for farmers. The UK share of the DWL and the consumer transfer is calculated using the UK share of EU agricultural imports from around the world. This is not a precise calculation, but should give a relatively good approximation of the exposure of UK consumers to the losses from price increases and market distortions which the agricultural support measures (including tariffs) create. These direct effects will also have knock-on indirect effects, which can again be estimated using an all economy output multiplier for the UK. This multiplier was chosen since money could be reinvested widely across the economy, and because it provides a general indication of how much impact it could have (it is sourced from the ONS - United Kingdom Input-Output Analytical Tables, 2005).

To calculate the full-time equivalent figures (the indicative impact on employment) we look solely at the direct effects, as these would be the most likely to directly boost employment. We take UK GDP for 2011-2012 to be £1,800bn and total employment to be 29.4m. We assume that the indirect impact on GDP will be proportionately the same on employment, therefore giving us an increase of up to 135,208 jobs.

85 There is a wide range of literature on the subject but the basis for our estimate were figures produced by the European Commission in their 2009 assessment of the EU industrial structure, see here: http://ec.europa.eu/enterprise/newsroom/cf/_getdocument.cfm?doc_id=5580 Supported by similar evidence here: http://www.voxeu.org/index.php?q=node/6314

CAP contributions

To calculate individual member states' contributions to the CAP, we assumed these were the same as the share of their direct national contributions to the EU budget. To get an overall figure for the 2007-2013 framework, we used an average of confirmed contributions from each year from 2007 to 2011. For 2012 we used the projected shares in the Commission's draft 2012 budget, while for 2013 we calculated an average of the figures for 2011 and 2012. To obtain the net contributions, we then took the difference between these figures and the Commission's figures on national ceilings on direct payments under Pillar 1, and funding allocated to member states for rural development over the whole framework under Pillar 2.

To convert the EU budget and CAP contributions to pounds, we used an average exchange rate over the past five years of 0.819 GBP to EUR (taken from the ECB's historical data) as this best captures the exchange rate over the budget period which has changed significantly over the last few years. For the CAP data we converted the figures to 2007 prices, to allow for the most up to date assessment of the contributions and receipts ahead of the budget period. To convert these figures to GBP, we used the same exchange rate as before.

ANNEX 6: SAVINGS UNDER A NEW ELIGIBILITY THRESHOLD FOR PILLAR 2

Full table of savings from Pillar 2 under eligibility threshold of GNI per capita at 90% or below the EU average

Member State	GNI per capita (% of EU average)	Eligible under new threshold?	Current Contribution	Current Receipts	Current Net Receipts	Estimated New Receipts	Estimated New Contribution	Estimated Saving Gross	Estimated Net Saving
BE	125	NO	2,813.1	288.1	-2,525.0	N/A	1,251.8	1,561.3	1,273.2
BG	43	YES	275.5	2,623.0	2,347.5	2,623.0	122.6	152.9	152.9
CZ	80	YES	1,102.7	2,793.7	1,691.0	2,793.7	490.7	612.0	612.0
DK	132	NO	1,884.1	443.1	-1,441.0	N/A	838.4	1,045.7	602.6
DE	125	NO	17,673.2	7,822.5	-9,850.7	N/A	7,864.5	9,808.8	1,986.3
EE	67	YES	118.0	715.3	597.2	715.3	52.5	65.5	65.5
IE	121	NO	1,145.1	2,408.7	1,263.6	N/A	509.6	635.6	-1,773.2
EL	93	NO	1,976.2	3,757.4	1,781.1	N/A	879.4	1,096.8	-2,660.6
ES	107	NO	8,343.2	7,454.0	-889.2	N/A	3,712.7	4,630.5	-2,823.4
FR	115	NO	16,004.8	6,439.7	-9,565.1	N/A	7,122.0	8,882.8	2,443.1
IT	107	NO	12,239.3	8,103.2	-4,136.0	N/A	5,446.4	6,792.9	-1,310.4
CY	98	NO	137.2	154.9	17.7	N/A	61.1	76.2	-78.7
LV	58	YES	153.2	1,043.0	889.9	1,043.0	68.2	85.0	85.0
LT	60	YES	230.1	1,749.3	1,519.2	1,749.3	102.4	127.7	127.7
LU	213	NO	243.7	77.7	-166.0	N/A	108.5	135.3	57.5
HU	63	YES	774.4	3,805.7	3,031.3	3,805.7	344.6	429.8	429.8
MT	81	YES	46.6	74.4	27.7	74.4	20.7	25.9	25.9
NL	139	NO	3,460.6	349.1	-3,111.5	N/A	1,540.0	1,920.7	1,571.6
AT	131	NO	2,042.7	3,881.4	1,838.7	N/A	909.0	1,133.7	-2,747.7
PL	60	YES	2,820.9	13,202.7	10,381.8	13,202.7	1,255.3	1,565.6	1,565.6
PT	81	YES	1,325.0	3,962.6	2,637.5	3,962.6	589.6	735.4	735.4
RO	47	YES	989.8	8,054.3	7,064.5	8,054.3	440.5	549.4	549.
4 SI	92	NO	291.6	895.0	603.4	N/A	129.8	161.8	-733.2
SK	75	YES	501.8	1,961.8	1,459.9	1,961.8	223.3	278.5	278.5
FI	125	NO	1,467.4	2,051.0	583.5	N/A	653.0	814.4	-1,236.5
SE	133	NO	2,282.7	1,794.8	-487.9	N/A	1,015.8	1,266.9	-527.9
UK	123	NO	9,513.7	3,950.5	-5,563.2	N/A	4,233.5	5,280.2	1,329.7
TOTALS			89,856.8	89,856.8	0.0	39,985.6	39,985.6	49,871.2	0.0

GNI figures taken as an average over the 2007 – 2010 period and expressed in terms of purchasing power parity. All cost figures in €m. Contributions to R&D and new Agricultural Modernisation Fund already accounted for.

