Chapter 3

Common Agricultural Policy

The summary

- The Common Agricultural Policy (CAP) accounts for around 40% of the EU budget and costs around £45 billion per year. Despite recent reforms which have begun to move the CAP towards a more market facing policy, it remains a hugely bureaucratic and costly policy, and one to which the UK makes a net contribution of around £1 billion per year.

- The CAP is split into two parts. Pillar 1 which includes the Single Farm Payment (SFP) and all other market management tools and Pillar 2 which focuses on rural development and is co-financed by member states. Pillar 1 accounts for around 80% of the total CAP budget. In addition further protection is provided to EU farmers through a range of tariffs applied to the import of agricultural goods.

- Apart from the budgetary costs to the UK treasury, UK farming is also penalised by the CAP as the policy is not commonly implemented across the EU. UK farmers receive less money in both Pillar 1 and Pillar 2 than their counterparts in most other EU countries. The cost of administering the CAP is also burdensome on administrations and farmers. Market management support systems also tend to increase the price of food for consumers.

- The European Commission has proposed a reformed CAP after 2013. This includes 30% "greening" of direct payments and new schemes for young and small farmers. It also proposes to cap payments to large farms and for more equal distribution of payments to member states in Pillar 1. However, it does not propose a reduction in the overall CAP budget.

- The CAP is constantly evolving, however current proposals do not address the key challenge for the future of farming which is how to feed a growing and more affluent global population. Estimates suggest that the world will need to produce 70% more food in the next forty years to meet global population growth.

- The CAP is a "common" European policy, meaning that there is no chance to withdraw from certain elements of it without being in breach of the Treaty. However, the CAP is revisited substantially approximately every seven years and this presents an opportunity for reform.

The options for change:

➔ Work within the current architecture of the CAP to reject the greening proposals, to reduce the agricultural budget and to work with like minded EU countries to complete the 2003 reforms. This would include a full decoupling of all Pillar 1 subsidies, a greater transfer of funds to Pillar 2 and a focus on tailoring all agricultural subsidies towards preparing the industry towards one which in the longer term did not need subsidising.

➔ The UK could use budget negotiations, and the need for a smaller EU budget as a tool to force a reduction in agricultural spending.

➔ The UK could be more active behind the scenes and in Council negotiations and could propose a new focus on environmentally focused agricultural subsidies within the existing architecture. This could have some success in time, but would be a long term project.

➔ The UK could propose that the EU unilaterally carried out the import tariff reductions proposed by the EU, but never implemented at the WTO Doha Round negotiations.

This is a long term approach, and unlikely to succeed without expending political capital due to the importance placed on agriculture by other EU member states. The UK could therefore propose a radical reform which would fundamentally change the architecture of the policy and significantly reduce CAP expenditure.

➔ Obtain the removal of Pillar 1 subsidies after an appropriate phase out period, with accompanying reform of Pillar 2 to focus on the delivery of "public goods".

Pillar 1 subsidies would be phased out, initially through a national co-financing requirement, and with a focus on short term payments designed specifically to gear farmers towards the market.

Accompanying measures would include country of origin labelling, a focus on the marketing of quality products which meet high standards and steps to improve the bargaining position of farmers in the food chain.

Pillar 2 would focus primarily on agri-environment schemes with the possibility of tradeable environmental payments, which farmers could pass onto other farmers if they did not wish to carry out the environmental measures.

This would be a radical change to the CAP, and would need the UK to expend significant political capital in order to be obtained. The UK would have to prioritise CAP reform above other issues and would probably have to be prepared to give up the rebate to achieve the benefits of reform.

➔ Unilaterally withdraw from the CAP and its budgetary implications in an attempt to force change.

This would be a clear breach of the UK’s EU treaty obligations and any agreement on the EU's multiannual financial framework in force at the time. In addition, as the UK contributions to the CAP can not easily be differentiated from its contributions to other parts of the EU budget, such a move is unlikely to be possible without withdrawing from all elements of the EU budget.

Farmers, who would face losing all their payments in the short term, could also be temporarily excluded from the internal market in agricultural products.

In short, this unilateral action would not provide a sustainable long-term solution. It could, though, be used as a negotiating tactic during negotiations over the multiannual financial framework.

The introduction

The Common Agricultural Policy (CAP) was created in 1962 by the founding six member states of the European Community. Today, along with the Common Fisheries Policy (CFP) it is one of only two truly common EU policies and accounts for 41% of the total EU budget.

In recent years the pressure for reform of the CAP has been building due to a number of factors, namely World Trade Organisation (WTO) negotiations; concern from European taxpayers as to whether spending €55 billion a year is good value for money and from budgetary constraint as a result of both the Eurozone crisis and the aspirations of treasury ministers around the EU who would like to spend more on other policies.

Initially designed at the insistence of France and because all six founding countries already subsidised their agriculture, the CAP was founded on five main objectives:

1. To increase productivity, by promoting technical progress and ensuring the optimum use of the factors of production, in particular labour.
2. To ensure a fair standard of living for the agricultural community.
3. To stabilise markets.
4. To secure availability of supplies.
5. To provide consumers with food at reasonable prices.

