



EUROPEAN COMMISSION

THE REFORM OF THE CAP TOWARDS 2020

CONSULTATION DOCUMENT FOR IMPACT ASSESSMENT

1. CONTEXT

The successive reforms of the Common Agricultural Policy (CAP) during the past decade have established an overall policy basis to be fully consolidated by the end of current financial framework in 2013.

On 12 April 2010, the Commission launched a public debate on the future of the CAP beyond that date, culminating in a public conference on 19 and 20 July 2010. The debate generated some 5600 contributions and the conference attracted over 600 participants. The European Parliament, the European Economic and Social Committee and the Committee of the Regions contributed to the public debate by issuing own-initiative opinions. The Council also discussed the future of the CAP during specific meetings held during the previous Presidencies.

The Commission's response to the debate on the future CAP comes in the form of the Communication "The CAP towards 2020: meeting the food, natural resources and territorial challenges of the future", which outlines the broad options for guiding the next CAP reform.

An adapted legislative framework will be prepared for the period post 2013, corresponding with the new financial perspectives, in accordance with the priorities of the "Europe 2020" strategy. It will be accompanied by an Impact Assessment, which is steered by an Inter-service Group (ISSG) within the Commission. In this context, preliminary formulation of the issues to tackle, objectives of the policy and scenarios are presented here by the ISSG and consulted with the interested parties in order to provide a comprehensive evidence-base for high quality and credible policy proposals.

2. ISSUES

The reform path of the CAP since the early 1990s included two major reforms (1992 and 2003) and two significant adjustments (1999 and 2008), which allowed the policy to adjust and adapt to the challenges it faced during the past two decades. Direct payments make an important contribution to keeping sustainable farming in place through the combined effect of the provision of basic income support and the link to cross-compliance. Decoupling of direct payments has improved market orientation, while

adjusted market measures form price safety-nets in cases of significant price declines, limiting instability. Rural development serves a wide range of objectives promoting competitiveness of the EU's agricultural sector, improving the environment and the countryside, and the balanced development of rural areas.

The new financial framework for the EU and the "Europe 2020" strategy priorities of smart, sustainable and inclusive growth offer an opportunity to define the vision for European agriculture by 2020 and to prepare a reform path for the Common Agricultural Policy accordingly. The Lisbon Treaty reaffirmed the objectives of the CAP, although these objectives are today played out on a much wider legal and political stage than when they were written, with other issues such as environmental integration now playing a crucial role. The public debate initiated by the Commission in spring 2010 indicated a broad consensus on the challenges the sector faces. The next step is to redesign the policy instruments to make the CAP more efficient, effective and simple, responsive to societal concerns and coherent with other EU policy objectives.

The challenge related to agricultural policy is two-fold. On the one hand, agriculture can potentially contribute substantially to many of the challenges faced by Europeans with right incentives and in the right setting, as described in the next section. On the other hand, its structure is diverse and economic situation fragile, as the subsequent section shows. In effect, short-term survival dominates the perception of many farmers over the long-term, broader perspective. If agricultural policy does not address the former, it will have little success in promoting the latter.

2.1. The broad challenges

The share of agriculture in EU-27 GDP amounts to 1.2 % - its steady decline being generally associated with wider economic development. Yet, its role is not well reflected in its share of GDP but rather by the extent to which it can offer solutions to meet the most important preoccupations of citizens. The foremost role of agriculture is to provide food and feed, but the issues of *how* it is done, *where*, and *by whom* are inherently linked to sustainability - in environmental terms through land management and use of natural resources, in social terms through territorial cohesion and maintaining rural communities and in economic terms through a competitive agricultural production. In addition, agriculture has a role in providing other products and uses, such as biomass for energy (as a source of green energy) and biomaterials (as a way of reducing dependency on fossil materials), thus contributing to fighting climate change and providing more sustainable energy supply.

Food security and safety

Ensuring that agricultural products are of good quality, healthy and safe and available to consumers at reasonable prices is considered by EU citizens to be the top priority for the Common Agricultural Policy. The concern regarding food security is less about the overall availability of supply in Europe, but rather about the role of the EU within a world-wide context. Particular attention is paid to ensuring the resilience of the current system– i.e. the "access, availability and acceptability" of food and diets.

Within a time span of three years the agricultural sector experienced a high price spike followed by an equally strong decline a few months later. Both were caused by a combination of factors on supply and demand side, including an increased influence of wider macroeconomic developments. While it has had a modest effect on the average

European consumer (food represents 16 % of household expenses and agricultural product prices represent a decreasing share of food prices), it revealed the sensitivity of the system to excess price volatility and other disruptions, asymmetry and tensions in the food chain.

Creating the conditions for easy access to healthy, diverse, sustainable and nutritious diet has clear public health benefits as diet is one of the major modifiable risk factor for chronic non-communicable diseases (obesity, diabetes, cardiovascular disease, cancer). The number of overweight children increases by 1.2 million per year and (with increase in child obesity 400.000 per year) in the EU. From a public health perspective, access to nutritious-efficient food remains insufficient for some groups of EU citizens (e.g. the most deprived), availability of local and directly marketed food stuffs is limited, and acceptability is largely influenced by mass media which is biased towards unhealthy food stuffs (soft drinks, highly processed foods). Finally, there are concerns as regards other qualities of the food, which include the ethical factors related to production and the way animals are treated.

