9 PROSPECTS FOR A REFORMED AGRICULTURAL POLICY

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Introduction

The Common Agricultural Policy (CAP) is not only the EU's[1] most expensive policy – it costs some €58 billion per year and accounts for 40 per cent of the EU budget – but also its most complex and interventionist programme. Yet, despite its many faults and failures, it attracts relatively little attention and criticism outside academic circles. This may reflect its presentation as delivering the benefits of a pleasant countryside and supporting a traditional rural way of life. The CAP has enjoyed an exceptional and prominent position since the founding of the EU; indeed, the promise of a common agricultural policy helped secure ratification of the Treaty of Rome (Parsons 2003). French determination to secure a profitable arrangement for their farmers reinforced a Commission keen to press ahead with at least one ambitious common policy, and none seemed more promising than agriculture (Ludlow 2005). Paradoxically, it was a sector with strong farmers' unions upon which the Commission hoped to build the type of relationship capable of breaking the national mould of European politics (White 2003).

Compared to its current manifestation, the CAP started out with the straightforward intention of holding the domestic prices

1 The term 'EU' will be used throughout, even where it would be more historically correct to speak of the EU's predecessors, i.e. the EEC or the European Communities (EC).

of key agricultural commodities at sufficiently high and stable levels to encourage production and provide a reasonable standard of living for farmers. Since its inception in the 1960s, the CAP has undergone several reforms. Each reform has been driven by political disquiet regarding the CAP's cost and effectiveness. Agricultural exceptionalism continues, but the method of support has changed, and the policy's complexity and scope has increased with the addition of new and diverse objectives. Despite the reforms, there is widespread doubt amongst academic critics regarding its ability to achieve its goals (Jambor and Harvey 2010).

The purpose of this chapter is twofold: firstly, to consider the prospects for fundamental reform of the CAP; and secondly, in the event of a 'Brexit', to examine the nature and pace of agricultural policy reform in the UK. Fundamental reform is defined here as ending agricultural exceptionalism and allowing the industry's structure and performance to be determined by unfettered market forces. In order to understand something of the complexity of the CAP and why it has proved so difficult to reduce the level of farm subsidies, I will first briefly outline how the policy has developed. I will also explain the political and industry forces that have successfully protected its exceptional position. Finally, I will consider to what extent the influence of these forces might wane following a Brexit, thereby allowing a fundamental reform of UK agricultural policy.

A politically driven policy

Perhaps inevitably when reaching agreement between divergent interests, the objectives set for the CAP at its founding were vague. In summary, its five objectives were to (i) increase productivity, (ii) ensure a fair standard of living, (iii) stabilise markets, (iv) assure supplies and (v) deliver 'reasonable' prices for consumers (European Union 2006). The objectives were crafted with the depressed state of agriculture in the 1930s, and the food

deprivations of World War II, in mind. Consequently, of the five objectives, ensuring a fair standard of living for farmers – by implication protecting farm incomes and farm numbers – was *primus inter pares*. Based largely on 'price support' involving variable levies, i.e. tariffs to raise import prices to domestic levels, and official intervention buying at predetermined prices, the CAP was spread from grains to other major products during the 1960s. Intervention prices for the coming year were set by the Agricultural Council, which operated *de facto* under an implicit rule of consensus (Hayes-Renshaw et al. 2006). This way of working ensured that as production responded to higher prices, eventually creating structural surpluses, i.e. a permanent state of excess supply, the Agricultural Council's reaction was to increase budgetary expenditure to cover the cost.

Under pressure from national governments and farmers' unions, the Agricultural Council refused to countenance a reduction in support price levels. Instead, as budgetary expenditure rose, it chose the less divisive policies of supply management and export subsidies. Production controls were first introduced for sugar in 1968 and for milk in 1983, to be followed by the voluntary 'set-aside' of productive land for cereals in 1988. But surpluses continued to mount, and the cost of export subsidies rose as the EU increasingly resorted to dumping its surplus agricultural commodities on world markets. These interventionist policies were failing to stem rising budgetary costs, and, moreover, the use of export subsidies was a source of tension with trading partners.