To these ends a common market in agricultural goods was created, along with a common set of rules consisting of import tariffs, internal price supports, export subsidies and direct income support to farmers.

Initially the CAP was immensely successful in its aim of producing food, to such an extent that very quickly European nations were producing far too much. The European Commission therefore had to buy up excess food and store it in an attempt to keep the prices in Europe high enough to ensure a fair standard of living for farmers.

These intervention stocks quickly became known as “food mountains” or “wine lakes” and the reputation of the CAP was further damaged when much of this food was dumped on markets in the developing world, thus making farmers there uncompetitive.

Partly in response to political pressure and to the opening up of global trade through the WTO, the CAP has recently undergone a series of reforms in an attempt to modernise the CAP, to make it fairer and to make it better value for money for the taxpayer.

In 1992, the MacSharry reforms marked the first, tentative attempt to liberalise the CAP with a focus on trying to limit production by introducing measures such as set aside (where farmers are paid not to produce on certain land) and reducing levels of support for certain sectors.

The Agenda 2000 reform established the current Two-Pillar structure of the CAP with all market support structures residing in Pillar 1, and Rural Development measures, including agri-environmental schemes making up Pillar 2.

The Fischler reforms of 2003 were arguably the most significant reforms and included the historic move of “decoupling” payments from production and the introduction of the Single Farm Payment (SFP). The level of direct payments to farmers was also reduced through a compulsory transfer of funding from Pillar 1 to Pillar 2.

In 2008, the Fischer Boel Health Check furthered the Fischler reforms, reconfirming the end of milk quotas in 2014 and increasing the amount of money transferred from Pillar 1 to Pillar 2. However, despite the Health Check being the price Prime Minister Tony Blair demanded for giving up part of the UK rebate in 2005, it fell a long way short of real reform.

The detail

The CAP is currently built around a two Pillar structure. Pillar 1 focuses on market management and income support and is wholly managed and funded at EU level. It accounts for nearly 80% of the total CAP budget. Pillar 2 concentrates on rural development, is co-financed by EU countries and whilst the overall framework is decided at EU level, EU countries have significant flexibility to create a policy tailored to their needs.

Pillar 1 payments are made up of:-

Single Farm Payment (SFP) – This is the basic direct payment which is payable on every hectare of eligible land. In order to receive the payment the land must be kept in good agricultural and environmental condition (GAEC) by meeting the various cross compliance requirements. The payment is decoupled from production and therefore is not directly market distorting. It incorporates previous, historical payments and differs substantially throughout Europe as a result. When initially brought in as part of the 2003 reforms, the SFP was intended to eventually become an area based payment (i.e. each hectare of eligible land would be worth a certain amount of money). However, as part of the transition process it was permitted for the payment to contain an historical element – i.e. the payment that a farmer used to get when he/she was paid a direct production subsidy.

Each EU country was able to decide for itself whether to move towards a full area based payment. To date, only Germany, Finland and England have moved to a full area payment, all other member states, as well as Scotland, Wales and Northern Ireland retain an historical element to the payment.

The SFP is the biggest single expenditure in the CAP, accounting for over 70% of the Pillar 1 budget.

Single Area Payment Scheme (SAPS) – In the new member states (those that joined since 2004), the SAPS scheme is used and is a simpler version of the SFP based on an area basis.

Coupled subsidy payments – In some sectors, notably cotton, flax, hemp and suckler cows, a coupled payment based on production levels is still paid.

Intervention – In the wheat, barley, maize, paddy rice, beef, veal and dairy sectors, the European Commission is permitted to buy up food if the market price falls below a specific trigger price. This tool is used if prices fall to a level which may threaten the economic viability of farms. The Commission stores the food and sells it back into the market when prices rise. In the past, trigger prices were set at a high level, leading to food mountains and significant expenditure for the European taxpayer. However in recent years, as a result of extreme price swings, the European Commission has actually made money from using intervention tools.

Private Storage Aid (PSA) – The Commission also pays for the private storage of the following commodities: white sugar, olive oil, flax fibre, beef, butter, skimmed milk powder, pig, sheep and goat meat.

Quotas – Quotas remain in the milk and sugar sector and through the regime of planting rights in the wine sector. They serve to impose a maximum limit on the amount of the commodity that can be produced.

Export Refunds – In some areas an export subsidy is paid to producers when they export their products. These are highly market distorting. The EU has substantially reduced its export subsidies in recent years and has pledged to abolish them altogether, although to date there is no concrete proposal in place to do this.

Social schemes – The CAP includes a number of social schemes within Pillar 1. These include the food for deprived persons, the school milk and the school fruit schemes.

Article 68 – Under this provision, an EU country is able to use up to 5% of its total budget in Pillar 1 to re-couple payments to a certain agricultural sector.