Food safety and animal and plant health are areas where constant adaptation is necessary, with diseases which were unknown a decade ago appearing (e.g. SARS) while others, such as foot and mouth disease, bluetongue and avian flu recently presenting new challenges, coupled with the increasing volume of trade in animal products and science and technology advances. This points to the need for strengthening the principle of prevention in animal and plant production, the strengthening of surveillance and a more risk-management based approach across the food chain.

The availability of food and the capacity of Europe to meet its needs is largely taken for granted (although access to food can be problematic for the most deprived people). Expectations relate to safety, quality, health, environmental and ethical aspects, which means that there is an increased interest in production methods and that farmers are put under the spotlight. This requires the creation of strong, stable links between farmers and consumers.

Environmental concerns

With agriculture and forests covering about 77% of the EU territory (about 47% for agriculture and 30 for forests), their interaction with the environment is significant. It is estimated that about one third of agricultural land in the EU is managed by farming systems delivering High Nature Value. Natura 2000 sites protecting biodiversity cover 10% of agricultural area. Although progress has been made in integrating environmental concerns into the CAP and in introducing environmental legislation at farm level, more needs to be done to ensure the sustainable management of landscapes and sustainable use of natural resources. In particular, water quality and quantity, soil quality and land availability are still areas of major concern, together with the question of how to protect, maintain and further enhance farmland habitats and biodiversity and to enhance the role of agriculture in preserving ecologically valuable landscapes.

According to the European Environment Agency (EEA), 24% of water abstraction is used for agriculture (and up to 80% in certain areas of southern Europe) with a relatively low return flow, as often just a third of the withdrawal water is returned to a water body. The data further show that agricultural water use across Europe has increased over the

last two decades. In addition an estimated 25% of EU soil suffers from unsustainable erosion and 45% of European soils have low organic matter content.¹

As regard the use of farm inputs, there has been a substantial decline from the fertiliser consumption peak of the seventies and eighties (by 2017 projections show a decrease of 28% for nitrogen compared to 1988, 67% for phosphorus and 61% for potassium in the EU-27 compared to 1979). The current use is rather steady with a general decrease of all nutrients in the EU-15, but an increase in the EU-12. The total amount of plant protection products used in the EU-25 increased steadily in the 1990s, stabilising in the late '90s and then declining continuously from 1999 until 2003 (declining in EU-15 and slightly increasing in EU-10).² New approaches to agricultural management slowly gain ground: organic farming and the use of integrated crop management techniques in many pesticide-intensive farming systems. In this context, prevention of the entry of non-native plant pests and diseases is essential.

Certain farming systems and practices are particularly favourable for the environment. These include extensive livestock and mixed systems, traditional permanent crop systems or organic farming. However, also modern farming systems have an important capacity to ensure good environmental outcomes. Integrated crop management (a whole farm management approach combining the ecological care with the economic demands) are of particular importance in this respect. Integrated farming systems, following defined codes of farming practices, are estimated to cover only about 3 % of the utilised agricultural area in the EU.

Many valuable habitats and the related biodiversity developed over centuries in interaction with farming, systems. Whilst these environmental features depend on appropriate management practices, those practices have been subject to changes, driven by competitive pressures. The assessment of the conservation status of Europe's most vulnerable habitat types and species protected under the Habitats Directive shows that while nearly 65 % of all habitat assessments are unfavourable, generally habitat types associated with agriculture have a worse conservation status than other types.

Intensification and specialisation threaten the environmental values associated with traditional farming systems. In some places, extensively used areas of particular environmental interest struggle with the problem of being economically less viable. These areas are most vulnerable to land marginalisation or abandonment, which is particularly a threat to biodiversity on farmland. Whilst the estimates of manifest land abandonment vary from 0.2 % to 2% of UAA annually on average (i.e. abandonment in spite of CAP support), the estimated area under risk of abandonment accounts for a significant proportion of the total agricultural land, and it is affecting mainly extensive grasslands, mountain areas, and areas with a poor soil and water conditions.

The prospect of more specialization and intensification in some production areas carries the risk of an increase of the above-mentioned pressures on the environment. This will require appropriate baseline rules and sufficient incentives in the CAP for farmers to

¹ For instance, there is clear scientific evidence that arable land in France and the UK has been steadily losing large quantities of organic carbon in recent decades.

² Yet, some of the more modern substances are needed in smaller quantities but can be more toxic.

adopt sustainable practices, and to make efforts to preserve biodiversity, habitats and environmentally valuable landscapes, and ensure the provision of ecosystem services.

Environmental concerns have become increasingly present in the CAP, with incentives coming mostly from the Rural Development measures. Rural Development is by far the largest source of EU funding for incentives specifically targeting the environment in rural areas. Given that there is, on the one hand, increasing competitive pressure and a trend towards intensification in many fertile areas, while on the other hand there is a threat of land abandonment in more marginal areas, it will be necessary to ensure that the systems of incentives for farmers to assume their role in the sustainable management of natural resources and the preservation of ecosystems and environmentally valuable landscapes is effective for farmers and land managers operating in very diverse conditions.