Within the European Council, as CAP expenditure rose to account for around 70 per cent of the EU budget, there was growing recognition that reform was inevitable. This view was reinforced by the launch of the Uruguay GATT Round and mounting anger by the US and Cairns Group[2] at the CAP's trade distorting policies.

2 A coalition of 19 agricultural exporting countries which account for over 25 per cent of the world's agricultural exports.

Eventually, these pressures resulted in the 1992 MacSharry[3] reform. The reform transferred the basis of support from farm prices to annual direct payments. In the process, it shifted the burden of support from consumers to taxpayers. By 1992, agricultural production in the EU was in chronic oversupply, so the authorities could not credibly claim that continued support was necessary to protect production. Thus, the payments were defended as 'temporary compensation' for lower market prices, while protection of the environment and rural development were introduced as justifying continued support.

The piecemeal approach to the environment embodied in the 1992 reform reinforced the belief that the objective was primarily to continue to support farm incomes without encouraging production growth. The reform had, however, opened the door to the environmental lobby – which seized the opportunity. The result was the consolidation of environmental objectives in the 2000 reform, which separated CAP expenditure into two tranches: Pillar I and Pillar II. Pillar I accounts for more than 70 per cent of CAP expenditure and is largely used to fund direct farm payments. Pillar II, which is co-financed from national funds, is aimed at improving agricultural competitiveness, the environment and the rural economy, i.e. largely channelled to farm businesses. The introduction of co-financing was implicit recognition that budgetary restraints would constrain future CAP expenditure, but it also marked, albeit on a small scale, the introduction of 'renationalisation'. In other words, under Pillar II national and/or regional authorities can decide, within limits, the objectives and content of rural policies for their regions.

In preparation for the impending eastward enlargement of the EU, the CAP was further reformed in 2003. This reform fully decoupled direct payments from production, i.e. they were to be

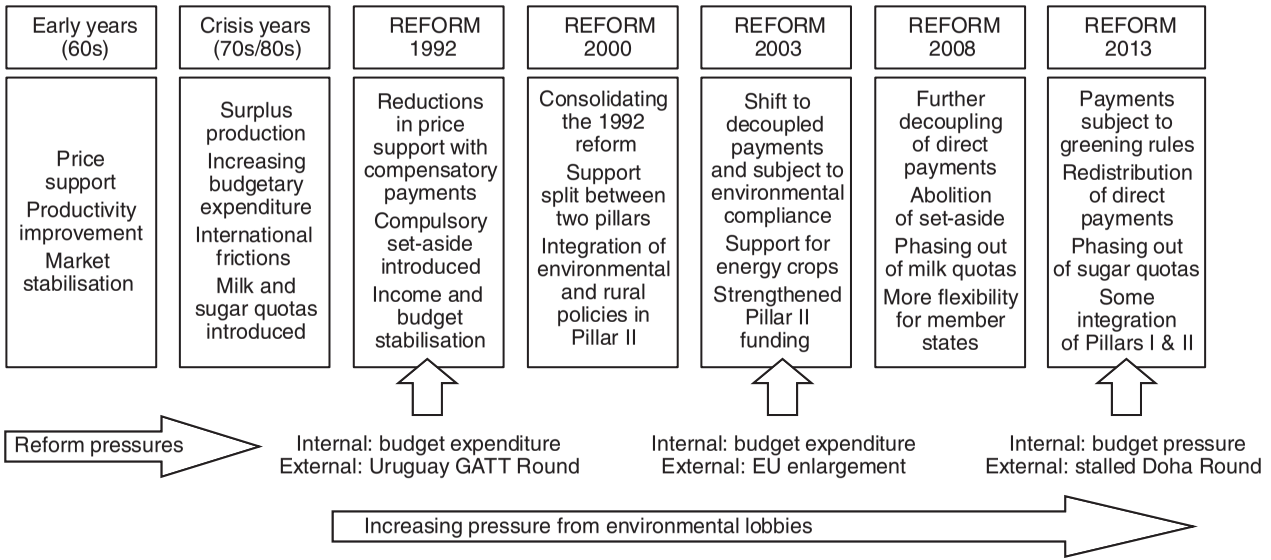
3 Irish politician Ray MacSharry was Commissioner for Agriculture and Rural Development, 1989–93.