Pillar 2 in detail :-

The Rural Development Pillar of the CAP is broken down into several components:-

- Axis 1: Improving competitiveness through farm modernisation.
- Axis 2: Improving the environment and countryside through agri-environment schemes.
- Axis 3: Diversification of rural economic activities.
- Leader schemes (community led initiatives).

Each member state must use a minimum of 10% of its rural development allocation on schemes in Axis 1 and Axis 3, 25% in Axis 2 and 5% in Leader schemes. However countries are free to develop their own schemes within these guidelines. The UK has very successfully developed a number of environmental stewardship schemes which fit into Axis 2.

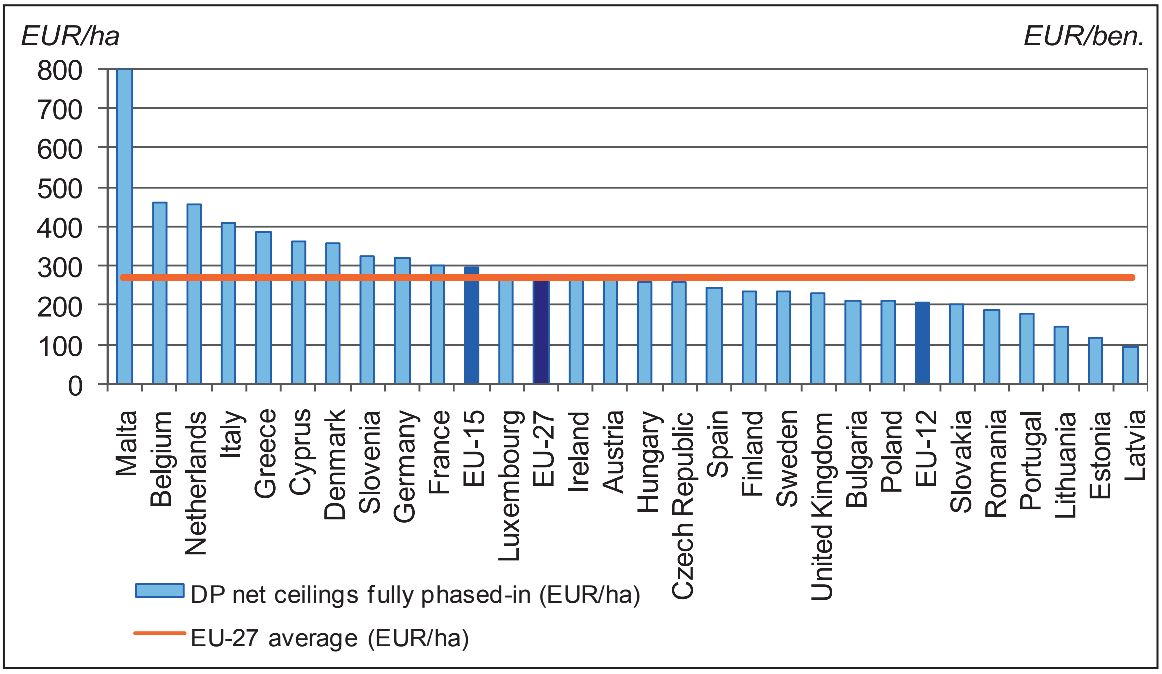
Schemes supporting Less Favoured Areas (LFAs) are funded through Pillar 2 funding.

To fund Pillar 2, 5% of all direct payments are modulated (transferred on a compulsory basis from Pillar 1 to Pillar 2). However countries are able to voluntarily move up to a further 20% from Pillar 1 to Pillar 2 if they so wish. The UK is the only country which uses this option.