Territorial cohesion

Agriculture is also closely linked with the development of rural areas. Of the EU-27 territory, 54% is predominantly rural, representing 19% of EU population. The results of the SCENAR2020 study suggest that most of the economic growth in rural areas now tends to be mainly driven by urban rather than rural economies, with increased urbanisation and a growing service sector, making the issue of rural-urban interaction an important factor. There are large disparities between rural areas themselves depending on their proximity to urban areas: from peri-urban areas, which are well integrated in the metropolitan systems to remote rural areas, which are suffering poor accessibility to services of general interest and population decline.

In predominantly rural areas the primary sector still represents 4.9% of value added (and more, if related food industry is considered) and 15.7% of employment. This is where the role of agriculture can be particularly important, not only directly but also indirectly - through the generation of additional economic activities. It is estimated that an increase in agricultural output produces an additional 150% increase in output among local purchasers and consumers of that output. Especially strong forward linkages exist with food processing, hotels and catering and trade, all sectors that, in turn, have further high links with the rest of the rural economy.

While agriculture is generally not the main driver of economic development in all rural areas, its disappearance in particularly fragile areas will have significant negative consequences for the regional economy.

Climate and energy

In the Climate and Energy Package of 2008, the EU committed unilaterally to reduce its overall greenhouse gas emissions by 20 % below 1990 levels by 2020, and by 30 % if other parties would commit to comparable efforts. The Europe 2020 Strategy establishes the reduction of greenhouse gases as one of the EU's five headline targets.

The 20 % reduction commitment is mainly implemented through Directive 2009/29/EC and Decision 406/2009/EC which require sectors participating in the EU Emissions Trading System (EU ETS) to jointly reduce emissions by 21 % below 2005 levels and non-trading sectors under the Effort Sharing Decision (ESD) to reduce emissions by 10 %. As agriculture is one of the non-trading sectors, policies at the national and EU level, in particular the reformed CAP, will play a key role.

Agriculture has contributed, and can continue to make a positive contribution, to the reduction of greenhouse gases as committed to by the EU³. Non-CO₂ emissions from the sector fell by some 20% in the period 1990-2005 to a level of around 9% of the EU total greenhouse gas emissions (excl. land use, land use change and forestry)⁴. However, baseline projections show that emissions in agriculture are predicted to largely remain at current levels in 2020 and 2030 unless further action is taken. Model results show that the sector offers additional cost-efficient mitigation potential for 2020; at a carbon price level of €30/ton (as predicted in the Commission's '20 to 30%' Communication), the EU as a whole could achieve reductions of non-CO₂ greenhouse gases in the agricultural sector by up to 11%. This is consistent with what is required by the non-trading sectors.

There is still underutilised mitigation potential in agriculture for reducing non-CO₂ emissions from manure management and fertilizers as well as for reducing CO₂ emissions, preserving carbon stocks and enhancing carbon sequestration in agricultural soils. Maintaining soil organic matter levels in carbon-rich soils (e.g. grasslands and peatlands) is seen by many scientists as an effective way for agriculture to avoid CO₂ emissions further aggravating climate change.

At the same time, future changes in climate are expected to have a significant effect on agricultural production. On the one hand, this is due to systemic changes, such as permanently drier or wetter conditions, or higher temperature averages. On the other hand, the increased likelihood and severity of extreme weather events will considerably increase the risk of crop failure.

The Renewable Energy Directive requires the EU to produce 20% of its final energy consumption from renewable sources in 2020, including a separate target for the transport sector of 10%. EU agriculture, together with forestry, provides one of the sources of renewable energies, for the heating, electricity and transports sectors. Agriculture has the potential to increase its contribution for example by increased supply of raw material (crops or by-products) for energy or by increased 'on farm' renewable energy production (production of electricity or heating from biogas, solar energy or wind energy). At the same time, the current EU legislation as well as the EU energy efficiency strategy currently under preparation requires energy efficiency improvement both in buildings and in production processes, implying that improvements are necessary also in farm buildings and in agricultural processing. Agriculture uses 2.4 % of the final energy consumption in EU.

Agriculture, as some other sectors, has achieved already a reduction in emissions, and with a decrease of 20% compared to 1990 this reduction has been more than twice the rate of the EU commitment required by the Kyoto Protocol. This is partly due to structural changes and partly to improvements in efficiency. However, further reductions are needed and possible. This will require a more integrated approach and may require changes in production methods, possibly adding costs to farming. Impacts of such cost increases on the competitiveness of EU agriculture

³ Emissions in the EU-15 fell by 12% and emissions in the EU-12 by 42% compared to 1990

⁴ The land use, land use change and forestry (LULUCF) sector is currently not part of the EU's greenhouse gas reduction commitment. The Commission is, however, assessing options and modalities for a possible inclusion of this sector in the future. The results will be reported in mid 2011 and, as appropriate, accompanied by a legislative proposal.

would need to be assessed to avoid negative consequences for the global GHG balance, while any loss of agricultural production capacity in the EU should be measured against the challenge of global food security. At the same time, EU agriculture will also have to adapt to the already observable impacts of climate change, which in some regions may, already in the medium term, lead to significant changes in the conditions for farming activities. At the same time the potential of EU agriculture to contribute to a greener energy supply needs to be facilitated.