set on an area basis, regardless of historical production. The new decoupled payments added a further dimension to renationalisation by allowing member states to adjust modestly the conditions attached to their receipt and the scope to modulate, i.e. reduce, the payments for larger-scale farms. A bizarre side effect was that it was no longer necessary to grow anything in order to receive payments. In principle, decoupling increased the influence of markets in farmers' decisions, and the 2008 reform continued this trend, most notably by abolishing set-aside and setting 2015 for the phasing out of milk quotas. In 2013, the CAP underwent further reform to make it 'more equitable and greener' and to phase out sugar quotas by 2017. The history of the CAP, the key pressures for reform and its growing complexity are summarised in Figure 3. In contrast to the US, where agricultural reform during the 1990s represented a decisive move towards market liberalism, in the EU the underlying protectionist goals remain intact (Skogstad 1998).

An inefficient and ineffective policy

According to the European Commission, financial support for farming is necessary to deliver 'viable' food production, the sustainable management of natural resources and balanced development across the EU (European Commission 2014). But the ability of the CAP to protect farm incomes and numbers is weak. At best, direct payments have slowed the long-term decline in the numbers engaged in farming. In practice, 'sustainable management' consists largely of attempts to constrain highly productive, intensive systems. As regards balanced development, direct payments are inequitably distributed, the product of their historical role as compensation for reductions in support prices. Direct payments, per hectare, are smallest in the countries with the lowest per capita incomes and greatest dependence on agriculture, as measured by share of GDP.

Figure 3 **History and reforms of the CAP**

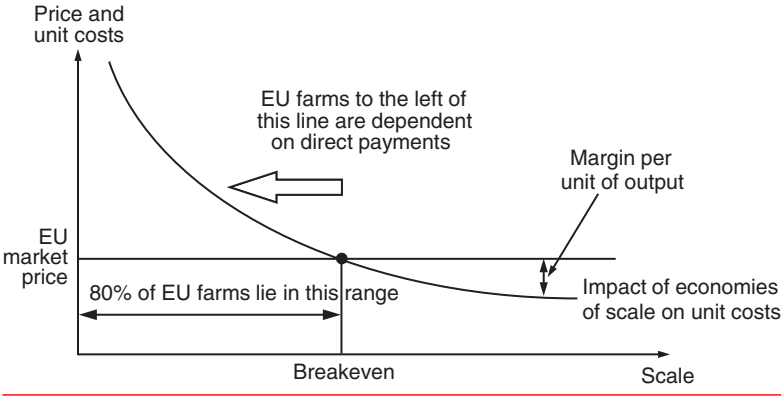


Source: Based on European Commission data.

Since the 1960s, both the number of EU farms and the numbers engaged in farming have declined at an annual rate of 2 per cent. Over the same period, the annual reduction in the utilised agricultural area has been less than 1 per cent. Consequently, there has been a slow but steady concentration of production on larger-scale, more specialised farms (Brouwer 2006). In the absence of decoupled payments, some 80 per cent of EU farms would not break even. If the payments are included in farms' revenue, then this proportion only falls to 65 per cent (European Commission 2010). The growing average size of farms in the EU is evidence of the existence of economies of scale. Larger farms deliver a superior performance in terms of productivity, unit costs and incomes. The average value added per labour unit for the EU's largest farm size group is more than ten times that for the smallest farms group (ibid.).