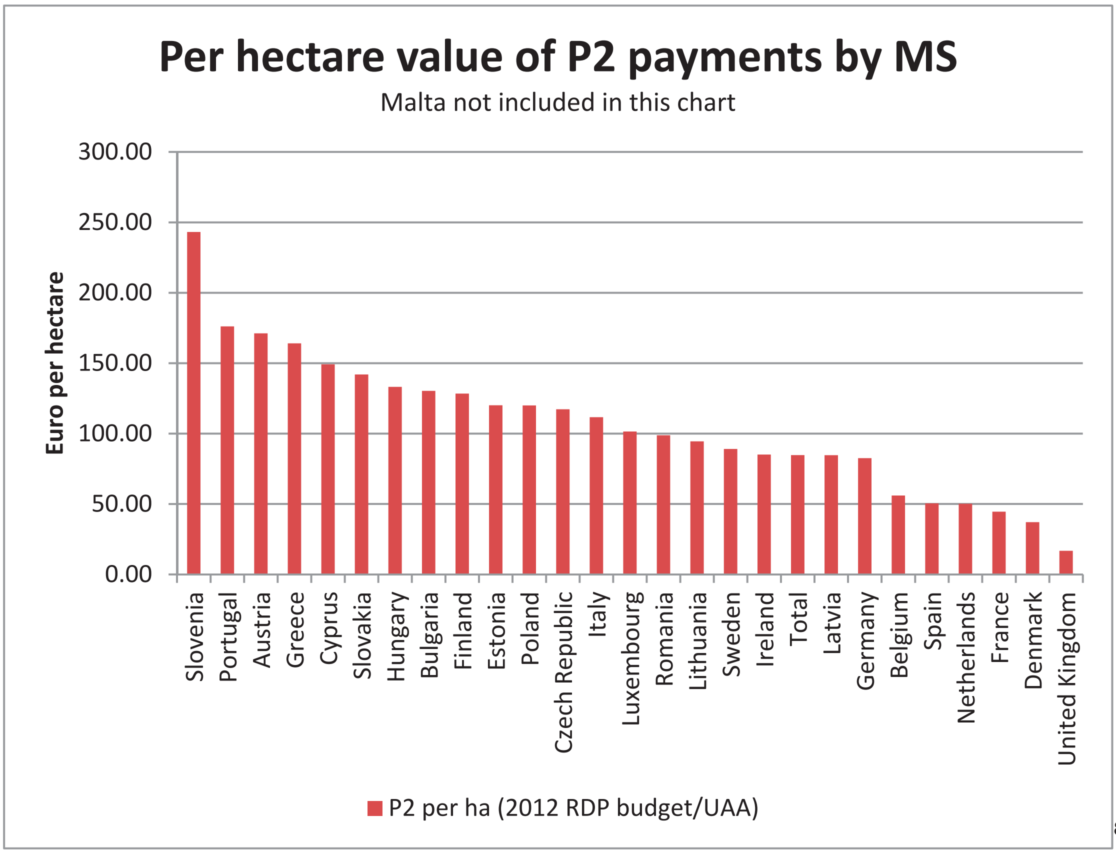
General Overview

EU countries receive very different amounts of funding based on a number of factors but most critically based on historical production levels. As a result average payments to farmers per hectare differ substantially across the member states. The average farmer in Belgium or the Netherlands receives €460 per hectare whilst his counterpart in Latvia receives only €100 per hectare. For the UK this figure is around €220, which is below the EU wide average.

Net ceilings per member state for Pillar 1[87]



In Pillar 2 the differences are even greater as the amount each country receives is based on the amount they spent on national schemes prior to the introduction of Pillar 2. As a result the UK does very badly out of Pillar 2, receiving around 3% of EU spending as opposed to the 12% it should be entitled to if it was based on the amount of agricultural land the UK has.



[88]

[87] Data supplied by the NFU.

The CAP has been fundamentally reformed over the past ten years. It is nowhere near as market distorting as it was previously. The worst excesses of the previous policy have been substantially reduced and farmers are now far freer to react to market signals than they were previously. However, the CAP still accounts for 41% of EU spending, costs around €55 billion a year, and is still the most generous farm support structure in the world. In addition, in most EU countries, including the UK, up to 70% of farm income comes from the Single Farm Payment.

International Trade and its effect on the CAP, the WTO and the role of tariffs

Tariffs

In addition to the internal market support mechanisms and direct payments to farmers, the EU employs a wide range of tariffs to protect the agricultural industry from global competition. Under WTO rules tariffs are set at maximum levels although the EU has freed up access substantially to countries of the Africa/Caribbean/Pacific region (ACP). However despite this, tariffs on imports from non ACP countries remain high. The average tariff on agricultural imports from Most Favoured Nation countries (MFN) is 15.4% and in some areas such as dairy products and fruit and vegetables can reach as high as 156%, effectively keeping much produce out of the EU and protecting domestic farmers from competition. When products are imported into the EU, costs are raised substantially for consumers.

In the highest tariff product group including animal products, dairy, sugars and confectionary, in which imports account for nearly 21% of the EU market, the average tariff is above 20% [89]

At the Doha WTO round of negotiations, the EU made a substantial offer to significantly reduce agricultural tariffs. In this case it was the reticence of other trading blocs and countries to agree to the deal rather than opposition from the EU.

As a result of the failure of the Doha round, the EU is in the process of completing or negotiating Free Trade Agreements (FTA) with a number of countries, including South Korea, the countries of Central America and the Andean countries. Negotiations are ongoing with India and Mercosur. The potential Mercosur deal is the most controversial within the EU because of the huge potential agricultural capacity of Brazil and Argentina. Although an eventual deal is probably unlikely, such an agreement would allow enhanced access to the EU agricultural markets and would pose a competitiveness challenge in the short term to EU livestock producers in particular.

Market distorting effect of CAP policies

According to the OECD the EU has reduced its agricultural support to 22% of total farm income, although because of the prevalence of small farms, for many farmers support still accounts for up to 70% of a given farm's income.

The EU figure is still above the OECD average but remains well below the level of support given to farmers in Korea (47%) Iceland (48%) Japan (49%) Switzerland (56%) and Norway (60%). In Russia support exceeds the OECD average and in China it is fast approaching the average.

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[88] Data supplied by the NFU.

[89] Trade Policy Research Centre Research Paper - EU Agricultural Protection : Felix Bungay and Ronald Stewart-Brown pg10-12.

