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EXECUTIVE SUMMARY OF THE IMPACT ASSESSMENT

Common Agricultural Policy towards 2020

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Agriculture is at a crossroads and in the headlines: EU agriculture and its Common Agricultural Policy (CAP) are no exception. Challenges, impacts and solutions worldwide vary, but a common theme is also emerging: sustainability is at the core of solutions. This is why the overarching objective for the future CAP should be sustainable competitiveness to achieve an economically viable food production sector, in tandem with sustainable management of the EU's natural land-based resources.

Previous reforms of the CAP were mainly driven by the need to respond to challenges that were primarily endogenous to agriculture, from huge surpluses to trade agreements or food safety crises. They have served the EU well both in the domestic and in the international front. But many of the challenges EU agriculture faces today are driven by factors beyond its control, and require much broader policy responses.

The future CAP should no longer be a policy that addresses the activity of a small, albeit essential, segment of the EU economy, but one that impacts on more than half of the EU territory and all of EU consumers, and is of strategic importance for food security and safety, the environment, climate change and territorial balance. This would also enable the CAP to enhance its contribution to the Europe 2020 strategy. What such a policy direction would imply is the focus of this report.

1. PROBLEM DEFINITION

Over the last two decades, the CAP has undergone a substantial reform process, which reflects the changing societal concerns related notably to the environment, food quality and safety, territorial balance, as well as to the evolving needs of the EU economy. As a result of this process, the CAP provides today the general framework that allows the policy to address competitiveness and sustainability challenges of agriculture and rural areas across the EU territory. This framework takes the form of two complementary pillars.¹

Pillar I includes instruments related to the functioning of agricultural markets and the food supply chain (Council Regulation (EC) No 1234/2007) and to direct payments (Council Regulation (EC) No 73/2009) conditional upon statutory management requirements and good agricultural and environmental conditions.² Combined, these measures provide a fundamental layer of support to EU farmers, creating the basis for keeping sustainable farming in place throughout the EU. Pillar I measures are mandatory for Member States and, with very few exceptions, there is no co-financing. This ensures the application of a common policy within the Single Market, monitored by an integrated administration and control system (IACS).

Pillar II – rural development policy (Council Regulation (EC) No 1698/2005) - includes measures that aim at improving the competitiveness of the agriculture sector, delivering specific environmental public goods and promoting the diversification of economic

¹ For detailed characteristics of CAP instruments and their evolution see a series of Policy briefs of DG AGRI http://ec.europa.eu/agriculture/analysis/perspec/app-briefs/index_en.htm.

² As defined in Annexes II and III of the Regulation (EC) No 73/2009.

activity and quality of life in rural areas. These measures are largely voluntary, contractual in nature, co-financed and delivered within a strategic framework which links policy action to European, national, regional and local needs.

The above framework responded to the challenges EU agriculture faced during the past two decades. However, for the policy to remain relevant, the framework under which it functions has to prove itself capable also to address the main challenges which EU agriculture is expected to face in the current decade: economic, environmental and climate change pressures as well as the territorial aspects of the policy.

In the economic front, agriculture faces today a global deterioration in its terms of trade. In recent years in particular, this has been more pronounced. During the 2004-2010 period, the average level of world agricultural prices increased by 50% from its corresponding level in 1986-2003; by comparison, energy prices jumped by 220% and fertiliser prices by 150%, while exhibiting at the same time the highest degree of volatility of the past three decades.

Stable higher prices could provide clear market signals to the sector. However, high volatility, the slowdown in factor productivity growth (land, energy, fertiliser, labour), the uneven and asymmetric transmission of price changes in the food supply chain and the declining share of agriculture in the value added of the chain are expected to put additional pressure on farm profitability in the EU, and require substantial investment in more productive methods for the sector to adjust in a sustainable manner.

In the environmental front, the main drivers affecting the environmental sustainability of agriculture relate to intensification of production in some areas with abandonment and under management of land in others, as well as changing land use patterns and agricultural and forestry practices. The CAP plays an important role in maintaining sustainable agriculture across the EU territory and in promoting environmentally and climate friendly practices.