Figure 4 is a schematic of the relationship between scale and dependency. The diagram shows how economies of scale cause unit costs to decline as farm size increases. In practice, some of the smallest farms are profitable, but most should be described as 'hobby' or 'lifestyle' farms operated on a non-commercial basis. More than one-third are involved in off-farm gainful activity, e.g. they are part-time or have other sources of unearned income (ibid.). Most EU farms are constrained by their small scale; about 70 per cent have an area of less than 5 hectares (European Commission 2013). Few of these farmers are likely ever to be in a position to earn a reasonable living from their land. The logic of Figure 4 is that structural change towards an industry composed of fewer, larger-scale farms would reduce the need for public subsidy. As decoupled payments prolong the life of unprofitable farms, they frustrate evolution to a more efficient industry structure. The Commission argues that decoupled payments improve competitiveness by encouraging farmers to tailor production decisions to market requirements, but the evidence for this is lacking (Rickard and Roberts 2008). Rather, they impact

Figure 4 **Scale and dependency**



negatively on efficiency (Rizov et al. 2013) by enabling farms to avoid productivity-enhancing change at a time when productivity growth and, most notably, crop yields across the EU display a slowing rate of increase (Lobell et al. 2009).

Besides public expenditure savings, other advantages would follow the removal of decoupled payments. Agricultural support was largely phased out in New Zealand during the 1980s. An OECD study concluded that this had 'enhanced the flexibility of a sector that had been renowned for its inability to respond to change' (Vitalis 2006). What is beyond dispute is the need for EU agriculture greatly to increase current levels of productivity, particularly with respect to natural resources, e.g. land, fresh water, minerals and fossil fuels. The Royal Society (2009) argues that more productive and sustainable agricultural systems – inevitably dubbed 'sustainable intensification' – could be delivered by technological advances. While much scientific research is now focused on scale-neutral biotechnology, engineering advances are now heavily concentrated on scale-biased, precision technologies. Defined as the fusing of agricultural engineering and

information technology, precision technologies achieve much greater efficiency in the use of scarce resources, but these benefits can only be realised when adopted at the farm level, and this involves expensive investment.

Decoupled payments may prolong the life of many smaller farms, but the extent to which they augment incomes is not sufficient to generate a surplus to fund performance improving investment (Viaggi 2011). An OECD review of the evidence concluded that 'larger farms are better performers as they can achieve economies of scale' (OECD 2011). As implied in Figure 4, economies of scale not only increase the likelihood that a farm is generating profits but also mean a greater volume of output over which to spread investment costs. Hence, larger-scale farms are better able than their smaller counterparts to invest in productivity and sustainability-enhancing, technological advances. Moreover, there is some evidence that when a scale-invariant advance, e.g. genetically modified (GM) crops, is combined with a scale-enhanced advance, e.g. precision technology, farms gain an additional economy of scope (Fernandez-Cornejo et al. 2001).

Prospects for radical reform of the CAP

The foregoing indicates that, if the objective is economic efficiency, the priority for future CAP reform should be the phasing out of direct payments. Indeed, the European Commission has acknowledged that such action would not only lead to:

> a more competitive and less diverse sector ... [but also] ... farms which will continue to be economically viable in the new environment will be larger, more open to innovation leading to cost optimisation, productivity growth and less labour-intensive. (European Commission 2011)

But the European Commission and the farmers' unions argue that the objectives of the CAP now embrace more than efficiency and competitiveness. The Commission rejected the phasing out of decoupled payments because it would 'lead to failure of many agricultural holdings and would put additional pressure on the viability of rural areas with higher unemployment and migration', and the concentration of production on larger-scale farms would cause the 'likely intensification of production in fertile areas and the abandonment of production and land in more marginal regions' (European Commission 2011). Significantly, the Commission did not claim that the removal of decoupled payments would be followed by a fall in total EU agricultural output. This reflects the fact that the contribution of smaller-scale farms – those deemed most vulnerable to the removal of support – is proportionally less than their numbers (Martins and Tosstorff 2011).