Non-food uses

Agriculture can provide raw materials for the high value added bio-based products, replacing fossil-based materials with renewable biological materials and bio-processes which are more environmentally sustainable. Also, the EU forestry sector makes an important contribution in providing the feed stocks for bio-energy and forests are an important source of raw materials for forest-based industries, providing the wood, pulp, cork and fibres that supply a wide range sectors.

Although bio-plastics are at present "niche markets" (50,000 tons of bio-plastics were produced in 2005, representing 0.1% of the total market), a dynamic growth is expected. Estimates suggest possible market shares in the order of 1-2% by 2010 and 2-4% by 2020.

European agriculture, as a provider of raw materials, stands to benefit from the developing bioeconomy, which will offer high-value outlets for specialized products. While most of the policy tools are beyond the CAP, it is necessary to create the links between farmers, research and industry to facilitate cooperation. Nevertheless, an increased use of both biomass-based energy and raw materials needs to be achieved in a way that is economically efficient and is compatible with food security and environmental objectives.

Global issues

The forecast population of 9.2 billion people in 2050 with a projected increase of world's average daily calorie availability by 11% will require 70% more production. While this is less than the increase of 148% that took place between 1961 and 2007, the big challenge to reduce hunger and poverty will relate not only to assuring the availability of food, but also access to food and improving nutritional adequacy of food intake.⁵ Most of the poor and hungry in the world live in rural areas, where agriculture is the main economic activity and small-scale farming is dominant: about 85% of farmers in developing countries produce on less than 2 hectares of land. Apart from investment and capacity building, relative stability of local agricultural markets is necessary to foster growth. On

⁵ Future global food security challenges in developing countries also include population growth, pressures on natural resources and ecosystem services, and adverse impacts of climate change on agriculture, affecting growing conditions and making adaptation measures necessary. The EU's policy framework to assist developing countries in addressing food security explores key issues such as nutrition, price volatility, social protection and safety nets, biofuels, food safety, research and innovation, large-scale land acquisition, and the "Right to Food".

the other hand, the increasing role of certain developing and emerging economies has transformed the agricultural trade landscape.

The EU remains the world's leading trader (biggest importer and one of the two biggest exporters together with the US) but Brazil is a constantly growing exporter of a whole range of agricultural products. China and India are both leading producers and consumers. Given their size, changes in their domestic situation translate into significant shifts in their trade position on the world market, especially when the latter is thin. Overall, a shift towards developing countries is occurring, both for agricultural production, consumption and trade.

The EU will continue its efforts to seek the conclusion of an ambitious, balanced and comprehensive agreement in the Doha Development Round. As part of an overall package deal, the EU has indicated its readiness to accept a steep reduction in the ceiling on its trade-distorting subsidies, the elimination of its export subsidies and a significant reduction of its border protection. In parallel, the EU will actively pursue its agenda of bilateral or regional trade negotiations, which come as a complement to the multilateral ones. This means that the EU agricultural sector will be exposed to growing pressure and volatility of prices and income and, as a result, production is likely to adjust. At the same time, new trade agreements provide opportunities for EU agricultural exports. And EU role in world agriculture makes it an important actor in the global standard setting for sustainable agricultural production and consumption.

The EU has substantially reduced its trade-distorting support to agriculture, opened markets for least developed countries (LDCs) and other key partners significantly, and shown its commitment for achieving an ambitious agreement in WTO negotiations, provided that it is comprehensive and balanced, including for the agricultural sector. This represents a challenge for EU farmers, but also offers an opportunity for EU food exporters.

2.2. Can agriculture do it?

The contribution of European agriculture to the challenges signalled above will hinge on it being a thriving and competitive sector, with positive prospects and longer-term perspective of a sector that is capable of attracting human and financial capital and is less dependent on public support.

Farm income

The main economic parameters give, however, reasons to be concerned, in particular about the profitability of farming. Farm income has been increasing only by 0.6% per year between 2000 and 2009. The dynamics have been very different in EU-15, where income stagnated for the last decade before falling by 17% following the economic crisis, and EU-12 where accession led to large increase in farm income, which despite a drop of 12.5% in recent years, stayed substantially above the levels at time of accession. The impact of the economic crisis has been severe for EU agriculture, leading to a cumulative decline in agricultural income that erased in just two years the gains of the past fifteen. The sector is also plagued by instability, with more than half of EU farms experiencing a variation of farm income by over 30% in comparison with the average for the previous three years.

In effect, while the vast majority of farms are able to cover variable costs, in the 2004-2006 period only 35% of farms in EU-25 were able to cover all costs. This is especially true for small farms, but the share of profitable large farms is also just above 62%. In practice, this means that family labour is not sufficiently remunerated and that family assets do not provide adequate returns. Farm incomes are lower than that of the rest of the economy. In 2008, the entrepreneurial income per worker employed in agriculture in the EU-27 was estimated to be around 58% of the average wage in the EU. The gap is more pronounced in the EU-12 than in the EU-15. Since the year 2000, the gap has decreased in the EU-12, but actually increased in the EU-15.