The environmental sustainability of farming is related to farmer decisions about whether to produce and what and how to produce, while market prices do not reflect the externalities linked to agricultural production and in many cases the supply of environmental public goods is insufficient. This is particularly important as modern farming puts many pressures on the environment. By contrast, certain farming systems and practices, such as extensive livestock and mixed systems, traditional permanent crop systems or organic farming, are particularly favourable for the environment and climate objectives.

The CAP should respond to these challenges by better integrating its objectives with other EU policies and adjusting its measures accordingly. The EU biodiversity strategy to 2020 requires further integration of biodiversity in key sectors such as agriculture and forestry in order to meet the ambitious EU headline target. The Europe 2020 Strategy establishes the reduction of greenhouse gases as one of the EU's five headline targets. In the Climate and Energy Package, the EU also committed to increase renewable energy uses in order to reach a 20% share in total EU final energy consumption in 2020.

Finally, with respect to social challenges, the primary sector still represents 4.9% of value added (and more, if related (food) industry is considered) and 15.7% of

employment in predominantly rural areas. This is where the role of agriculture can be particularly important, not only directly but also indirectly - through the generation of additional economic activities with strong multiplier effects, most notably with the food processing, hotels and catering, and trade sectors. These sectors in turn have further high links with the rest of the rural economy, thus helping among others remote rural areas, which have the most limited access to general services, such as schools, primary health care and banking.

1.1. The EU value added of the CAP

The added value of the CAP is in its ability to:

- respond effectively to transnational goals and cross-border challenges such as mitigating climate change, enhancing biodiversity and contributing to economic and social cohesion, the development of the Single Market and the EU trade policy, through a common set of rules, principles and objectives;
- ensure a more efficient use of the budgetary resources of the Member States vis-à-vis the coexistence of national policies (e.g. compared to a single common policy, 27 different policies would have been more costly and certainly less effective inducing different levels of intervention, a major risk for distortion of competition);
- help to develop a competitive and balanced European agriculture from an environmental and territorial point of view, which contributes positively to the competitiveness of the EU food supply chain and trade, and enhance the cohesion of rural areas by encouraging initiatives favouring their economic and social growth.

2. THE MAIN POLICY OBJECTIVES OF CAP REFORM

For the CAP to address the economic, environmental, climate change and territorial challenges, the objectives are to adapt the current CAP framework along the following lines:

- (1) Gearing the CAP measures towards increasing the productivity and the competitiveness of the agricultural sector by:
 - improving the functioning of the advisory system and creating networks (of farmers, advisors, researchers, food operators, consumers etc.) for knowledge creation and transfer and favouring innovative approaches in granting funding for projects for rural development measures
 - encouraging pro-competitive joint action among farmers in order to foster efficient use of resources, product development and marketing
 - provide incentives to use risk management instruments and active prevention strategies
- (2) Improving the environmental and climate change performance of the CAP by:

- increasing the number of agricultural areas which are under agricultural practices providing environmental and climate action benefits and encouraging the take-up of more advanced agri-environmental measures by Member States and farmers;
- (3) Enhancing the effectiveness and efficiency of the policy by:
- rebalancing the direct payment support to better reflect income support objective and environmental performance
 - reducing the disparities in direct payment support levels between Member States and farmers.

3. POLICY OPTIONS

Following a wide public debate and a series of own initiative positions from EU institutions and particular Member States, three coherent policy scenarios (adjustment, integration and re-focus) have been formulated to feed the decision-making process by exploring the continuum of possible policy evolutions in a holistic approach that also looks at the potential interactions and synergies between the main lines of policy intervention, while every element is individually assessed in specific annexes.

- The adjustment scenario focuses on adjusting the CAP in a limited way by emphasizing those elements that work well in today's CAP and addressing the major shortcomings of the current policy framework without making any fundamental changes to the policy.
- The integration scenario has the purpose of improving the targeting of CAP support to the objectives of the policy, especially by better integrating the contributions of different policy elements, which includes the introduction of new elements into the policy framework as well as substantial changes to structure of the policy.
- The re-focus scenario narrows down the focus of policy intervention of the CAP to environmental and climate change aspects while it is assumed that production capacity can be maintained without support through the reliance on market signals and the objective of contributing to the vitality of rural areas and territorial balance would be met by other Community policies.