Sources: World Bank, EU Commission, Open Europe Calculations

Full table of savings from Pillar 2 under eligibility threshold of GDP per capita at 90% or below the EU average

Member State	GDP per capita (% of EU average)	Eligible under new threshold?	Current Contribution	Current Receipts	Current Net Receipts	Estimated New Receipts	Estimated New Contribution	Estimated Saving Gross	Estimated Net Saving
BE	117	NO	2,813.1	288.1	-2,525.0	N/A	1,279.8	1,533.3	1,245.2
BG	43	YES	275.5	2,623.0	2,347.5	2,623.0	125.3	150.1	150.1
CZ	82	YES	1,102.7	2,793.7	1,691.0	2,793.7	501.7	601.0	601.0
DK	125	NO	1,884.1	443.1	-1,441.0	N/A	857.2	1,026.9	583.8
DE	117	NO	17,673.2	7,822.5	-9,850.7	N/A	8,040.5	9,632.7	1,810.2
EE	67	YES	118.0	715.3	597.2	715.3	53.7	64.3	64.3
IE	134	NO	1,145.1	2,408.7	1,263.6	N/A	521.0	624.2	-1,784.6
EL	92	NO	1,976.2	3,757.4	1,781.1	N/A	899.1	1,077.1	-2,680.2
ES	103	NO	8,343.2	7,454.0	-889.2	N/A	3,795.8	4,547.4	-2,906.5
FR	108	NO	16,004.8	6,439.7	-9,565.1	N/A	7,281.4	8,723.4	2,283.7
IT	103	NO	12,239.3	8,103.2	-4,136.0	N/A	5,568.3	6,671.0	-1,432.3
CY	98	NO	137.2	154.9	17.7	N/A	62.4	74.8	-80.1
LV	54	YES	153.2	1,043.0	889.9	1,043.0	69.7	83.5	83.5
LT	58	YES	230.1	1,749.3	1,519.2	1,749.3	104.7	125.4	125.4
LU	273	NO	243.7	77.7	-166.0	N/A	110.9	132.8	55.1
HU	64	YES	774.4	3,805.7	3,031.3	3,805.7	352.3	422.1	422.1
MT	80	YES	46.6	74.4	27.7	74.4	21.2	25.4	25.4
NL	133	NO	3,460.6	349.1	-3,111.5	N/A	1,574.4	1,886.2	1,537.1
AT	125	NO	2,042.7	3,881.4	1,838.7	N/A	929.3	1,113.4	-2,768.0
PL	59	YES	2,820.9	13,202.7	10,381.8	13,202.7	1,283.4	1,537.5	1,537.5
PT	79	YES	1,325.0	3,962.6	2,637.5	3,962.6	602.8	722.2	722.2
RO	46	YES	989.8	8,054.3	7,064.5	8,054.3	450.3	539.5	539.5
SI	88	YES	291.6	895.0	603.4	895.0	132.7	158.9	158.9
SK	72	YES	501.8	1,961.8	1,459.9	1,961.8	228.3	273.5	273.5
FI	117	NO	1,467.4	2,051.0	583.5	N/A	667.6	799.8	-1,251.2
SE	123	NO	2,282.7	1,794.8	-487.9	N/A	1,038.5	1,244.2	-550.6
UK	113	NO	9,513.7	3,950.5	-5,563.2	N/A	4,328.3	5,185.4	1,234.9
TOTALS			89,856.8	89,856.8	0.0	40,880.7	40,880.7	48,976.2	0.0

GDP figures taken as an average over the 2007 – 2010 period and expressed in terms of purchasing power parity. All cost figures in €m. Contributions to R&D and new Agricultural Modernisation Fund already accounted for.

Sources: Eurostat, EU Commission, Open Europe Calculations

About Open Europe

Open Europe is an independent think tank, with offices in London and Brussels, set up by leading UK business people to contribute positive new thinking to the debate about the future direction of the European Union.

While we are committed to European co-operation, we believe that the EU has reached a critical moment in its development. Globalisation, enlargement, successive No votes in EU referenda and the eurozone crisis have discredited the notion of 'ever closer union' espoused by successive generations of political and bureaucratic elites.

Faced with weak economic growth, rising global competition, insecurity and a looming demographic crisis, there is now an urgent need to find a new model for European cooperation, more in tune with modern economic realities and the preferences of citizens. We believe Europe has the potential to rise to these challenges and thrive as a vibrant economic region in the 21st century. Our vision is of a slimmed-down, outward-looking EU, which:

- facilitates and encourages free trade, internally and globally;
- is democratic, transparent and accountable to citizens;
- doesn't interfere in areas better – or equally well – handled locally or nationally; regulates far less but far better;
- is flexible enough to let powers flow back from the EU to its member states, and to let countries integrate with each other to different degrees.

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