In contrast New Zealand has the lowest level of government support to agriculture in the OECD at 1% of farm income, Australia (3%) Chile (4%) and the US is at (9%)[90]

The reforms of 2003 specifically tried to move the majority of EU support into less market distorting areas and the EU has moved a long way in this regard. However, EU farmers are still very well subsidised in comparison to most other developed countries.

The case study: the cost of the CAP to the UK

According to research by Open Europe, the UK will contribute a net total of £7.1 Billion to the CAP over the 2007-2013 financial framework, or just over £1 billion a year, however, this is balanced out somewhat by the rebate, which is designed to partly reimburse the UK for its net contributions to the CAP and totalled £2.7 billion in 2010-2011.[91]

Over the 2007-2013 period the UK receives a total of £26.6bn in Pillar 1 and £3.8bn in Pillar 2.

However, British farming is also penalised because the CAP is anything but a common policy. Farmers in many other EU member states still receive historical payments based on what they were producing nearly ten years ago. Many countries make use of Article 68 to recouple payments and no other EU member state employs voluntary modulation, which reduces the payments to British farmers even further.

In addition, the UK receives far less funding for rural development than it should under any objective criteria and this threatens the ability of the British Government to develop and run environmental schemes within the second pillar. As a result of this, the UK Government has been forced to use voluntary modulation to plug this funding gap.

European environmental, animal welfare and cross compliance legislation also impose costs on British farmers. Whilst much of this is outside the CAP, the UK Government is often guilty of gold plating EU legislation applied to farms as well as being overzealous in its enforcement. For example, UK farmers have been fined in the past for bringing cattle to market with only one ear tag, after the second, identical tag has fallen off in transit. Despite confirmation from the European Commission that such a situation is not automatically an infringement of the cross compliance regulations, the UK has often issued fines for such infringements.

The UK also sees costs as a result enforcing European legislation while other countries do not. New animal transport requirements as well as the ban on battery cages are examples of where the UK has fully enforced EU legislation but other countries have not, putting British farmers at a disadvantage in the single market.

Equally difficult to quantify is the cost to consumers of the CAP as its current structures allow many small farms to stay in operation when they would ordinarily go out of business or be subsumed by larger farms. As a result this may cause prices to be higher than they would be under a more liberalised system.

The system of tariffs imposed on imports into the EU also drives up the price of food to consumers. According to the University of Dublin, tariffs on agricultural imports to the EU

[90] Information from the OECD website http://www.oecd.org/document/32/0,3746,en_2649_37401_48625184_1_1_1_37401,00.html.
[91] OBR Fiscal Supplementary tables to 2012 UK budget.

from countries without most favoured nation status range between 18% and 28%, much higher than the average 3% paid on manufactured goods.

It is therefore difficult to quantify the cumulative cost to consumers of the current market management tools employed by the CAP and by EU trade policies or of the effects of the lack of a level playing field for British farmers within the internal market.

Global food security and challenges to agriculture

The most pressing issue for agriculture is food security. It is estimated that because of global population growth and due to the rise in incomes in China and India, food demand is likely to grow by 70% between now and 2050.[92] However, increasingly agricultural land is being lost to agriculture through climatic changes, both through droughts in some parts of the world and flooding in others. This coupled with concerns over the impact of intensive agriculture on the environment mean that this food will need to be grown using less land, less water, fertilisers and pesticides. The main challenge facing policymakers is therefore to devise an agricultural policy which will increase food production without damaging environmental sustainability.

The EU has an important role to play because not only does she possess a beneficial climate and some of the best land to produce food, but also because she is both the world's largest exporter of food and the largest importer. The EU imports food which needs the landmass of Germany to produce every year.

CAP reform proposals from the European Commission

The European Commission has made a comprehensive proposal for reform of the CAP post 2013 to coincide with the proposals for the EU's multiannual budget for 2014-2020. The key tenets of the proposal are:-

- Greening of Pillar 1 - 30% of the SFP will be contingent on farmers doing three environmental measures:–
    - 7% of land in an Ecological Focus Area (EFA) or "set aside".
    - At least three crops must be grown on arable land greater in size than 2 hectares.
    - At least 5% of the land must be kept as permanent grassland.
- A new small farmer payment.
- A new young farmer payment.
- The end of milk and sugar quotas.
- Capping payments to large farmers.
- Limiting payments only to active farmers.
- Increased scope for countries to use Article 68, allowing for more coupled payments.

The greening proposals have been made primarily to justify the Commission's wish to maintain funding for agriculture at roughly current levels and therefore the Commission has sought to provide a new justification for the payment of direct subsidies to farmers. They term this as the "delivery of public goods."

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[92] The Future of Food and Farming. Government office for Science Foresight Report pg67 http://www.bis.gov.uk/assets/bispartners/foresight/docs/food-and-farming/11-546-future-of-food-and-farming-report.

These proposals are misguided as they reverse the direction of recent reforms. Instead of making EU farmers more efficient and competitive, they will instead increase costs for producers and consumers, are likely to reduce the amount of food produced in the EU and will entrench a system of direct payments to farmers based on supposed environmental benefits, which will be much more difficult to challenge.
It is estimated that the set aside proposal would take 5.74m hectares of land out of food production.