These scenarios are cross-cutting approaches that each address the three broad policy objectives of the future CAP described in the previous section. They do, however, place different weights on the three objectives and are based, to a certain extent, on different approaches with respect to the necessity of policy intervention.

In doing so, these scenarios also address in different ways the essential risk that stems from the absence of policy intervention, market failures, and the consequent risk that stems from wrongly targeted policy intervention, policy failure. The latter risk formed the basis for discarding other policy scenarios that were presented during the public consultation.

With respect to the analysis of the effects of these scenarios, the reference is the status quo, which does not address the policy shortcomings identified in problem definition and the counterfactual scenario of having no policy at all, which is expected to lead to significant income and environmental problems.³

The scenarios are presented on the basis of implied changes in the three main lines of policy intervention, namely market measures (Council Regulation (EC) No 1234/2007), direct payments (Council Regulation (EC) No 73/2009) and rural development policy (Council Regulation (EC) No 1698/2005).

Table 1: Outline of main policy options by scenario and policy instrument

| | Market instruments (Council Regulation (EC) No 1234/2007) | Direct Payments (Council Regulation (EC) No 73/2009) | Rural Development (Council Regulation (EC) No 1698/2005) |
|--|---|---|---|
| Adjustment: <i>Emphasizing the CAP's achievements and addressing major shortcomings</i> | Streamlining and simplification of existing instruments Improving farmers' cooperation within competition rules. | Redistribution; enhanced cross compliance | Moderate increase in budget; used for competitiveness/innovation or environment |
| Integration: <i>Improving the targeting of the CAP to its objectives</i> | Streamlining and simplification of existing instruments Focus on food chain and improved bargaining power of farmers (3 sub-options) | Redistribution; new direct payment architecture; "greening" Enhanced cross compliance; capping; small farmer scheme; young farmer scheme | Redistribution between Member States Innovation, climate change and environment as guiding principles; Reinforced strategic targeting and common strategic framework with other funds |
| Re-focus: <i>Limiting the scope of CAP interventions to environmental aspects</i> | Abolished | Phased-out | Substantially increased funding; focus on climate change and environment |

³ http://ec.europa.eu/agriculture/analysis/external/scenar2020ii/index_en.htm

4. ASSESSING THE IMPACT OF ALTERNATIVE POLICY OPTIONS

The **adjustment** scenario assumes the continuation of the principles of the current policy framework based on market-orientation. It is expected to allow farmers, prompted by market signals, to make better use of available policy instruments to increase their competitiveness, while redistributed direct payments among Member States would shield them from excessive income fluctuations in a more effective and equitable manner throughout the EU. Redistribution of direct payments within Member States (regional model) would allow higher support for more environmentally beneficial agricultural areas and limit land abandonment, but increased economic pressure would likely drive towards intensification production in the most fertile regions. Rural development measures would continue to address wider rural issues, but the role of agriculture in the economy, employment and growth of rural areas would diminish.

The **integration** scenario proposes an enhanced policy framework geared towards support for competitiveness, sustainable development and innovation in the sector and aimed at fostering conditions under which farmers, either individually or collectively, would be better able to face upcoming economic and environmental challenges. Direct payments would provide a stable income, leading not only to more balanced, effective and equitable redistribution but actively targeting certain beneficiaries (small-scale holders, farmers in regions with natural constraints, sectors at risk, new entrants etc.). A greening component would also promote certain basic environmental practices throughout the EU, focusing principally on those farms, often most competitive, which have moved away from such practices as well as those which are considering abandoning them in the light of current economic pressures.

In **re-focus** scenario, a phasing out of direct payments would lead to strong restructuring in the sector and much larger and more capital intensive farms. Production intensification in the most fertile regions and land abandonment in less advantageous areas would have negative environmental consequences. Focusing policy on rural development-type environmental measures would alleviate these problems, but would not contribute to enhancing the sustainability of agriculture over the whole EU. Phasing out of direct payments would lead to failure of many agricultural holdings and would put additional pressure on the viability of rural areas with higher unemployment and migration.