Agricultural structure

The relatively low profitability of agriculture is partly a result of the fragmented and divided structure of EU agriculture. In 2007, there were 13.7 million holdings and 11.7 million annual working units⁶ in EU-27 and the most striking feature is the diversity of structures. The average farm in EU-27 has 12.6 ha (22 ha in EU-15 and 6 ha in EU-12), with an increasing number of farms above 4 ESU⁷. At the same time, 6.4 million holdings (46.6% of all farms) had an economic size of less than 1 ESU. These farms employ 2.7 million annual working units (23% of total labour force) but cover only 11 million hectares (6% of the total utilised agricultural area). Many of them in EU-12 are subsistence and semi-subsistence farming, with more than one third of EU-27 family farmers (36.4%) carrying out another gainful activity (apart from farm work). The demographic and education structure points to an issue of low level of human capital. In about a third of all farms, the managers are of 65 years and above (in further 20% they are between 55 and 64) and 80% of farm managers have no agricultural training but practical experience only. This diverse and fragmented structure is set to dominate EU agriculture in the longer perspective with the annual rate of decrease in the number of holdings of 2.2% (for EU-15 between 1995 and 2007 and EU-12 2003-2007).

The attractiveness of rural areas suffers from a significant development gap between the urban and rural areas. Many rural regions lag behind other types in terms of GDP per capita, employment rates or educational attainment. Their social capital suffers as they are more affected by aging population and outward flows. Their level of development of infrastructure and access to public amenities is low. In rural remote areas 43% of population lives more than 30 minutes of driving time by road from a hospital (against 2% in urban and 15% in rural close areas) and more than 1 hour of driving time by road from a university (against 1% in urban and 15% in rural close areas).

The diversity of structures, with a dominance of small-scale farming, will remain high in the 2020 perspective and is mostly a result of factors outside agriculture (e.g. economic and social development, legal framework for land, access to factors of production, heterogeneous agronomic conditions). As a result, the same instrument will have different impact on particular holdings and may not be sufficiently targeted in terms of achieving policy objectives. Moreover, these holdings have a different role with regard to the environment, local economy and social cohesion.

⁶ The annual work unit corresponds to the work performed by one person who carried out an agricultural activity on a full-time basis.

⁷ European size unit, abbreviated as ESU, is a standard gross margin of EUR 1 200 that is used to express the economic size of an agricultural holding or farm.

Factors influencing market income

Agricultural commodity markets, despite a sustained demand growth linked to increasing population, are unlikely to offer higher returns. Most medium-term projections for the agricultural sector show prices at levels above historical averages, but this is partly due to expectations of higher energy and other production costs, so producers' margins are not expected to increase. Further opening of access to markets will lead to stronger competition, especially in livestock sector, but for some sectors it will open new markets. Furthermore, price volatility is expected to remain significant due to series of factors, among which: uncertainties over energy markets, increased extreme weather events due to climate change, the financialisation of commodity markets and the use of distorting measures (e.g. export restrictions) which should add to the natural instability of agricultural markets.

A part of the unfavourable perspectives for the market income of EU farmers is related to the **functioning of the whole food chain**. Analysis shows that the overall competitiveness of the chain and its economic growth have underperformed as compared to the overall EU economy since 1995 (average value-added growth has been 2% lower per year than average growth in the EU). Moreover, it is facing increased competition from international actors and recent food price volatility has pointed to a lack of resilience to shocks in agricultural prices. Markets along the food supply chain suffer from a low and asymmetric price transmission as well as a lack of price transparency and predictability. Farmers tend to lose out – in particular due to the concentration of market power upstream and downstream and an unequal bargaining power among the partners of the chain.

In view of the above, there is an increasing relevance of product differentiation in specialised and local markets and higher value-added outlets, where they can gain a competitive advantage. Yet, these opportunities have remained a niche which is not easily transformable to a mainstream approach for most of these markets. In 2008 over 860 PDO/PGI products were registered for a total value of 14.5 billion EUR (about 4% of total production). The organic sector has been growing dynamically in the past decade. However it still represented in 2007 only 2% of food expenditure in EU-15 and even less in EU-12. Consumers and stakeholders do not seem to be sufficiently well informed about the characteristics and production methods that define the quality of products, with information and promotion activities becoming an important marketing tool. Promising outlets are also linked to the development of the bioeconomy and the supply of raw materials for bioplastics, although they are still marginal.

Overall, although prices on commodity markets are set to remain above historical levels, the agricultural margins will not grow due to higher input costs and increasing price and production risks. Moreover, the relatively weak position of farmers in the food chain means that they bear a disproportionate share of the risks within the chain. Specialised and local markets offer an alternative, but are not fully developed and sometimes lack the right framework. Innovative production techniques will also be increasingly needed for environmentally-friendly farming.