The options for change

The CAP is an immensely complex policy and therefore a large number of opinions exist as to what is the best way to support agriculture and whether agriculture should be supported at all at EU level. This leaves several potential options available for the UK, which include both trying to reform within the existing structures of a common policy, favoured by many in the industry as it guarantees some sort of level playing field with competitors in the rest of the EU, to unilateral withdrawal from elements of or all of the CAP.

The colour-coding used below for possible UK action follows the categorisation for all the Fresh Start Project's Green Paper chapters. Please see the Introductory Chapter to the Green Paper.

Try to reform the existing structures of the CAP towards a gradual liberalisation

The template for this already exists. The 2003 Fischler reforms created the Single Farm Payment which ultimately envisaged a single area based payment. Once this had been achieved, over time that payment would have been vulnerable to substantial reduction as a result of budgetary constraint, increased focus on Pillar 2 rural development, future WTO agreements and gradual restructuring of the agricultural industry into larger and more efficient units which would have gradually become more market focused and less reliant on subsidy, particularly against a background of increasing global food shortages.

The current Commission proposals seek to close the door on this option, instead imposing new means for justifying the long term continuation of direct payments to farmers and backtracking on the need for full decoupling of payments and for this reason the proposals should be vigorously opposed by the UK Government.

The UK could mount a determined effort to persuade other member states and the EU institutions to complete the 2003 reforms to their full conclusion. This would include full decoupling of payments in all EU countries, full abolishment of all quotas, reduction in trigger prices for intervention and private storage aid. The UK should demand a specific focus on increasing competitiveness and further transfer of funding throughout Europe from Pillar 1 to Pillar 2 and a fairer distribution of funding to the UK in Pillar 2.

The UK approach to CAP reform in the past has been criticised because the UK has often gone into negotiations with no vision for reform of Pillar 1, because such a vision would entail support for continuation of direct subsidies and as a result the UK has frequently been sidelined during negotiations which usually focus only on Pillar 1.

- This approach is likely to bring some success in the long term, as the growing demand for food, the vulnerability of the CAP budget, the existence of an alternative in Pillar 2 and increased pressure from global trading partners means that the CAP is under pressure from all sides. In addition, the UK currently finds itself in the unusual position of having allies in CAP reform negotiations. Very few other EU countries support the Commission proposals and many would like to see further, small scale reform within the confines of the existing framework of the CAP.

- Britain could also seek a much more active behind the scenes negotiating position within the relevant Commission departments (DGs) and bodies of the European institutions. The French were successfully able to ensure that the 2008 Health Check took place during their EU Presidency and often place key staff in key positions within the institutions at the time of major agricultural reforms. Britain should also seek to place the debate on agricultural spending more within the remit of finance ministers to ensure that it focuses more on the cost benefit analysis of funding agriculture ahead of other priorities. Downward pressure exercised because of a freeze in the overall EU budget could mean significant real reductions in agriculture spending over the medium term.

- The UK could also put pressure on the EU to focus strongly on either a WTO Doha round deal, or if this proves impossible, on bi-lateral Free Trade Agreements with third countries which will expose EU agriculture to more competition and may well once again necessitate the need for further reform of the CAP. In addition, the EU has already made a significant proposal to reduce tariffs on agricultural goods as part of the Doha Round. The UK could additionally put pressure on the EU to unilaterally carry out these proposed tariff reductions despite the absence of a deal at WTO level. This may undermine the EU negotiating position at future WTO negotiations but would show a commitment to the liberalisation of global agricultural markets.

Whilst it is possible that this collective approach will gradually move the EU towards a more open and less expensive agricultural policy, this is a long term approach which will take a significant amount of time and some political capital to achieve fundamental reform of the system and to avoid the previous reforms from being reversed. Such an approach also means that the many remaining criticisms of the existing CAP would not be formally addressed, at least in the short term.

In addition, the CAP is an area of vital strategic importance to France and it is extremely unlikely that any French government would allow a fundamental restructuring of the existing CAP without significant concessions elsewhere. It should also be noted that several other large EU members see the CAP as of vital strategic importance, including Poland, Germany, Spain and Italy.

Other Pillar 1 options

If a priority was to ensure that some element of public support remained in Pillar 1 there are a number of other CAP reform options that the UK could put forward whilst keeping the overall architecture of the current CAP.

- The idea of a type of bond scheme has been advanced[93] as a lower cost alternative to subsidy support. This would involve either the government or the EU paying a guaranteed sum to farmers for a fixed amount of time based on the farmer's activities at the time of the introduction of the bond. A farmer would then be free to retain or sell the bond and would receive it for the fixed amount of time is valid. The revenue from the bond could be reduced over time in a scenario of gradual phasing out of support. Alternatively, it could be used as a payment to compensate for "income forgone" as a result of meeting the EU's high animal welfare and environmental

[93] Sometimes referred to as the Tangermann Bond or Marsh Bond and advocated by Alan Swinbank of Reading University http://alanswinbank.website.orange.co.uk/.

requirements, if it was deemed necessary to retain some sort of basic payment. Cross compliance would no longer be necessary but this would mean that there would be no requirement to keep the land in good agricultural and environmental condition (GAEC). A bond scheme would also allow farmers better access to bank credit which is one of the concerns of completely phasing out support in Pillar 1. However, such an entitlement would retain some of the criticisms of the current SFP in that farmers could receive income from the bond without actually farming. A market in bond sales would also develop, possibly meaning that non farmers or investors could buy up the bonds in order to receive the income.