4.1. Administrative burden

Certain components of a new model for direct payments, such as capping, the definition of "active farmers" and the "greening" could potentially be burdensome with additional control requirements. On the other hand, the small farmer scheme would substantially reduce the administrative demands from the application for and granting of direct payments to such beneficiaries.

The removal of the current overlap between agri-environmental actions available under specific support in the Pillar I and in rural development and a uniform solution for coupled support would lead to simplification. However, the introduction of a possible approval process by the Commission could be more burdensome, mainly for the Commission services.

Improving the targeting of payments to active farmers would require careful fine tuning of definitions in cooperation with Member States and selecting criteria at Member State level to be integrated into the IACS register. This could require substantial administrative effort for them and certainly for farmers to prove eligibility, as they would have to provide supplementary detailed information and possibly submit accompanying documents with their application.

4.2. International dimension

The successive reforms of the CAP have diminished substantially the distortive impact of the policy on international markets. All the analysed scenarios should have minimal effects on global markets (including on developing countries). This is the combined result of previous CAP reforms and the present and expected future level of world prices that have turned the EU into a price-taker in agricultural markets.

4.3. Comparison of options

All three options aim at a more competitive, sustainable and resilient agriculture in vibrant rural areas, and thus seek to better align the CAP to Europe 2020, notably in terms of resource efficiency. To this end, it will be essential to improve agricultural productivity through research, knowledge transfer and generally promoting collaborative approaches. Hence the importance of innovation, including the upcoming European Innovation Partnership on agricultural productivity and sustainability, as a basic precondition that cuts across policy options. This cross-cutting element is present in all three options, and therefore not part of the comparison below.

In terms of budget, it is clearly the **refocus** option that would in the end place the lowest demands on the EU budget since direct payments would be phased out. This option places priority on market orientation, and thus on the acceleration of structural adjustment in the sector towards greater profitability of enterprises. This option would also expose the sector to greater risks in terms of market stability in the absence of appropriate safety nets and risk management tools, as well as the risk of decreased spending on innovation due to the pressure on farm income. Structural adjustment under the terms of the refocus option would come at a significant social and environmental cost. Income would fall by 25% and production would concentrate in the most profitable areas and sectors.

Even if spending on better targeted environmental measures under rural development doubles, this would not be able to achieve sustainable land management across the EU territory, as the policy would lose the leverage of direct payments coupled with the cross compliance requirements. In addition, the negative social consequences particularly in areas and sectors that are most dependent on direct payments (e.g. large field crops and dairy farms, extensive beef and sheep and goat farms) would be such that the temporary use of axis 1 measures to support restructuring would not be able to make up for losses from the phasing out of direct payments. The absence of axis 3 measures could threaten the rural fabric, especially in diversified rural economies, putting the territorial balance at risk. These results are not new, but echo similar results in the two prospective Scenar 2020 studies.

At the other end of the spectrum, the **adjustment option** would best allow for policy continuity with limited but tangible improvements both in agricultural competitiveness and environmental performance, through the redistribution of direct payments, enhanced cross compliance, simplification and streamlining of market instruments and support for cooperative approaches, as well as the channeling of additional resources into new challenges under rural development. The main new element in the adjustment option is the rebalancing of direct payments among and within Member States, for which different options have been analysed. The question is how to ensure a more equitable distribution and a better targeted support in line with the policy objectives while avoiding major disturbances. The convergence towards a flatter rate would particularly benefit those Member States that are currently significantly below the EU average.

The move towards a regional model (together with the inclusion of naked land) would rebalance support between farm types, especially in Member States currently using a historical model, mostly towards more extensive production systems. In fact, grazing livestock, wine and horticulture would benefit, while field crops, mixed and milk farms would lose from such redistribution.

There are however serious doubts as to whether the adjustment option can adequately address the important climate and environmental challenges in the future, thereby also underpinning the sustainability of agriculture itself in the longer term.