Longer-term perspectives

In terms of **efficiency gains**, the Total Factor Productivity (TFP) in EU-15 has increased at an average annual rate of 1.5% between 2000 and 2006, while it grew at around 2% per year in the nineties. The productivity gains result mainly from increased labour

productivity, while yields have not grown significantly. **Research and innovation** are the main factors that could reverse the declining trend of productivity growth in agriculture. The potential is large, as estimates of costs and benefits of agricultural research show rates of return on investment of around 45% - each 1 € spent gives 0.45 € gain per year in the future. It does not appear to be a problem of public spending on research. In terms of Agricultural R&D, Eurostat data show that EU public spending on agricultural research (GBAORD)⁸ accounted for close to 3.2 billion € in 2007 (double that of the USA and quadruples that of Japan) and showed a rising trend of 5.4 % growth per year since 2000. However, the process of knowledge dissemination and adaptation should be improved.

In the context of low profitability and diversified structure, EU agriculture has witnessed a slowdown of productivity growth which will reduce the potential of the sector to overcome current problems and develop in long-term perspective. Agricultural knowledge and innovation systems, including extension services, are fragmented and insufficiently responsive to evolving needs which hampers the implementation of research and uptake of innovation by the agriculture and the food sector.

2.3. Challenges to the current policy tools

A certain continuity is required to preserve what has already been achieved, but at the same time the reorientation towards a wider role for agriculture needs reinforcing.

The CAP is not a blank slate and the three broad types of CAP policy instruments: direct payments, market measures and rural development provide a starting point for discussions on the shape of the policy.

The decoupling of direct payments had successfully changed the focus of the policy from production to broader challenges. However, the actual support levels are still largely linked to historical type and level of production, resulting in large disproportions between farmers. The accession of EU-12 added to the imbalances. As the payments are not sufficiently targeted, they provoke strong criticisms and are difficult to justify to the general public. The main challenge is to achieve more equity between Member States and between farmers while strengthening the role of direct payments in the provision of public goods. However, more equity will not necessarily improve the targeting of the support. A particular challenge may therefore be to design targeted instruments that are considered as fair among Member States and farmers.

The market measures have been profoundly changed in previous reforms, which transformed their role from support to a safety-net function by lowering reference prices and removing tools which were inefficient. The 2009 dairy crisis has shown that market measures generally function well as a short-term relief in situations of very low prices. However, the high price volatility has prompted questions about the relevance of more risk management tools and a more global approach to the functioning of the whole food chain.

⁸ Government Budget Appropriations or Outlays on Research and Development (GBAORD) are all the appropriations allocated to R&D in central government or federal budgets.

Rural development policy has evolved from measures accompanying the reform process to an independent set of regionally adapted tools that, by virtue of its planning and financing, require strategic thinking in its approach. This has to be aligned with the EU 2020 strategy to benefit from synergies between different policies and reinforce the European added value of the policy. There is also a need to strengthen the delivery mechanisms to make it more effective.

There are also two cross-cutting issues, which will have to be taken into account when considering the effectiveness of the policy. Firstly - how to respond to the diversity of EU agriculture to provide tailored support without losing the common character of the policy. Secondly - how to assure further CAP simplification, while moving towards better targeting maintaining sound financial management and controllability and enforcement.

3. OBJECTIVES

The Lisbon Treaty has confirmed the relevance of CAP objectives of increasing agricultural productivity, ensuring a fair standard of living for the agricultural community, stabilising markets, assuring the availability of supplies and ensuring that supplies reach consumers at reasonable prices. **Yet, the challenges to EU agriculture have become broader (beyond the agricultural markets) and more complex (due to inter-linkages of economic, social and environmental issues and their global dimension).** Indeed, this greater breadth and complexity is reflected in changes to the Treaty since the first appearance of the CAP objectives by integrating additional obligations such as the environmental and public health concerns, territorial cohesion and the development cooperation objectives of the Union into other policies.

Therefore the policy tools have to address both the short-term viability and long-term competitiveness of European agriculture (low profitability and diverse structure) and its potential contribution to wider societal concerns (including food safety and quality, contribution to climate and energy policies, environmental sustainability, cohesion). A possible way of translating these is through the following objectives:

Maintaining the agricultural production capacity throughout the EU

- Attenuating volatility and its effect on incomes, fostering the development and growth of agricultural markets and better functioning of the food chain in order to help farmers derive adequate market income while contributing to high public health level.
- Enhancing the competitiveness and productivity of the agricultural sectors and fostering green growth through innovation in adopting new technologies and processes, developing new products and markets and supporting the transfer of research results to agriculture and the food sector, in view of the challenges and opportunities presented by evolving consumer preferences and increased trade liberalization.
- Contributing to reduction of the gap between agricultural and non-agricultural income in an equitable manner and compensate for difficulties in areas with natural handicaps, which are valuable from environmental or social sustainability perspective

Ensuring the provision of environmental public goods such as the sustainable management of natural resources and the preservation of the countryside

- Contributing to the provision of environmental services, such as the sustainable management of natural resources, the delivery of ecosystem services and the preservation of the countryside, as well as reducing environmental damage by agriculture
- Integrating and promoting climate change mitigation in actions supported by the CAP and enhancing agriculture's resilience to the threats posed by a changing climate

Contributing to the vitality of rural areas and territorial balance throughout the EU