- The idea of subsidising farming only when times are bad has frequently been advanced as a better way of providing a safety net for farmers and for saving taxpayer's money. However, different types of deficiency payments which set a target commodity price and pay farmers when the price falls below that level have been tried many times before, including in the UK which had a type of deficiency payment before the UK joined the EU. In general such payments do not fit within the WTO Green box and tend to be market distorting. However a type of insurance scheme, whereby farmers could take out insurance against a drop in commodity prices below a certain price could be investigated. Such a scheme would involve a financial contribution from farmers in addition to a financial commitment from either the EU or the national government. However, such a scheme would ultimately involve either the EU or the national government underwriting the scheme, thereby potentially making them open to large losses in the event of widespread market failure. It would also effectively amount to a subsidy to insurance providers.

Neither of these two options is therefore likely to solve the underlying criticisms of the existing CAP, nor are they likely to lead to its widespread liberalisation. Whilst the UK would expend political capital in trying to move these options forward, they are unlikely to be successful.

- A further option could be a complete "greening" of Pillar 1. The European Commission has proposed that 30% of Pillar 1 payments should be linked to greening measures, recognising that environmental public goods can be used as a justification to make payments to farmers. Open Europe, in its report of February 2012, proposed a system of tradable, environmental entitlements that could replace 100% of the existing Pillar 1. Within this proposal, an agri-environmental points scheme would allow farmers to be compensated for the "public goods" they provide. Productive farms could forego their payment and exempt themselves from the scheme, instead transferring their payments to farms where a payment could provide more environmental benefit.[94]

Such a system would retain the overarching architecture of the CAP and would allow farmers to be compensated for the environmental benefits that they provide to society. It would also be substantially cheaper and would allow a market in transferable environmental entitlements to develop, possibly allowing the subsidy to eventually settle on those farms that most need it. However, as it is very similar to the architecture of existing agri-environment schemes in Pillar 2, it could be better placed within the rural development section of the CAP.

[94] Open Europe More for Less: Making the EU's farm policy work for growth and environment pp25-27.

Seek fundamental and far reaching reform of the CAP, including repatriation

As the CAP is a common EU policy, it is very difficult for the UK to seek unilateral repatriation of elements of the policy. However, certain elements have been gradually repatriated over the past ten years. Voluntary modulation, Article 68 and rural development policies have all started the process of gradual repatriation of the CAP.

The UK could seek far reaching pan EU reform by proposing a completely new system which would either better target payments to farmers that need them and who provide environmental "public goods", or which would provide some new form of basic market support to farmers through either a "bond scheme" or through "insurance" schemes. Any such reform would start with the complete abolishment of direct subsidy payments under the existing Pillar 1.

Abolish existing direct payments

However to achieve such an outcome, the UK would need to set out a clear path which would enable other EU countries to buy into the UK vision and which would allow farmers a sufficient amount of time to restructure their farms to the eventual phasing out of the Single Farm Payment. With such a large percentage of farm income still reliant on the SFP it could not be withdrawn overnight, and a transition period of five to ten years or even longer could be proposed. During this transition process existing payments in the SFP should be geared specifically to competitiveness and to preparing farmers for a liberalised system.

To do this, the UK could initially propose national co-financing in Pillar 1, under similar rules to those that the Fresh Start project will propose as an option for structural funds. For example those member states whose GDP is less than 90% of the EU average could continue to receive Pillar 1 funding from the EU, whilst countries above the 90% threshold, could be obliged to co-finance payments at national level. This would make countries that receive money from the CAP, such as France, pay for their own CAP whilst allowing the EU to fully subsidise the agriculture in poorer EU member states. It would also highlight the cost to national taxpayers of CAP subsidies and would force EU countries to make decisions about the cost-benefit of subsidising farmers over spending the money in other areas. It would likely provoke a reduction in the total SFP payments whilst freeing parts of the EU budget for other priorities.

In conjunction with national co-financing, all CAP payments could be redesigned to focus on building farm business competitiveness rather than solely on a land payment. All possibilities for member states to re-couple payments to production should be stopped.

Over the transition period, the overall budget for the SFP could be progressively reduced to zero by the end of the period. This would free up around 70% of the CAP budget. A certain proportion of this could be modulated to Pillar 2 to fund enhanced schemes there, whilst the remainder could return to the EU budget or to the member states. Other market distorting measures including quotas and export refunds could be abolished and trigger prices for intervention and private storage aid progressively lowered. Social policies such as the food distribution for deprived persons and the school milk and fruit schemes should be completely repatriated to the member states.