A modelling exercise by a group of European academics (Renwick 2011) concluded that the overall reduction in EU production following the removal of decoupled payments was likely to be small – around 1 per cent – though the impact for regions and farm types would vary more significantly. The study also identified environmental benefits such as lower overall greenhouse gas emissions and reduced soil erosion. Indeed, the budgetary savings arising from the removal of all payments to farmers under the CAP would create scope for better-targeted and more efficiently funded environmental and rural policies. In the absence of the CAP, national governments would be free to implement environmental and rural policies based on regional rather than agricultural priorities. Moreover, the release of land as less efficient farms exited the industry would provide space to deliver ecosystem services, such as woodlands and habitat conservation, recreation, as well as carbon sequestration (Burgess and Morris 2009).

The CAP's multifunctionalism is an inefficient way to deliver environmental and rural policies, but it serves to deflect attention and criticism from income support. That it remains, despite multiple objectives, primarily a social policy was confirmed by an expert report (Sapir et al. 2003), commissioned by the President of the European Commission. The report concluded that the CAP had become a redistributive policy spreading wealth to farmers instead of an instrument to promote efficiency. Despite its authority, the report was ignored. Born in the era of the post-war welfare state, the CAP's objective of protecting farm incomes has endured – a situation viewed by both the political and wider populations of Europe as legitimate, if no longer open-ended. The fact that in each member state average agricultural earnings are lower than the national average, and that around half of the EU's farms are defined as semi-subsistent (Davidova et al. 2013), is stressed by the farming lobby as the justification for continued income support. And now that the Lisbon Treaty has given the European Parliament greater oversight of the CAP, there is little prospect of a significant reduction in funding for farm payments in the foreseeable future.

Strong political support for 'family farms' and very powerful farmers' lobbies explain why it has proved impossible to undertake any reform of the CAP without the assurance that funding would continue at prevailing nominal levels. The evidence points to another twenty years or more in which there will be periodic reforms of the CAP. But in the absence of some unforeseen external pressure, they will not seriously disturb the course set: the real value of decoupled payments will decline alongside a steady reduction in farm numbers. Future reforms will probably continue the drift towards a greater influence for market forces, the encouragement of sustainable farming practices and partial renationalisation. The farmers' lobbies are bitterly opposed to renationalisation (NFU 2013), and for this reason renationalisation will remain a minor adjunct to the CAP.

Visualising a reformed UK agricultural policy outside the EU

The relative efficiency of UK agriculture within the EU has featured heavily in the literature – see, for example, Lund and Hill (1979). Compared to other EU farm industries, only the Czech Republic has an average farm size greater than the UK, and, as indicated above, larger-scale farms tend to be more productively efficient. Productivity growth is a good indicator of longer-term survivability, but comparative studies show that since 1960 UK agriculture's total factor productivity (TFP) has grown at a slower rate than comparable countries, e.g. Germany and Denmark. This may indicate that other EU agricultural industries are now far ahead of the UK, or simply that they have been playing catch-up. What is beyond dispute is that all EU farming industries are being hampered by CAP Directives restricting or withdrawing some advanced technologies. GM plant seeds and the recent banning of certain plant protection products are examples of this. These restrictions are the product of the growing influence of non-farm pressure groups, specifically environmentalists. Whatever the merits of their campaigns, the result is that, within the EU, farmers are being required to operate below the technological frontier while increasingly facing international competition from farming industries that are not so constrained.