- by allowing for structural diversity in the farming systems, improving the conditions for small farms and developing markets for higher value-added specialised and local products
- by improving the general economic and social conditions in rural areas and promoting diversification

In order for the CAP to meet these objectives in the view of the challenges outlined above, the purpose of the reform is to rethink the existing policy instruments along the following lines:

- increase the role of instruments relating to the objective of ensuring the provision of environmental public goods and the preservation of countryside
- broaden the policy framework for agricultural markets to help farmers manage their risks better and derive adequate income from the market
- adjust current income support instrument so that it corresponds better to the needs in diverse economic, social and environmental conditions throughout the EU and complements market income

Moreover, the reforms of policy instruments have to take into account the EU obligations as regards international trade agreements, coherence with development policy goals, impact on public health, budgetary efficiency, as well as simplification and reduction of administrative burden.

4. POLICY SCENARIOS

Various ideas about the reform of the CAP towards 2020 have been expressed in the public debate, including the debate within EU Institutions. These ideas have been grouped here under three broad policy reform scenarios, which will be analysed in the Impact Assessment and compared to two reference scenarios (status quo and no policy). The three reform scenarios sketch alternative structures of the policy, within which possible reforms or introduction of individual instruments will be considered.

All three policy reform scenarios respond to the objectives of the reform and follow the ideas outlined in the EU Budget Review. What distinguishes them is the weight they give to particular objectives, the way of achieving them (EU-wide or local, generalised or

more targeted) and their expected impacts. Between them, a complete evidence base will be provided as to the impacts of reforming the policy.

All scenarios are, to a different extent, anchored in the Europe2020 strategy contributing to:

- sustainable growth by promoting resource efficiency, maintaining the food, feed and renewables production base, increasing competitiveness, providing environmental public goods, fighting climate change and biodiversity loss;
- inclusive growth by unlocking local potential, diversifying rural economies, developing local markets and opening up alternative opportunities to accompany agricultural restructuring;
- smart growth by supporting innovation, technology and skills, improving uptake of research, and developing high value added and quality products

In essence, the adjustment scenario continues the current policy path of gradual adaptation, while the other scenarios propose an increased effort to respond to the objectives of smart, sustainable and inclusive growth, either, by incorporating them better in the first pillar (integration scenario) or, in by concentrating efforts on strengthening the second pillar (re-focus scenario). In all scenarios, efforts would be made to make the policy more efficient and simple.

4.1. Adjustment scenario

As the challenges to sustainable agriculture in Europe are not new, the previous reforms have already allowed the adjustment of the policy to address them. This scenario assumes the continuation of this process with further gradual changes to the current policy framework. The main feature of future CAP reform under this scenario would be to lead the Single Payment Scheme (SPS) of direct payments towards a significant harmonisation in the level of payments throughout the EU (through a general flat rate payment or one adjusted by objective social and economic criteria), with further strengthening of rural development policy to target the challenges identified as priorities (resource efficiency and innovation) and streamlining of market measures (exceptional measures, public intervention and private storage).

This scenario would allow retaining a stable policy framework, while addressing the most pressing issues of payment redistribution and maintaining an economic viability of farming. A limited increase of funds to the second pillar would be available for climate change, water, biodiversity and renewable energy actions, going a certain way towards addressing the EU objectives of smart, sustainable and inclusive growth. The focus would remain on income support for farmers across the EU, given the low profitability of farming. More balanced payments across the EU would give impetus to EU-12 agriculture, where this sector is relatively more important for economic and social reasons.

Analysis will show the degree to which this would allow sufficient leverage for the EU to properly respond to environmental and social problems without undermining the long-term economic performance of the sector, with the risk of creating more pressure on income support.

4.2. Integration scenario

The approach assumed under this scenario is to project the type and scale of problems that agriculture will be faced with in the coming decade and anticipate them with a thoroughly revised policy framework, which integrates the three objectives in both first and the second pillar of the CAP, reinforcing their complementarities.

The SPS system would be divided into a basic income component (capped to avoid large payments to single beneficiaries) and additional payments targeting environmental issues applicable throughout the EU territory through generalised, non-contractual and annual environmental actions linked to agriculture (such as permanent pasture, green cover, crop rotation and ecological set-aside) with enhanced conditioning through cross-compliance. The option would be left to Member States to commit a certain part of the financial envelope to compensate specific natural constraints and address selected economic and social challenges. Rural Development would be aligned with EU priorities as provided in Europe2020 strategy and targets, with the objectives interpreted through guiding considerations of environment, climate change and innovation. It would be managed through a strengthened strategic targeting approach with an emphasis on outcomes rather than measures, in a common strategic framework for EU funds. Market measures would be reinforced as a safety-net with more focus on the whole food chain, through strengthening of producer and inter-branch organisations. A wider range of risk management instruments will be offered to farmers, helping them to cope with price and production risks (including those related to animal and plant health) through better access to insurances, mutual funds and income stabilisation instruments.