Such actions would probably need to be accompanied by measures designed to improve the position of farmers in the food chain, at least in the short term, particularly through strengthened roles for national food ombudsmen and binding codes of conduct for retailers and processors.

In addition, as EU rules on animal welfare and environmental protection would remain in place, farmers in the EU would be at a competitive disadvantage vis-a-vis imports from third countries which do not always meet the same standards. To ensure that EU farmers remain competitive, an increased focus should be given to the marketing of quality products and for UK and EU farmers to communicate their higher standards to consumers. Full country of origin labelling and information on farming methods should therefore be mandatory labelling requirements.

Pillar 2 reform

In conjunction with the phasing out of Pillar 1 support, the role of Pillar 2 could be strengthened to focus on providing environmental support and compensation for the delivery of "public goods" such as increased environmental and animal welfare standards. Such environmental justifications for subsidising farming are generally seen as more acceptable than subsidies directly for production.

This would necessitate a fundamental reform of Pillar 2 of the CAP although the existing principles of rural development funding could remain the same. It could continue to be co-financed by national governments which would have the freedom and flexibility to develop schemes that best suit their own circumstances under a common framework of EU rules to stop countries using this system to attempt to recouple payments.

The Open Europe report of February 2012 which was described in the previous section could be better placed within a Pillar 2 context. Open Europe proposed a system of tradable entitlements within an agri-environmental points scheme where farmers could be compensated for the "public goods" they provide and where productive farms could transfer their payments to farms where a payment could provide more environmental benefit.[95] This approach could be applied within a Pillar 2 setting and could be extended to provide the main environmental and farm support payment within the CAP in a similar way to how current UK environmental schemes work or current LFA funding is. In addition, a basic payment could be offered to farms meeting enhanced animal welfare criteria

This would necessitate a significant increase in Pillar 2 CAP funding which would be more than compensated for by the reduction of expenditure in Pillar 1. However, these schemes, by focusing firstly on environmental and competitiveness rather than on market support and because they would be co-financed by the member states, would be significantly cheaper, less market distorting and more national focused than the existing system.

This type of reform to eliminate Pillar 1 and to place more national focus on Pillar 2 would be truly radical as it involves a deconstruction of the many layers of market management that have existed for over 50 years. The phasing out of the CAP in such a way is also an existential question for many in the EU as the CAP is the only real embodiment of a common European policy. The UK would therefore face severe opposition and it is unlikely to initially gain any support from other EU member states. Many would be radically opposed to this option, even if in the long term external pressures may force the EU to eventually move towards such a system.

Such a reform proposal could only be offered if the UK put all options on the table, including the rebate and used all available political capital, prioritising such a CAP reform over changes in the UK-EU relationship in other areas. An important question is whether such a fundamental reform of the CAP should be a priority when external pressures, including

[95] Open Europe More for Less: Making the EU's farm policy work for growth and environment pp25-27.

budgetary constraint, trade agreements (both bilateral and WTO) and increasing market returns for farmers may force the EU into fundamental reforms in the medium term anyway.

Take unilateral action to prompt a negotiation

It is possible that the UK would not be able to move forward the CAP reform agenda using the existing EU procedures. It is equally possible that recent reforms could be reversed and the EU slips back into the more protected and protectionist agricultural policy that existed prior to the reforms of the early 2000s.

In this scenario, the UK could theoretically take unilateral action and withdraw both from the common agricultural policy and from its budgetary implications in an attempt to force fundamental change.

It could do this by refusing to make contributions to Brussels up to the estimated amount of the British contribution to the CAP. At the same time the British government would no longer receive payments from Brussels for the reimbursement of monies paid to British farmers.

This would however be a clear breach of the EU's treaty obligations and any previous agreement on the EU's multiannual financial framework in force at the time. In addition because the UK contributions to the CAP budget can not easily be differentiated from its contributions to other parts of the EU budget, it would likely cause a severe breakdown in the UK's relationship with the EU, loss of EU funding for British projects in other areas, including structural funding and consequences for all other elements of the EU's budget.

This course of action would threaten the British rebate, which is in part compensation for the net contribution the UK makes to the CAP budget. It would also mean that British farmers, who would face losing all their payments in the short term, may also temporarily excluded from the internal market in agricultural products.

Such unilateral action would not provide a sustainable long-term solution and in the short term may lead to a substantial loss for the UK Treasury, as CAP monies already paid out would not be refunded by Brussels. In addition, as the debate over CAP funding is an intrinsic part of the overall EU budget and impacts on all other spending areas, such a move is unlikely to be possible without withdrawing from all aspects of the EU budget.

Therefore the best possibility for the UK to take such action would probably be as a negotiating tactic during the negotiations over the multiannual financial framework. The negotiations for the 2014-2020 are likely to continue well into 2013, however this would also require prioritising reform to the CAP budget ahead of reform to other parts of the EU budget. As such the suitability of this approach is likely to depend on the UK's priorities and its bottom line regarding its future relationship with the EU.