David Cameron has not, at the time of writing, revealed the areas in which he hopes to negotiate a new relationship with the EU; but the foregoing suggests it would be futile to attempt fundamental reform of the CAP. At best, if he is so minded, he might be able to extend renationalisation to allow national governments to determine what practices and technologies farmers adopt. For example, the EU has recently given governments the power to decide – within limits – whether to plant GM crops. In principle, if the UK voted to leave the EU, fundamental reform would be possible. This, however, raises two questions. First, would the actual pace

of reform in the UK be faster? And secondly, what form might it take? In 2005, the Labour government published its 'vision for the CAP' (HM Treasury 2005), in which it argued that the CAP not only imposed substantial costs on consumers and taxpayers but also was out of step with the challenges of globalisation, and a source of international criticism. According to the 'vision document', the solution was the elimination of all market support, including decoupled payments, while retaining 'targeted' payments to maintain the environment and promote sustainable rural development.

Further guidance as to UK agricultural policy in the event of Brexit is provided by the Coalition's submission to the European Commission in advance of the 2013 reform (Defra 2011). On this basis, the UK would reduce public expenditure on farming 'without interfering with the EU level playing field', but funding would continue for environmental and rural payments to farmers. The concern to preserve a level playing field is worrying. This is a key argument used by the National Farmers' Union (NFU) and its fellow lobbyists to justify the continued receipt of direct payments. The devolved administrations in Scotland, Wales and Northern Ireland are also supportive of decoupled payments, as a larger proportion of their farmers would be vulnerable by virtue of their smaller scale and more difficult geography. The erroneous argument that the loss of direct payments for UK farmers would make them less competitive within the EU holds sway with many, who perhaps should know better (House of Commons 2013a). Also, the rapid removal of decoupled payments might be thwarted if the government feared claims for compensation on the basis that investment decisions had been made on the expectation that the payments would continue for many years. That said, it seems likely that, whatever government is in power, decoupled payments would be reduced at a faster pace if the UK was freed of the need to comply with the CAP.

The speed and nature of agricultural policy reform in the UK would be subject to negotiation not only with the devolved

administrations but also with the NFU, as the leader among farmers' lobbies, and non-farm pressure groups. The reaction of the environmental lobby to the 'vision document' was more positive than that of the farmers because of the expectation that expenditure on Pillar II-type environmental and rural payments would be increased. The existence of devolved administrations and powerful pressure groups suggests that there would be transitional arrangements spreading a substantial reduction, if not the complete removal, of decoupled payments over a period of years. Furthermore, the overall fall in public spending would be moderated by a significant switch to Pillar II-type measures. These are often criticised as indirect farm income support, but the government might view such expenditure – in principle aimed at improving farm efficiency and productivity – as serving to reduce opposition to cuts in decoupled payments.

In addition to reduced public funding, UK agricultural policy outside the EU would almost certainly involve a greater focus on competitiveness. Successive UK governments have argued for the removal of remaining trade barriers and the liberation of farmers in making decisions regarding their businesses. However, it is far from clear to what extent the government would remove the regulations currently imposed on farm businesses. It is difficult to conceive – particularly given the strength of the UK environmental lobbies – a significant moderation of existing EU Directives regarding pollution, e.g. nitrate and pesticide leaching, water quality, birds, habitats and animal welfare.

A more subtle but potentially significant change would be a more embracing attitude towards the frontiers of science and technology. Freed from the constraints of the CAP's voting rules, a British government is likely to be more accepting of biotechnological advances. These would include GM technology, and both farmers and manufacturers would benefit from the UK's exit from the EU's long, drawn-out, opaque system for approving new pesticide products. There is, however, a question as to how

quickly British farmers would take up the more controversial technologies. Consumer attitudes would be a major influence: a recent survey showed that only 14 per cent of UK consumers are strongly opposed to GM foods, while 82 per cent were either undecided or held only mildly positive or negative opinions (IGD 2014). Experience suggests that environmental lobbies would continue to oppose the adoption of GM technologies and, more generally, larger-scale, intensive farms.