The new elements in the SPS would reinforce the support for the provision of environmental public goods in the first pillar by providing an EU-wide instrument for actions which would concern all farmers, whilst reducing negative climate change and environmental impacts. It would be supplemented by local level actions through Rural Development, with a wider possibility of alignment with Europe2020 strategy. Basic income support would provide a more equitable support for farmers. Market measures would focus on avoiding extreme price fluctuation and improving farmers' position in the food chain to help increase market revenues. The current balance between the first and the second pillar will be maintained, thus risking that the local responses will not sufficiently match future needs.

4.3. Re-focus scenario

With direct payments representing the bulk of CAP spending, the current policy has a strong focus on income support. This scenario assumes the gradual re-focus of support solely around ensuring the environmental and climate change objectives through the rural development policy strategic framework, thus fostering sustainable growth. It assumes that production capacity can be maintained without support (albeit with an accelerated and strong restructuring of the sector). The objective of contributing to the vitality of rural areas and territorial balance would be achieved by the cohesion policy.

The SPS system would be progressively phased out to allow a smoother adjustment within the timeframe of 2020, with parallel abolition of the remaining market measures. Funding for Rural Development would be increased significantly and redistributed between Member States based on objective criteria. It would be focused on climate change and environment aspects with certain temporary measures to support the phasing-

out of direct payments, fostering innovative approaches and with a simplified management system.

By providing significantly increased funding for environmental and climate change issues, this scenario would encourage the creation of regional strategies for addressing these issues in order to assure the implementation of EU objectives at a local level.

However, the difficult income situation in the EU agriculture could result in lowering the effectiveness of the environmental incentives as the farming sector concentrates and intensifies production in the most competitive regions with the aim of receiving adequate market income. This scenario allows significant CAP savings for the EU budget, but, depending on the impacts, may leave open the sources of compensation for expected income losses via national policies.

4.4. Status quo

This reference scenario examines the effects of current trends as regards environmental, social and economic factors affecting EU agriculture if current policy framework was maintained. It allows the illustration of the main problems and adaptation needs and serves as a benchmark for other options.

4.5. No policy

This reference scenario examines the effects of current trends as regards environmental, social and economic factors affecting EU agriculture if no policy framework were available, except for general common market rules. As a counter-factual scenario, it provides an insight into the role of policy in other scenarios.

5. QUESTIONS

The above description of issues, objectives, options and scenarios tries to sum up various ideas that were put forward in the public debate. It represents a certain choice with regard to issues tackled, main objectives and possible policy evolutions. This consultation process calls on interested parties to express their opinion on the relevance of the described elements, the consistency of approach and possible improvements that could be made.

The public consultation also allows to acquire a broad range of information and knowledge on the expected effects that each broad policy scenario and consequent changes to the CAP instruments. The stakeholders are invited to provide factual, analytical contributions that will complement other sources of information in assessing the impacts of policy reform. In order to guide and structure the contributions, the following questions were prepared by the Inter-service Steering Group:

Policy scenarios

- (1) Are the policy scenarios outlined consistent with the objectives of the reform? Could they be improved and how?
- (2) Are there other problems apart from those set in the problem definition section of this document that should be analysed when considering the architecture of the

CAP in the post 2013 period? What causes them? What are their consequences? Can you illustrate?

- (3) Does the evolution of policy instruments presented in the policy scenarios seem to you suitable for responding to the problems identified? Are there other options for the evolution of policy instruments or the creation of new ones that you would consider adequate to reach the stated objectives?

Impacts

- (4) What do you see as the most significant impacts of the reform scenarios and the related options for policy instruments? Which actors would be particularly affected if these were put in place?
- (5) To what extent will the strengthening of producer and inter-branch organizations and better access to risk management tools help improve farmers' income levels and stability?
- (6) What environmental and climate-change benefits would you expect from the environment-targeted payments in the first and the second pillar of the CAP?
- (7) What opportunities and difficulties do you see arising from a significant increase of the rural development budget and a reinforcement of strategic targeting?
- (8) What would be the most significant impacts of a "no policy" scenario on the competitiveness of the agricultural sector, agricultural income, environment and territorial balance as well as public health?

Monitoring and evaluation

- (9) What difficulties would the options analysed be likely to encounter if they were implemented, also with regard to control and compliance? What could be the potential administrative costs and burdens?
- (10) What indicators would best express the progress towards achieving the objectives of the reform?
- (11) Are there factors or elements of uncertainty that could significantly influence the impact of the scenarios assessed? Which are they? What could be their influence?

6. PRACTICAL INFORMATION:

Consultation is open until 25th January 2011. Contributions should be sent either:

- through the electronic form to be filled on the consultation webpage:

http://ec.europa.eu/agriculture/cap-post-2013/consultation/index_en.htm

- or to a functional mailbox: agri-cap-towards2020@ec.europa.eu

Please address any inquires to:

agri-cap-towards2020@ec.europa.eu

or:

The European Commission
ISSG CAP post-2013
c/o Pierre BASCOU
130, Rue de la Loi
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The Impact Assessment will take into account the contributions to the consultation. Relevant elements will be integrated in the Impact Assessment report and a chapter will be dedicated to the consultation process, main results and participants. The report is foreseen for the summer 2011.

For regularly updated information on progress of the Impact Assessment exercise, please consult the CAP post-2013 webpage:

http://ec.europa.eu/agriculture/cap-post-2013/index_en.htm