The **integration option** takes the need to green the CAP a step further with the "greening" component of direct payments. The challenge is how to design such greening so as to reap considerable environmental and climate change benefits and assure the sustainable use of natural resources without undermining territorial balance throughout the EU as well as the long-term competitiveness of the agricultural sector and unduly complicating the management of direct payments.

The analysis shows that this is possible although some administrative burden cannot be avoided. The resulting negative impact on income remains moderate on average (but varies significantly between Member States, regions and farming systems); this negative impact would be exacerbated with a more ambitious crop diversification measure, but alleviated in the case of more ambitious provisions for ecological focus areas, due to the market impact.

The greening component would also free up funds in rural development to be deployed towards more sophisticated agri-environment and climate focused measures. The combined effect of environmental and LFA measures in both pillars could thus significantly enhance the CAP contribution to the provision of public goods, though at the cost of additional administrative efforts to manage a more complex structure and avoid duplication of measures. Provided that the right balance is struck in the design of measures and their implementation by Member States, this option best safeguards territorial balance by addressing the long term sustainability of agriculture and rural areas.

A significant change in rural development policy is also part of the integration option. The result should be a more effective policy that delivers results in line with the Europe 2020 priorities under a common framework with the other EU funds, provided that the possibilities are used well by Member States and regions at the level of programming and

that the closer coordination with the other funds does not remove the synergies with Pillar I. The distribution of rural development support would also better reflect the policy objectives while taking into account the current distribution.

Finally, better targeting of support by means of the different components of direct payments (in particular capping, the small farmer scheme and the better definition of "active farmers") can help achieve more effectiveness in terms of income support and provision of environmental public goods. For the food supply chain, there is a balance to be found between improving the bargaining power of farmers and assuring the competitiveness and improved performance of the whole chain.

The integration option would maximize the EU value added by best maintaining a sustainable agriculture throughout the EU, addressing important cross-border issues such as climate change and reinforcing solidarity among Member States; this would be followed by adjustment and then refocus.

In terms of cost-effectiveness, the integration option would make the best use of the budget by maximizing EU value added. On the other hand, the adjustment option would place equally important demands on the EU budget without the same ambition in terms of results, while the refocus option would produce budget savings but at the same time significantly reduce the scope and added value of EU action.

Table 1: Comparison of options by objective, EU value added and cost effectiveness

| | Adjustment | Integration | Re-focus |
|--|-------------------|--------------------|-----------------|
| Viable food production | ++ | +++ | + |
| Sustainable management of natural resources and climate action | + | +++ | ++ |
| Balanced territorial development | ++ | +++ | + |
| EU value added | ++ | +++ | + |
| Cost effectiveness | + | ++ | + |

On the basis of the above comparison, the preferred option is the integration option, followed by the adjustment option and finally the refocus option. This assessment coincides with the preferences expressed in the public consultation (see Annex 9). While the adjustment option may not be sufficiently targeted and the refocus option too risky, the integration option appears to strike the right balance in progressively steering the CAP towards the Europe 2020 objectives, and this balance will also need to be found in the implementation of the different elements.

5. MONITORING AND EVALUATION OF COSTS, BENEFITS AND ACHIEVEMENT OF THE DESIRED EFFECTS

In the future, it will be important to reinforce monitoring and evaluation for the CAP, including new elements of the design of the policy introduced in Pillar I, such as greening. The future monitoring and evaluation system for rural development should also better reflect the reinforced strategic approach with common indicators based on objectives and priorities and facilitate the use of evaluation as a management tool throughout the programming period.

In addition, monitoring and evaluation for both pillars should be brought together into a common framework to measure the performance of the CAP as a whole within Europe 2020. To this end, a process is under way for the development of a common set of indicators linked to the policy objectives, which would consist of:

- impact indicators linked to general objectives;
- result indicators linked to specific objectives;
- output indicators linked to expenditure under different instruments.

In addition, to address data gaps, for instance on sustainability indicators, it is also envisaged to launch a pilot project that would create a process which, by filling existing data gaps of indicators at farm level, would allow the better monitoring and evaluation of implemented reforms.