Of key importance would be the UK's post exit trade relationship with the EU. There are in principle four trade relationships that the UK could seek with the EU (House of Commons 2013a): a highly integrated option of a European Economic Area (EEA) agreement; a less conditional European Free Trade Area (EFTA) agreement; a UK specific preferential Regional Trade Agreement (RTA); or resort to a WTO most-favoured-nation (MFN) agreement. An EEA agreement would appear to offer the greatest likelihood of equivalence to existing arrangements. However, the House of Commons Foreign Affairs Committee inquiry into the UK's future relationship with the EU concluded:

> we agree with the Government that the current arrangements for relations with the EU which are maintained by Norway, as a member of the European Economic Area, or Switzerland, would not be appropriate for the UK if it were to leave the EU. (House of Commons 2013b: 9)

Agricultural trade is, in principle, excluded from EEA and EFTA agreements. It is instead covered by separate bilateral agreements, which grant limited preferential access to both sides. Presumably, the government's Plan A would be to negotiate a preferential RTA. The out campaigners assert that a satisfactory RTA could be negotiated but they provide no articulation on the details of such an agreement. However, it is doubtful whether the EU would be willing to enter into such an agreement if it did not include the four

'freedoms' involving the movement of goods, capital, services and people. These four freedoms are incorporated in the EU's treaties with the EEA and Switzerland as a member of the EFTA (House of Commons 2013a). Given the uncertainty attached to successfully negotiating a preferential RTA, voters should be clear as to Plan B before an in–out referendum. This presumably would be the adoption of WTO 'most favoured nation' tariffs. To use just one of many examples, UK exports to the EU of cheddar cheese with a minimum fat content of 50 per cent would face a tariff of €167.10 per 100 kg. As the UK has a persistent trade deficit with the EU in food and agricultural products – £16.4 billion in 2014 (Defra 2014) – this suggests that it would be in the EU's interest to reach a negotiated bilateral agreement.

The resort to WTO 'most favoured nation' agreements would leave UK exporters of agricultural products in the position of, say, US exporters today in facing non-tariff barriers of various kinds involving compliance with prevailing CAP regulations. For example, UK exports would continue to be subject to the CAP's regulations concerning maximum pesticide residues. However, in the event of the UK rapidly adopting GM crops, this is unlikely to pose a problem. The CAP's paradoxical approach is an almost complete *de facto* moratorium on growing genetically altered crops, but the same products can be imported from non-EU countries. The removal or reduction of trade barriers arising from regulations and standards lies at the heart of the Transatlantic Trade and Investment Partnership (TTIP) currently being negotiated with the US. Membership of a TTIP agreement should be a priority for an independent UK. Otherwise, regulations, particularly those addressing new products and technologies, are likely increasingly to diverge, creating additional challenges for food producers seeking to be certified as permitted to sell in both the EU and US. Finally, further uncertainty surrounds the web of regional trade agreements that the EU has with many countries. Presumably, the UK would seek to negotiate new regional

trade agreements with these countries in order to continue with the EU's tariff preferences. But there might be opposition; for example, Brazil would surely protest if the UK offered tariff concessions on raw sugar to least developed countries as if it were still applying the EU's Economic Partnership Agreements.

End piece

Following the 2013 reform, the CAP's current multifunctional structure will not change before 2020. Following the adoption by the EU of a seven-year multiannual financial framework, there is little prospect, in the absence of a serious funding crisis, of an overall reduction in the funds devoted to the CAP, specifically to a lessening in the share going to decoupled payments in the following seven years. This implies that the pace of structural change will continue at its lacklustre historic rate. Renationalisation will continue within strict limits, although it is highly probable that the EU's reticence towards biotechnological advances will wane. In the event of Brexit, UK agricultural policy reform is likely to move at a faster pace and also in a direction that gives primacy to productivity and competitiveness. Unfettered access to the single market would be a priority for the food industry in any exit negotiation, but it is impossible at this time to anticipate how successful the UK might be in this endeavour. Finally, those hoping for a rapid reduction in wasteful public expenditure on agriculture are likely to be disappointed, as powerful lobbies will bring their influence to bear to minimise cuts in payments and extend the transitional period.

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